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## Net Operating Losses – Part 1

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Center for Agricultural Law and Taxation  
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### Agenda

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- Eligibility for an NOL
- The Form 1045
- How To Figure an NOL
- How To Claim an NOL Deduction
- How To Figure an NOL Carryover
- Special situations

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### What is a Net Operating Loss? § 172 and § 56

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- § 172(c) defines an NOL as “the excess of the deductions allowed over the gross income”
- Such “excess” is computed with the modifications detailed in IRC §172(d)
- § 56(d)(2) sets forth additional adjustments to the NOL for purposes of computing the alternative tax net operating loss deduction (ATNOLD)
  - The ATNOLD for a loss year is carried back and carried over in accordance with § 172(b)

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### What is a Net Operating Loss? § 172 and § 56

- If business losses are more than the total income for the year, a taxpayer can use the excess loss to lower the income and reduce taxes in another year
- The IRS carryback and carryforward rules govern how this is accomplished
- A net operating loss (NOL) is determined in a period where a businesses allowable tax deductions are greater than its taxable income, resulting in a negative taxable income

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### Applying

- If a company has a net operating loss, it can apply the tax relief in two ways:
  - The loss can be applied to past tax years and receive a tax savings or
  - The loss can be applied to future tax years, reducing the tax in future periods
- The terms of the relief and how it can be applied varies by jurisdiction (states) but for federal tax law the NOL can be carried back 2 years, and forward 20 years
- After 20 years, any remaining NOL expires and is no longer available for use
- NOL amounts carried forward are recorded on the balance sheet as deferred tax assets ("DTA")

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### Code Sections

- § 172(b) defines the components of an NOL, (NOL carrybacks and carryforwards)
- § 172(b)(1) sets forth the years to which an NOL is carried (unless a valid § 172(b)(3) election is made to forego the entire carryback period)
- § 172(b)(2) provides the rules for how much of an NOL is carried to each year (how much of an NOL is utilized or absorbed)

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### § 172(b) and § 172(b)(1)

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- Years to which loss may be carried
  - General rule, except as otherwise provided, a net operating loss for any taxable year—
    - Shall be a net operating loss carryback to each of the 2 taxable years preceding the taxable year of such loss, and
    - Shall be a net operating loss carryover to each of the 20 taxable years following the taxable year of the loss

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### Taxable Income

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- Once the NOL is determined, taxable income is modified in the years to which the loss is carried
- This determines how much of the NOL can be utilized

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### What Can Cause and NOL?

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- Trade or business
- Work as an employee
- Casualty or theft loss
- Moving expenses
- Rental property
- Owners of pass through entities – partners, members of LLC's and shareholders in an S-Corporation
  - Discuss briefly but not in depth
- Corporations

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### Who Can Claim and NOL?

- Individuals
- Sole proprietorships
- Owners of pass through entities – partners, members of LLC’s and shareholders in an S-Corporation
- Corporations
- If a C Corporation converts to an S corporation, any NOL carryovers it had at the time of conversion cannot be used
  - They can only be used if the S corporation goes back to a C corporation
  - This will have an impact on built-in capital gains

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### Form 1120 - Schedule K Section

7 At any time during the tax year, did one foreign person own, directly or indirectly, at least 25% of (a) the total voting power of all classes of the corporation's stock entitled to vote or (b) the total value of all classes of the corporation's stock? . . . . .

For rules of attribution, see section 318. If "Yes," enter:  
 (i) Percentage owned ▶ \_\_\_\_\_ and (ii) Owner's country ▶ \_\_\_\_\_

(c) The corporation may have to file Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Enter the number of Forms 5472 attached ▶ \_\_\_\_\_

8 Check this box if the corporation issued publicly offered debt instruments with original issue discount . . . . .

If checked, the corporation may have to file Form 8281, Information Return for Publicly Offered Original Issue Discount Instruments.

9 Enter the amount of tax-exempt interest received or accrued during the tax year ▶ \$ \_\_\_\_\_

10 Enter the number of shareholders at the end of the tax year (if 100 or fewer) ▶ \_\_\_\_\_

11 If the corporation has an NOL for the tax year and is electing to forego the carryback period, check here . . . . .

If the corporation is filing a consolidated return, the statement required by Regulations section 1.1502-21(b)(3) must be attached or the election won't be valid.

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### Eligible Loss for an NOL

- For an individual, an eligible loss is any loss of property arising from fire, storm, shipwreck, other casualty, or theft
- For a small business (as defined in §172(b)(1)(E)(iii)) or a farming business (as defined in § 263A(e)(4)), an eligible loss is any loss attributable to a federally declared disaster
- Per § 263A(e)(4) – Citrus groves and almonds as well as casualty

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### Small Business

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- Small business § 172(b)(1)(E)(iii)
  - A corporation or partnership which meets the gross receipts test of § 448(c) for the taxable year in which the loss arose or
  - Sole proprietorship, which would meet such test if such proprietorship were a corporation
  - A corporation or partnership meets the \$5,000,000 gross receipts test if for any prior taxable year the average annual gross receipts for the 3-taxable-year period ending with such prior taxable year does not exceed \$5,000,000

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### Farming Loss

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- The carryback period for a farming loss is 5 years
- Only the farming loss portion of the NOL can be carried back
- A farming loss is the smaller of:
  - The amount that would be the NOL for the tax year if only income and deductions attributable to farming businesses were taken into account under § 263A(e)(4)
    - Special rule for citrus and almond groves or
  - The NOL for the tax year
  - Some limitations apply

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### Farming

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- A farming business is a trade or business involving cultivation of land or the raising or harvesting of any agricultural or horticultural commodity
- A farming business can include operating a nursery or sod farm or raising or harvesting most ornamental trees or trees bearing fruit, nuts, or other crops
- The raising, shearing, feeding, caring for, training, and management of animals is also considered a farming business
- A farming business does not include contract harvesting of an agricultural or horticultural commodity grown or raised by someone else
- It also does not include a business in which a taxpayer merely buy or sell plants or animals grown or raised entirely by someone else

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### Waiving the 5-year Carryback for Farming

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- The taxpayer can choose to figure the carryback period for a farming loss without regard to the special 5-year carryback rule
- To make this choice for 2017, attach to the 2017 income tax return filed by the due date (including extensions) a statement that the taxpayer is choosing to treat any 2017 farming losses without regard to the special 5-year carryback rule
- If the taxpayer files the original return on time but did not file the statement with the return, they can make this choice on an amended return filed within 6 months after the due date of the return (excluding extensions)
- Attach the election statement to the amended return, and write "Filed pursuant to section 301.9100-2" at the top of the statement
- Once made, this choice is irrevocable

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### Farming Loss

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- Your client operates a farming business and incur an NOL of \$50,000 for 2017
- \$25,000 of the NOL is attributable to income and deductions of the farming business - carried back 5 years
- \$10,000 is attributable to a fire in the personal residence (an eligible loss) - carried back 3 years
- The remaining \$15,000 is attributable to the spouse's work as an employee - carried back 2 years
- Any unused portion of this NOL can be carried forward up to 20 years

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### Qualified Disaster Losses

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- To the extent the NOL is a qualified disaster loss, that part of the loss is carried back to the 5th tax year before the loss
- Any such loss not used in that year is carried to the 4th preceding year and then applied consecutively forward through the 1st preceding year
- Any such loss not applied in the 5 preceding years can be carried forward up to 20 years

