

Tax News

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Expanded NOL Carryback Rules Under 2009 Tax Act

The recently enacted American Recovery and Reinvestment Tax Act of 2009 (“the Act”) increases the period during which qualifying small businesses may elect to carry back a 2008 net operating loss (NOL) beyond the pre-Act limitation of two years.

The following are key factors to consider when determining the appropriate carryback period that maximizes the income-tax benefits for a qualifying business.

Background

An NOL is commonly defined as the excess of a business taxpayer’s deductions over gross income for a particular tax year. Under prior law, an NOL could be carried back two years and carried forward up to 20 years to offset taxable income in those years. By carrying back an NOL, a business can be entitled to a refund of taxes paid in the prior years.

Example: Michael’s Catering, Inc. had taxable income of \$20,000 in Year 1 and \$35,000 in Year 2. In Year 3, the business suffered a \$55,000 net operating loss.

The company may carry back the loss to offset taxable income in Year 1 and Year 2, resulting in a refund of taxes paid for those prior years.

Variations to NOL rules apply in certain circumstances, such as that relating to qualifying farming losses.

Generally, the NOL is carried back to the earliest tax year possible, and then any excess loss is applied to the next earliest tax year. Alternatively, a taxpayer may choose to carry the NOL forward and forego the applicable carryback period (when, for example, there were no taxes paid in the applicable carryback years).

Increased NOL Carryback Period Under the Act

An eligible business may now elect a two-, three-, four-, or five-year NOL carryback period in the case of an NOL for any taxable year ending in 2008. Alternatively, the taxpayer may choose to apply the new rule to an NOL for any taxable year beginning in 2008 (generally, this option may be desirable if the tax year is not the calendar year

and extends into 2009). In general, an “eligible small business” is a trade or business whose average annual gross receipts are \$15 million or less.

In assessing whether to carry back an NOL three, four or five years, a determination needs to be made as to which election results in the largest income-tax savings. For instance, the ability to carry back the NOL to a year in which income was taxed at a relatively higher tax rate will yield a greater tax refund in applying the NOL to that year. Alternately, depending on the combined income of the prior five years – and how that combined income relates to the amount of the NOL – it may be prudent to simply carry back the NOL for two years only or elect to carry it forward.

Example: ABC Company, an eligible small business, had an applicable NOL for 2008. ABC had no taxable income for both tax years 2006 and 2007, but did for 2005. Accordingly, ABC can elect a three-year carryback for the NOL, to 2005, offsetting 2005 income and generating a tax refund.

In summary, a qualifying small business incurring a net operating loss for 2008 can elect to carry the NOL as far back as 2004, if desired.

Have More Questions?

The opportunity to extend the carryback period for an NOL relating to the 2008 tax year is limited. If your business incurred a loss for 2008, we would be happy to discuss various tax-planning scenarios with you in an attempt to maximize a possible tax refund associated with the expanded NOL rules under the American Recovery and Reinvestment Tax Act of 2009. Call the professionals at Doeren Mayhew today at (248) 244-3000 for help determining how the new rules relate to your specific tax situation.