

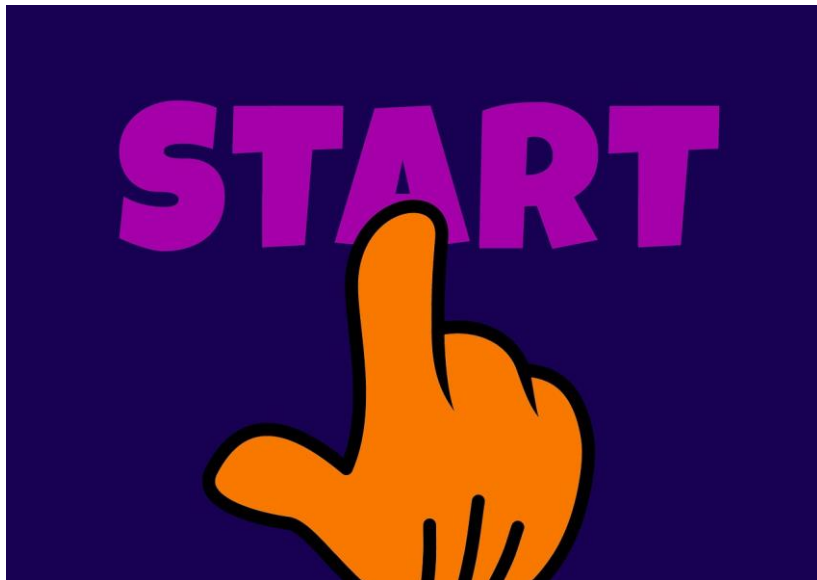
Net Operating Losses

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Basic Issues



- Net Operating Loss rules are designed to deal with “unfairness” from
 - Annual measurement in taxation
 - Marginal rate issues
- Rules provide
 - Default periods
 - Deal with statute issues

Computing the Net Operating Loss – What Your Software Won't Get Right

Net Operating Losses - Dealing with the Complexities



Basics of a Net Operating Loss



- Loss defined at IRC §172
 - Only if deductions allowed per section exceed gross income
 - Deductions only allowed if already allowed for income taxes
- Initial calculation is to separate business and nonbusiness income and deductions

Business Income

- Trade or business income
- Salary and wages
- Business income from flowthrough
- Rental income
- Gain from sale or property used in
 - Trade or business
 - Rental



Business Deductions



- Casualty thefts and losses (all)
- Moving expenses
- Employee business expenses
- State income tax on business profits
- Interest and litigation expenses on business taxes (subject to caveat for individual income taxes)
- Educator expenses
- Self-employment tax deduction
- Self-employed health insurance

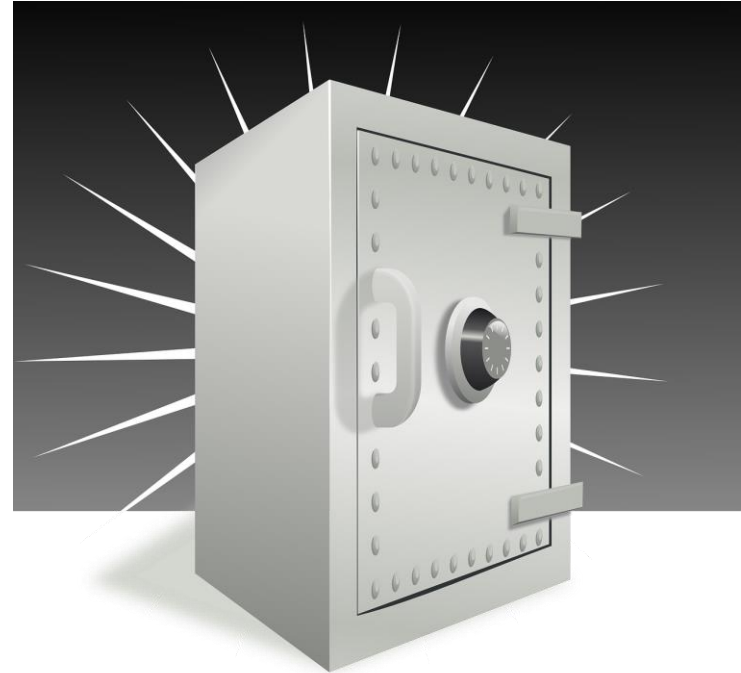
Business Deductions



- Loss on rental property
- Loss on sale of accounts receivable (accrual)
- IRC §1244 stock loss
- Passthrough business losses
- Basis of annuity on decedent's final return
- Federal employee buyback of sick leave

Nonbusiness Income

- Interest
- Dividends
- Annuities
- Gain on the sale of nonbusiness, nonrental assets