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Qualified Disaster Losses

- Only the qualified disaster loss portion of the NOL can be carried back 5 years
- The taxpayer can make an election to figure the carryback period for a qualified disaster loss without regard to the special 5-year carryback rule
- To make this election for 2017, attach to the 2017 income tax return filed by the due date (including extensions) a statement that you are electing to treat any 2017 qualified disaster losses without regard to the special 5-year carryback rule

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Qualified Disaster Losses

- If the client has filed the original return on time, they can make the election on an amended return filed within 6 months after the due date of the return (excluding extensions)
- Attach the election to the amended return and write "Filed pursuant to section 301.9100-2" on the election statement
- Once made, the election is irrevocable

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Qualified Disaster Losses

- A qualified disaster loss is the smaller of:
  - 1.The sum of:
    - a. Any losses occurring in a disaster area (as defined in § 165(i)(5)) and attributable to a federally declared disaster occurring before January 1, 2010, plus
    - b. Any qualified disaster expenses that were allowable under § 198A (even if the taxpayer didn't elect to treat such expenses as qualified disaster expenses), or
  - 2.The NOL for the tax year

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Qualified Disaster Loss

- The carryback period for a qualified disaster loss is 5 years
- Only the qualified disaster loss portion of the NOL can be carried back for the 5 year period
- A qualified disaster loss is the smaller of:
  - 1. The sum of:
    - a. Any losses occurring in a disaster and attributable to a federally declared disaster occurring before January 1, 2010, plus
    - b. Any qualified disaster expenses that were allowable under § 198A (even if you did not elect to treat such expenses as qualified disaster expenses), or
  - 2. The NOL for the tax year

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Excluded Losses

- A qualified disaster loss does not include any losses from property used in connection with:
  - Any private or commercial golf course
  - Country club
  - Massage parlor
  - Hot tub facility
  - Suntan facility, or
  - Any store for which the principal business is the sale of alcoholic beverages for consumption off premises

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Excluded Losses

- A qualified disaster loss also does not include any losses from any gambling or animal racing property
  - Gambling or animal racing property is any equipment, furniture, software, or other property used directly in connection with gambling, the racing of animals, or the on-site viewing of such racing, and the portion of any real property (determined by square footage) that is dedicated to gambling, the racing of animals, or the on-site viewing of such racing, unless this portion is less than 100 square feet

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### Specified Liability Loss

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- Generally, a specified liability loss is a loss arising from:
  - Product liability, or
  - An act (or failure to act) that occurred at least 3 years before the beginning of the loss year and resulted in a liability under a federal or state law requiring:
    - 1. Reclamation of land
    - 2. Dismantling of a drilling platform
    - 3. Remediation of environmental contamination, or
    - 4. Payment under any workers compensation act
- Any loss from a liability arising from (1) through (4) can be taken into account as a specified liability loss only if the taxpayer used an accrual method of accounting throughout the period in which the act (or failure to act) occurred

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### Where Does the NOL Go?

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- The NOL will appear as a negative on line 21 of the Form 1040
- On the corporate return, it shows on Line 28
  - Use Form 1139 instead of Form 1045 to claim carryback and refund
  - The Schedule K will be used for carryforwards, Line 11
- Form 1041 – NOL, Line 15a
- Trusts - On the termination of the estate or trust, any unused NOL carryover that would be allowable to the estate or trust in a later tax year, but for the termination, is allowed to the beneficiaries succeeding to the property of the estate or trust
  - Schedule K-1 (Form 1041), box 11, codes D and E

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### Corporations Differences Between Corporate and Non-Corporation NOL's

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- Cannot use the DPAD activity to create or increase the NOL
- The taxpayer can use the deduction for dividends paid on certain preferred stock of public utilities without limiting it to its taxable income for the year
- The taxpayer can take the deduction for dividends received without regard to the aggregated limits that normally apply
- Finally, corporations can deduct dividends received from other US corporations, but the deduction is limited to a total of 70% or 80% of the corporates taxable income
  - If the corporation has an NOL, the taxable income limit does not apply

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Form 1045




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Form 1045

**1045** Application for Tentative Refund OMB No. 1545-0098

Department of the Treasury Internal Revenue Service **2017**

Name(s) shown on return Social security or employer identification number

Number, street, and apt. or suite no., if a P.O. box, see instructions. Spouse's social security number (SSN)

City, town or post office, state and ZIP code. If a foreign address, also copy into space below (see instructions). Date time phone number

Foreign country name Foreign post office code

1 This application is filed  a Net operating loss (NOL) (Sch. A, line 20)  b Unused general business credit  c Net section 1256 contracts loss to carry back

2a For the calendar year 2017, or other tax year beginning  2017, and ending  2017, and ending  2017, did the tax return was filed

3 If this application is for an unused credit created by another carryback, enter year of first carryback

4 If you filed a joint return (or separate return for some, but not all, of the tax years involved in filing the carryback, list the years and specify whether joint (J) or separate (S) return for each

5 If SSN for carryback year is different from above, enter  SSN  and  Year(s)

6 If you changed your accounting period, give date permission to change was granted

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Form 1045

7 Have you filed a petition in Tax Court for the year(s) to which the carryback is to be applied?  Yes  No

8 Is any part of the decrease in tax due to a loss or credit resulting from a reportable transaction required to be disclosed on Form 8886, Reportable Transaction Disclosure Statement?  Yes  No

9 If you are carrying back an NOL or net section 1256 contracts loss, did this cause the release of foreign tax credits or the release of other credits due to the release of the foreign tax credit (see instructions)?  Yes  No

**Computation of Decrease in Tax** (see instructions)

	tax year ending <input type="checkbox"/> preceding		tax year ending <input type="checkbox"/> preceding		tax year ending <input type="checkbox"/> preceding	
	Before carryback	After carryback	Before carryback	After carryback	Before carryback	After carryback
10 NOL deduction after carryback (see instructions)						
11 Adjusted gross income						
12 Deductions (see instructions)						
13 Subtract line 12 from line 11						
14 Exemptions (see instructions)						
15 Taxable income, line 13 minus line 14						
16 income tax (see instructions and attach an explanation)						
17 Excess advance premium tax credit repayment (see instructions)						
18 Alternative minimum tax						
19 Add lines 16 through 18						

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 104570A Form 1045 2017

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### Waiving the Carryback Period

- The client can elect to carry an NOL forward only, instead of first carrying it back
- To make this election for an NOL incurred in the 2017 tax year, attach to the 2017 tax return filed on or before the due date (including extensions) a statement that the taxpayer is electing under § 172(b)(3) to relinquish the entire carryback period for any 2017 NOL
- If the client files the return on time without making the election, they can still make the election on an amended return filed within 6 months of the due date of the return (excluding extensions)

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### Sample Election from Parker Pro Library

#### Sample Election Statement

Election to Waive Net Operating Loss Carryback Period

Name: [Taxpayer's name]

Taxpayer identification number: [TIN]

I hereby elect under Section 172(b)(3) of the Internal Revenue Code (Code) to waive the carryback period for a [amount of NOL] net operating loss I incurred in the tax year ending [last day of tax year] (the loss year), and instead carry the loss forward to each of the 20 years following the loss year. I am entitled to make this election because the loss constitutes a net operating loss as defined in Section 172(c) of the Code, and under Section 172(b)(1)(A)(i) of the Code, I would otherwise be entitled to carry the net operating loss from the loss year back to the two tax years preceding the loss year.

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### Waiving the Carryback Period – Why Make the Election?

- By not waiving the carryback the taxpayer could lose some of the NOL
- Example
  - If the taxpayer just carries forwards without making the election – the IRS will treat the carryback as if a portion of the NOL has been used – like allowed or allowable- so make the election if the taxpayer chooses

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### No Original Election Made?

