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**E-Newsletter Article**

## **Five Year Carryback of Net Operating Losses Extended and Enhanced**

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In November of 2009, Congress passed the Worker, Homeownership, and Business Assistance Act of 2009. This Act included a number of updates to current tax law and extended certain soon-to-expire income tax provisions. One of these extended provisions is the election to carry back net operating losses three, four, or five years, rather than the normal two year period. This article discusses this extended and enhanced net operating loss carryback election.

### **Net Operating Losses**

A net operating loss (NOL) is the excess of business deductions (computed with certain modifications) over gross income in a particular tax year. The loss can be deducted, through an NOL carryback or carryover, in another tax year in which gross income exceeds business deductions. In general, an NOL may be carried back two years and forward twenty years. The NOL is first carried back to the earliest tax year for which it's allowable as a carryback or a carryover, and is then carried to the next earliest tax year. A taxpayer may irrevocably elect to forego the entire carryback period for an NOL and instead carry it forward.

For alternative minimum tax purposes (AMT), NOLs must be tracked separately. Other complications arise with regard to AMT when dealing with NOLs which are beyond the scope of this article. Please feel free to give us a call if you have any questions related to AMT and NOLs.

### **NOLs and ESBs**

For NOLs arising in tax years ending after December 31, 2007, eligible small businesses (ESBs) can elect to increase the NOL carryback period for an applicable 2008 NOL from two years to three, four, or five years. An ESB is a business that meets the gross receipts test for the tax year in which the loss arose. The gross receipts test provides that average annual gross receipts for the three-tax-year period ending with the tax year in which the loss arose are \$15 million or less.

An applicable 2008 NOL is the taxpayer's NOL for any tax year ending in 2008, or, at the taxpayer's election, any tax year beginning in 2008. Any such election is irrevocable. Additionally, any carryback election may be made only with respect to one tax year. For 2009 NOLs, the Act now provides an election for most taxpayers (not just ESBs) to increase the carryback period to three, four, or five years from the usual two years. It is also important to note that making the election to increase the carryback period does not change any carryforward period for NOLs. The carryforward period remains at twenty years.

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### **One Election Rule**

An election may generally be made for only one tax year. However, there is an exception for an ESB that made or makes an election under the Code as in effect before Nov. 6, 2009. Such a taxpayer may make an election for two tax years instead of just one.

This means that if an ESB elects to carry a 2008 NOL back to the 3rd, 4th or 5th preceding tax year under the provisions of pre-Act law, it can also elect to carry a 2009 NOL back to the 3rd, 4th, or 5th preceding tax year as well.

### **50% Limit on Carryback to 5<sup>th</sup> Preceding Tax Year**

The Act limits the amount of the NOL that can be carried back to the 5th tax year before the loss year to no more than 50% of the taxpayer's taxable income for that 5th preceding tax year determined without taking into account any NOL for the loss year or for any tax year after the loss year.

The 50% limitation does not apply to the applicable 2008 NOL of an ESB with respect to which an election is made under pre-Act law even if the election is made after Nov. 6, 2009, the date of enactment of the Act.

### **Election**

The extended carryback election under the Act must be made by the due date (including extensions) for filing the taxpayer's tax return. The taxpayer must affirmatively elect the increased carryback. Absent any election, the regular NOL carryback period rules apply. Once made, the extended carryback election is irrevocable.

### **Conclusion**

Net operating losses can be a valuable tool for individuals and businesses when used wisely. The new rules allow for increased flexibility with regard to certain NOLs. Although the calculations may be complex, an analysis of the effects of the possible elections involving NOLs resulting in the greatest tax savings can be an extremely effective tax planning tool and should not be overlooked. If you have any questions about the content of this article, or the effect NOLs may have on your overall tax liability, please give one of our CPAs a call.

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