Nonbusiness Deductions



- Alimony
- Health savings account
- Contributions for proprietor or partner to
 - Keogh
 - SEP
 - SIMPLE
- IRA contributions
- Nonbusiness itemized deductions
- Standard deduction

Adjustments to NOL

- Nonbusiness capital losses allowed only to extent of nonbusiness capital gains
- Nonbusiness deductions allowed only to extent of nonbusiness income
- Prefer to see
 - Nonbusiness income
 - Business deductions



Step-by-Step NOL Computation

1. Compute tax for year (must be negative before exemptions)
2. Determine amount of NOL, if any
3. Decide to elect to carryforward or accept default carryback
4. Deduct NOL against first year carried to
5. Determine if fully absorbed—if not go on to next year



Schedule A—NOL (see instructions)

1	Enter the amount from your 2014 Form 1040, line 41, or Form 1040NR, line 39. Estates and trusts, enter taxable income increased by the total of the charitable deduction, income distribution deduction, and exemption amount			1
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		
11	Business capital losses before limitation. Enter as a positive number	11		
12	Business capital gains (without regard to any section 1202 exclusion)	12		
13	Add lines 10 and 12	13		
14	Subtract line 13 from line 11. If zero or less, enter -0-	14		
15	Add lines 4 and 14	15		
16	Enter the loss, if any, from line 16 of your 2014 Schedule D (Form 1040). (Estates and trusts, enter the loss, if any, from line 19, column (3), of Schedule D (Form 1041).) Enter as a positive number. If you do not have a loss on that line (and do not have a section 1202 exclusion), skip lines 16 through 21 and enter on line 22 the amount from line 15	16		
17	Section 1202 exclusion. Enter as a positive number			17
18	Subtract line 17 from line 16. If zero or less, enter -0-	18		
19	Enter the loss, if any, from line 21 of your 2014 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	19		
20	If line 18 is more than line 19, enter the difference. Otherwise, enter -0-	20		
21	If line 19 is more than line 18, enter the difference. Otherwise, enter -0-			21
22	Subtract line 20 from line 15. If zero or less, enter -0-			22
23	Domestic production activities deduction from your 2014 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 do not have an NOL			25

Where Your Tax Software Will Have Issues



- Business/Nonbusiness income
- Business capital gains/losses
- State income taxes related to business
- Should review software's Form 1045 Schedule A equivalent
 - Should be able to prove each major number
 - May need to make adjustments

When to Use an NOL

- Default
 - Carried back 2 years
 - Forward 20 years
- Exceptions
 - 3 Year Losses
 - Casualty & theft
 - Small business disaster loss
 - 5 Year Losses - Farming



When to Use an NOL

- Exceptions
 - 10 Year Losses
 - Product liability
 - Reclamation of land
 - Dismantle drilling platform
 - Remediation of environmental contamination
 - Payment under workers compensation act



Forgoing the Carryback Period



- Must attach statement to return
- Election irrevocable and must be made on timely filed original return
- Relief option if decide to elect within 6 months of original unextended due date
 - File amended return with election
 - Note filing under Reg. §301.9100-2(b)

Mechanics of Calculating Refund Due from Tax Year

- No difference regardless if loss carried back or forward to a year
- Will impact all items affected by AGI
 - Special rule for passive losses from rentals
 - Social security
 - IRA deductions
- Refigure and may affect carryovers (can create a “circular” problem)



Mechanics of Calculating Refund Due from Tax Year

- Refigure taxable income
 - Calculate regular income tax
 - Calculate AMT using ATNOL
- Self-employment tax is not affected
- If release general business credit, carry that back 2 more years



Computing an NOL Carryover – What's Left?



- If $\text{NOL} > \text{taxable income}$ in year carried to, may have amount left to carryover
- Carryover is:
 - Net operating loss in excess of
 - Modified taxable income

Modified Taxable Income Computation

- Remove NOL deduction for year computing carryover for
- Remove any deduction for a net capital loss
- Remove a deduction for exemptions
- Refigure anything affected by AGI after making first two changes
- For charitable carryover, include NOL for year computing carryover



Complete one column before going to the next column. Start with the earliest carryback year.