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- Attach the election to the amended return and write "Filed pursuant to § 301.9100-2" on the election statement
- The election must be made within 6 months of the due date of the return excluding extensions
- Once made the election is irrevocable

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### Filing

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- If the client carries back any portion of an NOL or an unused general business credit to tax years before the 3 years preceding the 2017 tax year, they may need to use additional Forms 1045
  - Complete lines 1 through 9 and Schedule A on only one Form 1045
  - Use this Form 1045 for the earliest preceding tax years
  - The taxpayer must sign the Form 1045, but do not need to sign the other Forms 1045 – sign anyway

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### When To File?

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- You must file Form 1045 within 1 year after the end of the year in which an NOL, unused credit, net § 1256 contracts loss, or claim of right adjustment arose
- Be sure to file the 2017 income tax return no later than the date the Form 1045 is filed

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### Where To File?

- File Form 1045 with the Internal Revenue Service Center at the campus at the place where the taxpayer lives as shown in the instructions for the 2017 income tax return
- Don't include Form 1045 in the same envelope as the 2017 income tax return

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### 2016 Form 1045

Form **1045** Application for Tentative Refund

OMB No. 1545-0048

Department of the Treasury Internal Revenue Service

► For individuals, estates, or trusts. ► Mail in separate envelope. (Don't attach to tax return.) ► Go to www.irs.gov/Form1045 for the latest information.

Name(s) shown on return \_\_\_\_\_ Social security or employer identification number \_\_\_\_\_

Number, street, and apt. or suite no. if a P.O. box, see instructions. \_\_\_\_\_ Spouse's social security number (SSN) \_\_\_\_\_

City, town or post office, state, and ZIP code. If foreign address, also complete space below, see instructions. \_\_\_\_\_ Country (three letter code) \_\_\_\_\_

Foreign country name \_\_\_\_\_ Foreign postal code \_\_\_\_\_

1 This application is filed: a Net operating loss (NOL) (Sch. A, line 20) in carryback \$ \_\_\_\_\_ b Unused general business credit \$ \_\_\_\_\_ c Net section 1256 contracts loss \$ \_\_\_\_\_

2a For the calendar year 2017 or other tax year beginning \_\_\_\_\_, 2017, and ending \_\_\_\_\_, 20\_\_\_\_ b Date this return was filed \_\_\_\_\_

3 If this application is for an unused credit created by another carryback, enter year of first carryback ► \_\_\_\_\_

4 If you filed a joint return for separate return for some, but not all, of the tax years involved in figuring the carryback, list the years and specify whether joint (J) or separate (S) return for each ► \_\_\_\_\_

5 If SSN for carryback year is different from above, enter a SSN ► \_\_\_\_\_ and b Year(s) ► \_\_\_\_\_

6 If you changed your accounting period, give date permission to change was granted ► \_\_\_\_\_

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### What To Attach

- Attach copies of the following, if applicable, to Form 1045 for the year of the loss or credit
  - For an individual, pages 1 and 2 of the 2017 Form 1040 and Schedules A, D, and J (Form 1040), if applicable
  - Any Form 4952, Investment Interest Expense Deduction, attached to the 2017 income tax return
  - All Schedules K-1 received from partnerships, S corporations, estates, or trusts that contribute to the carryback
  - Any application for extension of time to file the 2017 income tax return

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### What To Attach

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- All Form 8886, Reportable Transaction Disclosure Statement, attached to the 2017 income tax return
- Forms 8302, Electronic Deposit of Tax Refund of \$1 Million or More
- Alternative Minimum Tax Net Operating Loss (AMTNOL) or Alternative Tax Net Operating Loss Deduction (ATNOLD) calculation
- Form 6251, Alternative Minimum Tax—Individuals for each loss year
- Any detailed allocation schedules for a filing status change or for different spouses between the gain and loss years

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### What To Attach

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- Any applicable election statement
- All other forms and schedules from which a carryback results, such as :
  - Schedule C or F (Form 1040)
  - Form 3800, General Business Credit
  - Form 6478, Biofuel Producer Credit (for years 2008, 2009, 2010, 2011, 2012)
  - Alcohol and Cellulosic Biofuel Fuels Credit; for years before 2008, Credit for Alcohol Used as Fuel
  - Form 6781, Gains and Losses From § 1256 Contracts and Straddles
  - Form 3468, Investment Credit

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### What To Attach

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- Also attach to Form 1045 copies of all forms or schedules for items refigured in the carryback years, such as:
  - Form 6251 (original and revised for each gain year)
  - Form 8960 and
  - Form 8962

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### Warning

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- Attach copies of all required forms and complete all lines on Form 1045 that apply to the client
- Otherwise, the application may be delayed or disallowed

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### IRS and the Form 1045

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- There has been issues in processing as a result of training or lack of training
- Generally best to file the Form 1045 whenever possible
- Procedures in the IRM govern the processing

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### Disallowance of the Application

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- The application is not treated as a claim for credit or refund
- It may be disallowed if it has material omissions or math errors that are not corrected within the 90-day period
- If the application is disallowed in whole or in part, no suit challenging the disallowance can be brought in any court
- But the taxpayer can file a regular claim for credit or refund before the limitation period expires

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### Disallowance of the Application

- Individuals can get a refund by filing Form 1040X, instead of Form 1045
- An estate or trust can file an amended Form 1041
- In most cases, an amended return must be filed no later than 3 years after the due date of the return for the applicable tax year

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### Form 1041

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### Disallowance of the Application Form 1040X

- When using Form 1040X or other amended returns, attach Schedule A of Form 1045 showing the computation of the NOL and, if applicable, a copy of Schedule B of Form 1045 showing the computation of the NOL carryover
- Complete a separate Form 1040X or other amended return for each year for which the taxpayer requests an adjustment

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### Disallowance of the Application Form 1040X

- The procedures for Form 1040X and Form 1045 are different
- The IRS is not required to process the Form 1040X within 90 days
- However, if they do not process the form within 6 months from the date the taxpayer filed, the taxpayer can file suit in court
- If the IRS disallows the claim on Form 1040X and the client disagrees with that determination, the taxpayer must file suit no later than 2 years after the date it was disallowed

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### Corporations

- A corporation can get a refund by filing Form 1120X (or other amended return, such as an amended Form 1120-PC) instead of Form 1139
- Generally, the corporation must file an amended return within 3 years after the date the return was due for the tax year in which an NOL, net capital loss, or unused credit arose (or, if later, the date the return for that year was filed)
- Corporations must file Form 1120X (or other amended return) instead of Form 1139 to carry back:
  - A prior year minimum tax credit released due to an NOL or net capital loss carryback
  - A prior year foreign tax credit released due to an NOL or net capital loss carryback, or
  - A prior year general business credit released because of the release of the foreign tax credit

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### Corporations

- The procedures for processing an amended return and Form 1139 are different
- The IRS is not required to process an amended return within 90 days
- However, if the IRS does not process it within 6 months from the date a corporation files it, the corporation can file suit in court
- If the IRS disallows a claim on an amended return and the corporation disagrees with that determination, the corporation must file suit no later than 2 years after the date the IRS disallows it

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### Unused General Business Credit

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- If the taxpayer claims a tentative refund based on the carryback of an unused general business credit, attach a detailed computation showing how the credit carryback was figured and a re-computation of the credit after applying the carryback
- Generally, an unused general business credit must be carried back 1 year
- If the taxpayer filed a joint return (or separate return) for some but not all of the tax years involved in figuring the unused credit carryback, special rules apply to figuring the carryback - See the Instructions for Form 3800

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### General Business Credit

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- Enter in the column labeled "After carryback" for each affected carryback year the total of the recomputed general business credits
- Review Form 3800 (or using Forms 3800, 5884, 6478, 8586, 8835 (Part II), 8844, or 8846, if applicable, to re-compute the general business credits for years before 2008)

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### Net Premium Tax Credit

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- If the client claimed a premium tax credit in 2014, 2015 or 2016, complete a new Form 8962 using the refigured household income
- Enter the refigured premium tax credit in the column labeled "After carryback" for 2014, 2015 or 2016

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### Other Credits

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- Review the tax return for the carryback year for any additional credits such as:
  - The earned income credit
  - Credit for child and dependent care expenses
  - Child tax credit
  - Education credits
  - Foreign tax credit
  - Retirement savings contributions credit, etc., that will apply in that year
- If there is an entry on this line, identify the credit(s) claimed

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### Self-Employment Tax

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- Don't adjust self-employment tax because of any carryback

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### Additional Medicare Tax

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- Don't adjust Additional Medicare Tax because of any carryback

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### Net Investment Income Tax

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- Enter in the column labeled "After carryback" for each affected carryback year any refigured Net Investment Income Tax (NIIT) using Form 8960 for the applicable carryback year
- Review § 1411 and the related regulations for information on the use of an NOL for NIIT purposes

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### Health Care: Individual Responsibility

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- Enter in the column labeled "After carryback" for each affected carryback year any refigured shared responsibility payment using the Shared Responsibility Payment Worksheet in the Instructions for Form 8965 for the applicable carryback year
- For information on health care coverage exemptions or calculating a shared responsibility payment, review the Instructions for Form 8965

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### Other Taxes

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- Review the tax return for the carryback year for any other taxes not previously mentioned such as:
- Recapture taxes, tax on an IRA, etc., that will apply in that year
- If an entry is made on this line identify the taxes that apply

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## The Process



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### Form 1045

- Complete the entity section of the upper part of Form 1045
- Line 1-9 are important so address as needed each area

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### Form 1045

- Enter in the column labeled "Before carryback" the adjusted gross income (AGI) for the carryback year as shown on the original or amended return
- Enter in the column labeled "After carryback" the AGI refigured after applying the NOL or net § 1256 contracts loss carryback and after refiguring any items of income and deductions that are based on or limited to a percentage of the AGI

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### Line 12—Deductions

- Enter in the column labeled “Before carryback” for each applicable carryback year the amount shown (or as previously adjusted) on Form 1040A, enter the amount shown (or as previously adjusted) on:
  - Line 24 for 2010 – 2015
  - Line 24a for 2009, or
  - Line 24 for 2006 – 2008

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### Net Operating Loss Step 1

- The process begins with completing a taxpayer’s income tax return for that year
- If the taxpayer has a negative amount on:
  - Line 41 of Form 1040
  - Line 39 of Form 1040NR
  - Line 22 of Form 1041
- If the amount on that line is positive, the taxpayer does not have an NOL

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### Our Example: Laurie

- Laurie has a small business and works part-time in a beauty salon, her wages are \$2,360
- She has interest income from a savings account of \$341
- A long term capital gain of \$2,000 (sale of business investment property) and a short term capital loss of \$1,000 from the sale of stock Non-Business
- Her business has a loss in 2017 of \$10,260
  - Gross income \$61,467 – expenses of \$71,727

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Tip

- Perfect return to be audited
- The greater the loss and in consecutive years increases that chance

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Laurie's Form 1040 (2016 Form – No Draft of 2017 as of this Date)

<b>Income</b>  Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.  If you did not get a W-2, see instructions.	7	Wages, salaries, tips, etc. Attach Form(s) W-2	7	2390
	8a	Taxable interest. Attach Schedule B if required	8a	341
	b	Tax-exempt interest. Do not include on line 8a	8b	
	9a	Ordinary dividends. Attach Schedule B if required	9a	
	b	Qualified dividends	9b	
	10	Taxable refunds, credits, or offsets of state and local income taxes	10	
	11	Alimony received	11	
	12	Business income or (loss). Attach Schedule C or C-EZ	12	(10260)
	13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13	1000
	14	Other gains or (losses). Attach Form 4797	14	
	15a	IRA distributions	15a	
	b	Taxable amount	15b	
	16a	Pensions and annuities	16a	
	b	Taxable amount	16b	
	17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17	
	18	Farm income or (loss). Attach Schedule F	18	
	19	Unemployment compensation	19	
	20a	Social security benefits	20a	
	b	Taxable amount	20b	
	21	Other income. List type and amount	21	
	22	Combine the amounts in the far right column for lines 7 through 21. This is your total income	22	6529

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Laurie's Form 1040

<b>Adjusted Gross Income</b>	23	Educator expenses	23	
	24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24	
	25	Health savings account deduction. Attach Form 8889	25	
	26	Moving expenses. Attach Form 3903	26	
	27	Deductible part of self-employment tax. Attach Schedule SE	27	
	28	Self-employed SEP, SIMPLE, and qualified plans	28	
	29	Self-employed health insurance deduction	29	
	30	Penalty on early withdrawal of savings	30	
	31a	Alimony paid b Recipient's SSN	31a	
	32	IRA deduction	32	
	33	Student loan interest deduction	33	
	34	Tuition and fees. Attach Form 8917	34	
	35	Domestic production activities deduction. Attach Form 8803	35	
36	Add lines 23 through 35	36	(6529)	
37	Subtract line 36 from line 22. This is your adjusted gross income	37		

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form 1040 (2016)

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**Summary**

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- Laurie’s deductions exceed her income by \$12,829 (\$17,560 - \$4,731)
- However, to figure whether she has an NOL, certain deductions are not allowed

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**Net Operating Loss**  
**Step 2**

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- There are rules that limit what can be deducted when figuring an NOL
- In general, the following items are not allowed when figuring an NOL

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**After Carryback**

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- If the taxpayer itemized deductions in the carryback year, enter in the column labeled “After carryback” the total of the deductions after refiguring any that are based on, or limited to a percentage of, the adjusted gross income
- To refigure the deductions, use the refigured adjusted gross income (Form 1045, line 11, using the “After carryback” column)
- Amounts that may have to be refigured include:
  - Medical expenses
  - Mortgage insurance premiums – Caution here
  - Personal casualty and theft losses
  - Miscellaneous deductions subject to the 2% limit

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### Six Items Not Allowed

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- Nonbusiness deductions in excess of non-business income
- Any deduction for personal exemptions (not a Form 1045 Schedule A issue) – instructions are confusing
- Capital losses in excess of capital gains
  - Business losses
  - Individual losses
- The § 1202 exclusion of the gain from the sale or exchange of qualified small business stock
- The net operating loss deduction
- The domestic production activities deduction (DPAD)

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### Grouping Items

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- Grouping items will assist in preparing the Schedule A of Form 1045
- Pay special attention to business and non-business
- Losses and gains
- Adjustments to income

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### Group 1 Nonbusiness Deductions in Excess of Non-Business Income

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- These amounts are not connected to business income:
  - Alimony paid
  - Deductions for contributions to an IRA or a self-employed retirement plan
  - Health savings account deduction
  - Archer medical savings account deduction
  - Most itemized deductions (except for casualty and theft losses, state income tax on trade and business income, and any employee business expenses)
  - The standard deduction

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## What Amounts Do We Ignore?




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### Group 1 Deductions Connected to Business

- Disregard the following when calculating the Group 1 amount:
  - State income tax on income attributable to trade the business (including wages, salary, and unemployment compensation) – will play a part on Schedule B
  - Moving expenses
  - Educator expenses
  - The deduction for the deductible part of self-employed health insurance
  - Domestic production activities deduction
  - Rental losses

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### Group 1 Deductions Connected to Business

- Loss on the sale or exchange of business real estate or depreciable property
- The share of a business loss from a partnership or an S corporation
- Ordinary loss on the sale or exchange of stock in a small business corporation or a small business investment company
- If the client itemizes deductions, casualty and theft losses (even if they involve non-business property)
- Employee business expenses (such as union dues, uniforms, tools, education expenses, and travel and transportation expenses)

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**Group 1**  
**Deductions Connected to Business**

- Loss on the sale of accounts receivable (if the accrual method of accounting is used)
- Interest and litigation expenses on state and federal income taxes related to the business
- Unrecovered investment in a pension or annuity claimed on a decedent's final return
- Payment by a federal employee to buy back sick leave used in an earlier year

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**Our Simple Example - Group the Items**

- **INCOME**
- Wages \$2,390
- Interest on savings \$341
- Net long-term capital gain on sale of business investment property \$2,000
- Laurie's total income **\$4,731**
- **DEDUCTIONS**
- Net loss from business (gross income of \$61,467 minus expenses of \$71,727 = (\$10,260)
- Net short-term capital loss on sale of stock (\$1,000)
- Standard deduction (\$6,300)
- Laurie's total deductions **(\$17,560)**

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**Group 1**

- The standard deduction of \$6,300 is part of Group 1
- This is the only amount that pertains to our example

Schedule A - NOL (see instructions)

1	Enter the amount from your 2016 Form 1040, line 41, or Form 1041/NR, line 39. Estates and trusts, enter taxable income increased by the total of the charitable deduction, income distribution deduction, and exemption amount (see instructions)	1
2	Nonbusiness capital losses before limitation. Enter as a positive number	2
3	Nonbusiness capital gains (without regard to any section 1202 exclusions)	3
4	If line 2 is more than line 3, enter the difference. Otherwise, enter -0-	4
5	If line 3 is more than line 2, enter the difference. Otherwise, enter -0-	5
6	Nonbusiness deductions (see instructions)	6
7	Nonbusiness income other than capital gains (see instructions)	7
8	Add lines 5 and 7	8
9	If line 6 is more than line 8, enter the difference. Otherwise, enter -0-	9
10	If line 8 is more than line 9, enter the difference. Otherwise, enter -0-. But don't enter more than line 5	10

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**Group 2**  
**Nonbusiness Income**

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- Income that is not related to a trade or business or employment
  - Annuity income
  - Dividends and interest on investments
  - Share of nonbusiness income from partnerships and S corporations

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**Form 1045 Schedule A - Nonbusiness Income**

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- \$341 of interest is nonbusiness income

**Schedule A—NOL** (see instructions)

1	Enter the amount from your 2015 Form 1040, line 41, or Form 1040NR, line 38. Estates and trusts, enter taxable income increased by the total of the charitable deduction, income distribution deduction, and exemption amount (see instructions)		<b>1</b>
2	Nonbusiness capital losses before limitation. Enter as a positive number	2	
3	Nonbusiness capital gains (without regard to any section 1202 exclusion)	3	
4	If line 2 is more than line 3, enter the difference. Otherwise, enter -0-	4	
5	If line 3 is more than line 2, enter the difference. Otherwise, enter -0-	5	
6	Nonbusiness deductions (see instructions)	6	
7	Nonbusiness income other than capital gains (see instructions)	7	
8	Add lines 5 and 7	8	
9	If line 6 is more than line 8, enter the difference. Otherwise, enter -0-	9	
10	If line 8 is more than line 6, enter the difference. Otherwise, enter -0-. But do not enter more than line 5	10	

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**What Is Business Income?**

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- Income from the trade or business or employment
  - Salaries and wages
  - Self-employment income Our Example (10,260)
  - Unemployment compensation
  - Share of business income from partnerships and S corporations
  - Rental income
  - Ordinary gain from the sale or other disposition of business real estate or depreciable business property

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### Group 3 Nonbusiness Capital Losses

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- Non business capital losses are **limited** to the amount of the nonbusiness capital gains
- §1202 exclusions do not come into play
- If the nonbusiness capital losses are more than nonbusiness capital gains the excess cannot be deducted

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### Group 4 §1202 Exclusion

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- Gain excluded under § 1202 on the sale or exchange of qualified small business stock

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### Group 5 - Domestic Production Activities Deduction

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- The client cannot take the domestic production activities deduction when figuring the NOL

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**Group 6**  
**NOL Carryovers or Carrybacks**

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- The client cannot deduct any NOL carryovers or carrybacks from other years
- Enter the total amount of the NOL deduction for losses from other years

23	Domestic production activities deduction from your 2016 Form 1040, line 35, or Form 1040NR, line 34 (or included on Form 1041, line 15a)	23	
24	NOL deduction for losses from other years. Enter as a positive number	24	←
25	NOL. Combine lines 1, 9, 17, and 21 through 24. If the result is less than zero, enter it here and on page 1, line 1a. If the result is zero or more, you don't have an NOL.	25	

Form 1045 (2016)

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**Our Simple Example**

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- INCOME**
- Wages \$2,390 *I*
- Interest on savings \$341
- Net long-term capital gain on sale business investment-property \$2,000 **B**
- Laurie's total income **\$4,731**
- DEDUCTIONS**
- Net loss from business (gross income of \$61,467 minus expenses of \$71,727 = (\$10,260) **B**
- Net short-term capital loss on sale of stock (\$1,000) *I*
- Standard deduction (\$6,300) *I*
- Laurie's total deductions **(\$17,560)**

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**Our Simple Example**

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- The following items are not allowed in computing the NOL on Form 1045, Schedule A
  - Nonbusiness deductions, (standard deduction, \$6,300)
  - Minus nonbusiness income (interest, \$341) = \$ 5,959
  - Total = \$5,959 ties to Line 9 of Form 1045 – we will see this in a moment

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### Computing the NOL

- Laurie's original deductions \$ 17,560
- Total deductions disallowed (\$ 5,959)
- Capital Loss (non-business) (\$ 1,000)
  - Line 15 of Form 1045 - No nonbusiness gain to offset
- Difference (\$ 10,601)
- Income \$ 4,731
- Total NOL \$ 5,870

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### Our Simple Example - Summary

- Laurie's total 2016 income \$4,731
- Less: Laurie's original 2016 total deductions = \$17,560
- Reduced by the disallowed items:
  - Nonbusiness net short-term capital loss \$1,000
    - No nonbusiness gain to offset
  - Nonbusiness deductions (standard deduction, \$6,300) minus nonbusiness income (interest, \$341) = \$5,959
- Total adjustments to net loss = \$ 6,959, two separate figures \$5,969 and \$1,000

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### Form 1045 Schedule A

Line	Description	Amount	Amount	Amount
1	Enter the amount from your 2016 Form 1040, line 41, or Form 1040NR, line 30. Estates and trusts, enter taxable income increased by the total of the charitable deduction, income distribution deduction, and exemption amount (see instructions)	4731		
2	Nonbusiness capital losses before limitation. Enter as a positive number	1000		(1282)
3	Nonbusiness capital gains (without regard to any section 1202 exclusion)	0		
4	If line 2 is more than line 3, enter the difference. Otherwise, enter -0-	1000		
5	If line 3 is more than line 2, enter the difference. Otherwise, enter -0-	0		
6	Nonbusiness deductions (see instructions)	6300		
7	Nonbusiness income other than capital gains (see instructions)	341		
8	Add lines 6 and 7	6641		
9	If line 6 is more than line 7, enter the difference. Otherwise, enter -0-	341		5959
10	If line 8 is more than line 9, enter the difference. Otherwise, enter -0-. But don't enter more than line 6	0		
11	Business capital losses before limitation. Enter as a positive number	0		
12	Business capital gains without regard to any section 1202 exclusion	2000		
13	Add lines 10 and 12	2000		
14	Subtract line 13 from line 11. If zero or less, enter -0-	0		
15	Add lines 4 and 14	1000		
16	Enter the loss, if any, from line 16 of your 2016 Schedule D (Form 1040), Estates and trusts, enter the loss, if any, from line 16, column (D), of Schedule D (Form 1041). Enter as a positive number. If you don't have a loss on that line (and don't have a section 1202 exclusion), skip lines 16 through 21 and enter on line 22 the amount from line 15	0		
17	Section 1202 exclusion. Enter as a positive number	0		
18	Subtract line 17 from line 16. If zero or less, enter -0-	0		
19	Enter the loss, if any, from line 21 of your 2016 Schedule D (Form 1040), Estates and trusts, enter the loss, if any, from line 20 of Schedule D (Form 1041). Enter as a positive number	0		
20	If line 18 is more than line 19, enter the difference. Otherwise, enter -0-	0		
21	If line 19 is more than line 18, enter the difference. Otherwise, enter -0-	0		0
22	Subtract line 20 from line 18. If zero or less, enter -0-	0		1000
23	Domestic production activities deduction from your 2016 Form 1040, line 35, or Form 1040NR, line 24 or included on Form 1041, line 10d	0		23
24	NOL deduction for losses from other years. Enter as a positive number	0		24
25	NOL. Combine lines 1, 9, 17, and 21 through 24. If the result is less than zero, enter it here and on page 1, line 1a. If the result is zero or more, you don't have an NOL.	5870		5870

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### What About the Personal Exemption?

- The instruction state not to make adjustments on the Form 1045 Schedule A for personal exemptions
- By starting with Line 41 – the personal exemption has already been removed from the calculation
- The examples in Publication 536 are confusing in the fact it includes the personal exemption and then subtracts it out
- For the purpose of calculating the NOL ignore the personal exemption on Schedule A

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### When to Use the NOL

- Generally, if the taxpayer has an NOL for a tax year ending in 2017, they must carry back the entire amount of the NOL to the 2 tax years before the NOL year (the carryback period), and then carry forward any remaining NOL for up to 20 years after the NOL year (the carryforward period)
- The taxpayer can, however, choose not to carry back an NOL and only carry it forward – must make an election
- They cannot deduct any part of the NOL remaining after the 20-year carryforward period

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### What is the NOL Year?

- This is the year in which the NOL occurred

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### How To Carry an NOL Back or Forward

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- The client can choose to carry back the NOL
- They must first carry the entire NOL to the earliest carryback year
- If the NOL is not used up, carry the rest to the next earliest carryback year, and so on
- If they waive the carryback period or do not use up the NOL in the carryback period, carry forward what remains of the NOL to the 20 tax years following the NOL year

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### How To Claim an NOL Deduction

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- If the taxpayer has not already carried the NOL to an earlier year, the NOL deduction is the total NOL
- If the taxpayer carried the NOL to an earlier year, the NOL deduction is the carried over NOL minus the NOL amount used in the earlier year or years
- If the taxpayer carries more than one NOL to the same year, the NOL deduction is the total of these carrybacks and carryovers

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### NOL Resulting in No Taxable Income

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- If the NOL is more than the taxable income of the year carried to (figured before deducting the NOL), the taxpayer generally will have an NOL carryover to the next year

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## Review



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### Deducting a Carryback

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- If the taxpayer carries back the NOL, they can use either Form 1045 or Form 1040X
- They can generally get the refund faster by using Form 1045, but they have a shorter time to file it
- They can use Form 1045 to apply an NOL to all carryback years
- If they use Form 1040X, they must use a separate Form 1040X for each carryback year to which they apply the NOL

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### Estates and Trusts

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- Estates and trusts that do not file Form 1045 must file an amended Form 1041 (instead of Form 1040X) for each carryback year to which NOLs are applied
- Use a copy of the appropriate year's Form 1041, check the "Amended return" box

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**Signatures**

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- Individuals
  - Sign and date Form 1045
  - If Form 1045 is filed jointly, both spouses must sign
- Estates
- All executors or administrators must sign and date Form 1045
- Trusts
  - The fiduciary or an authorized representative must sign and date Form 1045

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**Special Circumstances**



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**Refigured Mortgage Insurance Premiums**

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- Is the modified adjusted gross income from Form 1045, Schedule B, line 13, more than \$100,000 (\$50,000 if married filing separately)?
- If YES – the deduction is limited, refigure the deduction using the Mortgage Insurance Premiums Deduction Worksheet
- If NO - the deduction isn't limited, enter the amount from line 19 on line 20 and enter -0- on line 21

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### Mortgage Insurance Premiums Worksheet - Form 1045 Instructions

**Mortgage Insurance Premiums Deduction Worksheet—Line 20** *Keep for Your Records* 

*Before you begin:* / See the instructions for line 20 to see if you must use this worksheet to refigure your deduction.

1. Enter the total premiums you paid in the carryback year for mortgage insurance for a contract issued after December 31, 2006 ..... **1.** \_\_\_\_\_
2. Enter the amount from Form 1045, Schedule B, line 13 ..... **2.** \_\_\_\_\_
3. Enter \$100,000 (\$50,000 if married filing separately) ..... **3.** \_\_\_\_\_
4. Is the amount on line 2 more than the amount on line 3?
  - No.** Your deduction isn't limited. Enter the amount from line 19 on line 20 of Form 1045, Schedule B, and enter -0- on line 21. Don't complete the rest of this worksheet.
  - Yes.** Subtract line 3 from line 2. If the result isn't a multiple of \$1,000 (\$500 if married filing separately), increase it to the next multiple of \$1,000 (\$500 if married filing separately). For example, increase \$425 to \$1,000, increase \$2,025 to \$3,000, or if married filing separately, increase \$425 to \$500, increase \$2,025 to \$2,500, etc. .... **4.** \_\_\_\_\_
5. Divide line 4 by \$10,000 (\$5,000 if married filing separately). Enter the result as a decimal. If the result is 1.0 or more, enter 1.0 ..... **5.** \_\_\_\_\_
6. Multiply line 1 by line 5 ..... **6.** \_\_\_\_\_
7. **Refigured mortgage insurance premiums deduction.** Subtract line 6 from line 1. Enter the result here and on Form 1045, Schedule B, line 20 ..... **7.** \_\_\_\_\_

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### Refigured Charitable Contributions

- Refigure the charitable contributions using line 24 as the adjusted gross income unless, for any preceding tax year:
  - The taxpayer entered an amount other than zero on line 23, and they had any items of income or deductions based on adjusted gross income which are listed in the instructions for line 6 of Schedule B
  - If the taxpayer can't use the amount from line 24 as the adjusted gross income, figure the adjusted gross income as follows:

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### Refigured Charitable Contributions

- First, figure the adjustment to each item of income or deduction in the same manner as explained in the instructions for line 6 of Schedule B, except don't take into account any NOL carrybacks when figuring adjusted gross income
- Attach a computation showing how the adjustments were figured

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### Refigured Charitable Contributions

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- Second, add lines 3, 4, 5, 11, and 23 of Schedule B to the total adjustments figured in the first step
- Use those results as the adjusted gross income to refigure the charitable contributions
- For NOL carryover purposes, the taxpayer must reduce any charitable contributions carryover to the extent that the NOL carryover on line 10 is increased by any adjustment to charitable contributions

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### Change in Filing Status

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- If the client was married and filed a joint return for each year involved in figuring NOL carrybacks and carryovers, figure the NOL deduction on a joint return as you would for an individual
- Treat the NOL deduction as a joint NOL
- If the couple was married and filed separate returns for each year involved in figuring NOL carrybacks and carryovers, the spouse who sustained the loss may take the NOL deduction on a separate return
- Special rules apply for figuring the NOL carrybacks and carryovers of married people whose filing status changes for any tax year involved in figuring an NOL carryback or carryover

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### Separate to Joint Return

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- If the couple file a joint return for a carryback or carryforward year, and were married but filed separate returns for any of the tax years involved in figuring the NOL carryback or carryover, treat the separate carryback or carryover as a joint carryback or carryover

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### Joint to Separate Returns

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- If the couple file separate returns for a carryback or carryforward year, but filed a joint return for any or all of the tax years involved in figuring the NOL carryover, figure each of the carryovers separately

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### Joint Return in NOL Year

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- Figure each spouse's share of the joint NOL through the following steps
- 1. Figure each spouse's NOL as if he or she filed a separate return
  - If only one spouse has an NOL, stop here. All of the joint NOL is that spouse's NOL
- 2. If both spouses have an NOL, multiply the joint NOL by a fraction, the numerator of which is spouse A's NOL figured in (1) and the denominator of which is the total of the spouses' NOLs figured in (1)
- The result is spouse A's share of the joint NOL
- The rest of the joint NOL is spouse B's share

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### Example 1

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- Mark and Nancy are married and file a joint return for 2017
- They have an NOL of \$5,000
- They carry the NOL back to 2015, a year in which Mark and Nancy filed separate returns
- Figured separately, Nancy's 2017 deductions were more than her income, and Mark's income was more than his deductions
- Mark does not have any NOL to carry back
- Nancy can carry back the entire \$5,000 NOL to her 2015 separate return

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Example 2

- Assume the same facts as in Example 1 , except that both Mark and Nancy had deductions in 2017 that were more than their income
- Figured separately, his NOL is \$1,800 and her NOL is \$3,000
- The sum of their separate NOLs (\$4,800) is less than their \$5,000 joint NOL because his deductions included a \$200 net capital loss that is not allowed in figuring his separate NOL
- The loss is allowed in figuring their joint NOL because it was offset by Nancy's capital gains
- Mark's share of their \$5,000 joint NOL is \$1,875 ( $\$5,000 \times \$1,800/\$4,800$ ) and Nancy's is \$3,125 ( $\$5,000 - \$1,875$ )

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Joint Return in Previous Carryback or Carryforward Year

- If only one spouse had an NOL deduction on the previous year's joint return, all of the joint carryover is that spouse's carryover
- If both spouses had an NOL deduction figure each spouse's share of the joint carryover through the following steps

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Steps

1. Figure each spouse's modified taxable income as if he or she filed a separate return
2. Multiply the joint modified taxable income used to figure the joint carryover by a fraction, the numerator of which is spouse A's modified taxable income figured in (1) and the denominator of which is the total of the spouses' modified taxable incomes
  - This is spouse A's share of the joint modified taxable income
3. Subtract the amount from the joint modified taxable income
  - This is spouse B's share of the joint modified taxable income

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### Steps

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- 4. Reduce the amount but not below zero, by spouse B's NOL deduction
- 5. Add the amounts
- 6. Subtract the amount from the spouse A's NOL deduction
- This is spouse A's share of the joint carryover
- The rest of the joint carryover is spouse B's share

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### Example

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- Sam and Wanda filed a joint return for 2015 and separate returns for 2016 and 2017 - we must allocate the NOL § 1.172-7(d)
  - Assume the joint NOL is \$10,000
  - The husband's NOL would have been \$4,000
  - The wife's NOL would have been \$3,000
  - The amount allocated to the husband:  $\$4,000/\$7,000 \times \$10,000 = \$5,714$
  - The amount allocated to the wife:  $\$3,000/\$7,000 \times \$10,000 = \$4,286$

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### Example

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- Suppose that a married couple had filed joint returns until the death of one spouse
- If the surviving spouse has an NOL in a year after the other spouse died, and that NOL is carried back to a year before the other spouse died, then the income and deductions for the carryback year must be allocated between the spouses, since the NOL can be used to offset only the surviving spouse's income in the carryback year

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**Rev. Rul. 86-57**

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- If an NOL is carried from a year after two taxpayers are divorced back to a year in which they filed a joint tax return, then the income, deductions, and tax payments on the joint tax return must be allocated between the taxpayers to determine their respective shares of the income tax refund that results from the carryback
- Each spouse’s percentage of the recomputed joint liability is calculated by dividing his or her recomputed separate liability by the total of the two spouses’ recomputed separate liability
- Rev. Rul. 86-57

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**Table to Assist**

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NOL Year	Taxpayers are Not Married	Married and Filing a Joint Return	Married and Filing a Separate Return
Not Married	No allocation required	Income and Deductions must be Allocated	No allocation required
Married Filing Jointly	NOL Allocation Required	No allocation required	NOL Allocation Required
Married Filing Separately	No allocation required	No allocation required	No allocation required

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**Self-Employment Tax**

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- An NOL carryback or carryforward does not reduce self-employment tax

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### Passive Activity

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- Passive activity losses cannot be treated as net operating losses, since they are subject to other rules
- Once the business goes bankrupt an investor can claim a capital loss of up to the maximum allowed depending on filing status

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### Corporation Converts to an S Corporation

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- An NOL cannot be carried forward but can be used to offset any built-in capital gains tax on any property that appreciated while held as a C Corporation

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### Special Rules for an Acquired NOL IRC § 382 limitation

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- The Internal Revenue Service has placed restrictions on the use of an acquired NOL
- The restriction is documented in § 382 and states:
  - The § 382 limitation for any post-change year is an amount equal to—
    - (A) The value of the old loss corporation, multiplied by
    - (B) The long-term tax-exempt rate

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**Special Rules for an Acquired NOL  
IRC § 382 limitation**

- If the new loss corporation does not continue the business enterprise of the old loss corporation at all times during the 2-year period beginning on the change date, the § 382 limitation for any post-change year shall be zero
- The acquirer can only use that portion of the NOL in each successive year that is based on the long-term tax-exempt bond rate multiplied by the stock of the acquired entity

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**§ 1.1374-5 Loss Carryforwards**

- The loss carryforwards allowed as deductions against net recognized built-in gain under § 1374(b)(2) are allowed only to the extent their use is allowed under the rules applying to C corporations
- Any other loss carryforwards, such as charitable contribution carryforwards under § 170(d)(2), are not allowed as deductions against net recognized built-in gain
- Parker Tax Pro Library

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**§ 1.1374-5 Loss Carryforwards (The § 382  
Limitation)**

- Venice is a C corporation that has an ownership change under § 382(g)(1) on January 1, 2013
- On that date, Venice has a fair market value of \$500,000, NOL carryforwards of \$400,000, and a net unrealized built-in gain under § 382(h)(3)(A) of \$0

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**§ 1.1374-5 Loss Carryforwards (The § 382 Limitation)**

- Assume Venice’s § 382 limitation under § 382(b)(1) is \$40,000
- Venice elects to become an S corporation on January 1, 2017
- On that date, Venice has NOL carryforwards of \$240,000 (having used \$160,000 of its pre-change net operating losses in its 4 preceding taxable years) and a § 1374 net unrealized built-in gain of \$250,000
- In 2017, Venice has net recognized built-in gain of \$100,000
- Venice may use \$40,000 of its NOL carryforward as a deduction against its \$100,000 net recognized built-in gain, because Venice’s § 382 limitation is \$40,000

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**§ 382. Limitation on Net Operating Loss Carryforwards and Certain Built-in Losses Following Ownership Change**

- The amount of the taxable income of any new loss corporation for any post-change year which may be offset by pre-change losses shall not exceed the § 382 limitation for such year

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**What is the § 382 Limitation?**

- Remember
- Except as otherwise provided the § 382 limitation for any post-change year is an amount equal to -
- (A) the value of the old loss corporation, multiplied by
- (B) the long-term tax-exempt rate

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### Choices and Present Value

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- Companies can waive the carryback period, but it is generally advisable to carry back NOL to the extent possible, and use any remaining NOL at the earliest available opportunity in subsequent periods
- This will maximize the present value ("PV") of the NOL

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### Corporate Net Operating Loss Carryforward – States ( December 2015)

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- Thirty states and the District of Columbia conform to the federal standard of offering 20 years of NOL carryforwards
- Six states offer 15 years
- Tax Foundation website: [taxfoundation.org](http://taxfoundation.org)
- Other states are less generous
  - Illinois offers 12 years
  - Kansas, Michigan, New Hampshire, and Vermont offer ten years
  - Montana offers seven
  - Arkansas and Rhode Island only offer five
  - This year, Louisiana and New York both increased their number of carryforward years from 15 to 20

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### Corporate Net Operating Loss Carrybacks (December 2015)

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- Twelve states conform to the federal standard of offering 2 years of NOL carrybacks
- Three states have a more generous provision of three years
- Twenty-nine states and the District of Columbia do not allow NOL carrybacks
- This year, New York increased its number of carryback years from 2 to 3
- Louisiana eliminated its carryback provisions while increasing the amount of available carryforward years

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### NOL Caps (December 11, 2015)

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- It is also important to mention that some states limit the effectiveness of their NOL policies by placing a “cap” on the net operating losses that businesses are allowed to carry forward or back
- New Hampshire caps its carryforwards at \$10 million
- Pennsylvania caps its carryforwards at \$5 million
- Illinois allowed a particularly low \$100,000 cap to expire
- Utah caps its carrybacks at \$1 million
- West Virginia at \$300,000
- Idaho at \$100,000
- Delaware at \$30,000
- As part of a corporate tax reform package, New York eliminated its nation’s lowest \$10,000 carryback cap this year

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### Interest

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- Interest is paid to the taxpayer if the IRS does not process an NOL case within 45 days
- The IRS pays millions of dollars in interest payments annually because many NOL cases are not processed within 45 days
- This interest is costly to the Government and creates a burden to taxpayers when their refunds are delayed
- 2012 TIGTA report

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### TIGTA Report - October 2015

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- Corporate NOLs occur when a C corporation’s
- Allowable tax deductions exceed its gross income for the year
- The Great Recession caused corporate income tax receipts to drop from a historic high of \$395.5 billion in Fiscal Year (FY) 2007 to a low of \$225.5 billion in FY 2009
- The corporate income tax returns filed during this period showed more than \$722 billion in NOLs
- Going forward, in Processing Year (PY) 2012, corporate income tax returns showed that there were more than \$1.96 trillion in NOL carryforwards available to be offset against future income tax

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**IRS Responsibility**

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- The IRS has two significant responsibilities in administrating NOLs in accordance with established tax policies
- First, the IRS receives the claims for NOL carrybacks and must expedite their processing to ensure that refunds are timely issued to avoid paying unnecessary interest
- Second, the IRS has processes and procedures to determine the validity of loss claims and to ensure that NOL carryforwards are taken in accordance with legal guidelines

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**45 day Timeframe Issues**

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- Cases were reassigned multiple times before closure
- Cases were not given the proper priority code on the system used to track and monitor the cases
- Manual refunds were not always issued when required
- Interest paid was not monitored
- The 90-day statutory time period for processing Forms 1045 is not monitored

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**Last Thoughts**

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- Advantages of Using Form 1045
  - The IRS has only 90 days to process the form
  - One claim can be submitted for all the carryback years
  - The form does a good job of showing which prior year items are adjusted as a result of the net operating loss

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### Last Thoughts

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- Disadvantages of Using Form 1045
  - Must file within one year of the last day of the year in which the NOL occurred
  - Processing the form and paying the requested refund does not guarantee that IRS has accepted the application as correct
    - The IRS can still audit and impose additional taxes, penalties and interest after the refund is issued
  - If the application is disallowed – no challenge can be brought in any court - must then submit on Form 1040X

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### Last Thoughts

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- Disadvantages of Using Form 1045
  - Finally, any amount applied, credited or refunded based on Form 1045 that IRS later determines is excessive may be billed as if it were due to a math or clerical error on the return

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### Last Thoughts

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- Advantages of Using Form 1040X
  - The deadline for filing Form 1040X to claim a refund for the carryback of the NOL year's loss is the same as the deadline for changes to the NOL year's return
  - The amended return must be filed no later than three years after the due date of the return for the NOL year
  - Generally, the deadline to file Form 1040X for 2015 to claim a refund generated by a 2017 NOL is April 15, 2021

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### Last Thoughts

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- Advantages of Using Form 1040X
- If the 2017 return is filed with a valid extension, the deadline is October 15, 2021
- If the IRS does not process the claim within six months from the date filed, the taxpayer may file suit in court
- If the IRS disallows the claim, the taxpayer has two years from the date of disallowance to file suit

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### Last Thoughts

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- Disadvantages of Using Form 1040X
- Separate returns must be prepared for each carryback year.
- It may take more than 90 days for the IRS to process the returns and issue refunds
- Preparers using software to prepare the return must manually adjust for some of the deductions that are based on AGI

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### Questions



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**The Scoop – Upcoming Dates**

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- July 19
- August 2
- August 16
- August 30
- September 13
- October 4
- October 18
- November 1
- Held at 8:00 am and 12:00 pm Central time

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**Up Coming Webinars**  
<http://www.calt.iastate.edu/calendar-node-field-seminar-date/month>

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- Form 1099 Preparation July 13
- Tax Basis for Farmers July 24
- Reconstructing Records for Tax Compliance August 17
- Uber/Lyft Drivers and Business Expenses August 22
- Tax Reform and New Law Update October 17
- New Partnership Audit Rules October 19

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**Upcoming Seminars – Mark Your Calendar – Final Dates**

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- S Corporation – July 20-21, 2017, Live and Webinar
- September 21, 2017 Ag Law Seminar, Live and Webinar
- September 22, 2017 Farm and Estate Tax Review, Live and Webinar
- Retirement and Social Security Issues(Webinar) = October 10-11, 2017

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### The Schedule is Finalized for the 44th Annual Federal Income Tax Schools

- November 2-3, 2017 – Maquoketa, Iowa – Centerstone Inn and Suites
- November 6-7, 2017 – Le Mars, Iowa – Le Mars Convention Center
- November 8-9, 2017 – Atlantic, Iowa – Cass County Community Center
- November 9-10, 2017 – Mason City, Iowa – North Iowa Area Community College
- November 16-17, 2017 – Ottumwa, Iowa – Indian Hills Community College
- November 20-21, 2017 – Waterloo, Iowa – Hawkeye Community College
- December 11-12, 2017 – Ames, Iowa and Live Webinar – Quality Inn and Suites

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