	_____ preceding tax year ended ▶	_____ preceding tax year ended ▶	_____ preceding tax year ended ▶
1 NOL deduction (see instructions). Enter as a positive number			
2 Taxable income before 2014 NOL carryback (see instructions). Estates and trusts, increase this amount by the sum of the charitable deduction and income distribution deduction			
3 Net capital loss deduction (see instructions)			
4 Section 1202 exclusion. Enter as a positive number			
5 Domestic production activities deduction			
6 Adjustment to adjusted gross income (see instructions)			
7 Adjustment to itemized deductions (see instructions)			
8 Individuals, enter deduction for exemptions (minus any amount on Form 8914, line 6, for 2006 and 2009; line 2 for 2005 and 2008). Estates and trusts, enter exemption amount			
9 Modified taxable income. Combine lines 2 through 8. If zero or less, enter -0-			
10 NOL carryover (see instructions)			
Adjustment to Itemized Deductions (Individuals Only) Complete lines 11 through 38 for the carryback year(s) for which you itemized deductions only if line 3, 4, or 5 above is more than zero.			
11 Adjusted gross income before 2014 NOL carryback			
12 Add lines 3 through 6 above			
13 Modified adjusted gross income. Add lines 11 and 12			
14 Medical expenses from Sch. A (Form 1040), line 4 (or as previously adjusted)			
15 Medical expenses from Sch. A (Form 1040), line 1 (or as previously adjusted)			
16 Multiply line 13 by percentage from Sch. A (Form 1040), line 3			
17 Subtract line 16 from line 15. If zero or less, enter -0-			
18 Subtract line 17 from line 14			
19 Mortgage insurance premiums from Sch. A (Form 1040), line 13 (or as previously adjusted)			
20 Refigured mortgage insurance premiums (see instructions)			
21 Subtract line 20 from line 19			



Schedule B—NOL Carryover (Continued)

Complete one column before going to the next column. Start with the earliest carryback year.

	_____ preceding tax year ended ▶	_____ preceding tax year ended ▶	_____ preceding tax year ended ▶
22	Modified adjusted gross income from line 13 on page 3 of the form		
23	Enter as a positive number any NOL carryback from a year before 2014 that was deducted to figure line 11 on page 3 of the form		
24	Add lines 22 and 23		
25	Charitable contributions from Sch. A (Form 1040), line 19 (line 18 for 2004 through 2006), or Sch. A (Form 1040NR), line 5 (line 7 for 2004 through 2010), or as previously adjusted		
26	Refigured charitable contributions (see instructions)		
27	Subtract line 26 from line 25		
28	Casualty and theft losses from Form 4684, line 18 (line 23 for 2008; line 21 for 2009; line 20 for 2005, 2006, and 2010)		
29	Casualty and theft losses from Form 4684, line 16 (line 21 for 2008; line 18 for 2005, 2006, and 2010; line 19 for 2009)		
30	Multiply line 22 by 10% (.10)		
31	Subtract line 30 from line 29. If zero or less, enter -0-		
32	Subtract line 31 from line 28		
33	Miscellaneous itemized deductions from Sch. A (Form 1040), line 27 (line 26 for 2004 through 2006), or Sch. A (Form 1040NR), line 13 (line 15 for 2004 through 2010), or as previously adjusted		
34	Miscellaneous itemized deductions from Sch. A (Form 1040), line 24 (line 23 for 2004 through 2006), or Sch. A (Form 1040NR), line 10 (line 12 for 2004 through 2010), or as previously adjusted		
35	Multiply line 22 by 2% (.02)		
36	Subtract line 35 from line 34. If zero or less, enter -0-		
37	Subtract line 36 from line 33		
38	Complete the worksheet in the instructions if line 22 is more than the applicable amount shown in the instructions. Otherwise, combine lines 18, 21, 27, 32, and 37; enter the result here and on line 7 (page 3)		

Dealing with the Alternative Minimum Tax and the Net Operating Loss

Net Operating Losses - Dealing with the
Complexities



Alternative Tax Net Operating Loss



- Recalculate NOL using amounts allowed for the alternative minimum tax
- Will also need to recalculate any carryovers
- ATNOL will be used to compute AMT for years carried back to
- Election to forgo carryback period applies to both NOLs

Adjustment Made on Form 6251

7	Tax refund from Form 1040, line 10 or line 21	7	()
8	Investment interest expense (difference between regular tax and AMT).	8			
9	Depletion (difference between regular tax and AMT)	9			
10	Net operating loss deduction from Form 1040, line 21. Enter as a positive amount	10			
11	Alternative tax net operating loss deduction	11	()
12	Interest from specified private activity bonds exempt from the regular tax	12			
13	Qualified small business stock (7% of gain excluded under section 1202)	13			
14	Exercise of incentive stock options (excess of AMT income over regular tax income)	14			
15	Estates and trusts (amount from Schedule K-1 (Form 1041), box 12, code A)	15			
16	Electing large partnerships (amount from Schedule K-1 (Form 1065-B), box 6)	16			

Limitations on ATNOL

- Deduction generally limited to offsetting no more than 10% of tentative minimum taxable income
- Due to AMT exemption (which is affected by AGI) generally only “hurts” if loss >
 - Single/HOH \$543,000
 - MFJ \$845,000
 - MFS \$422,500



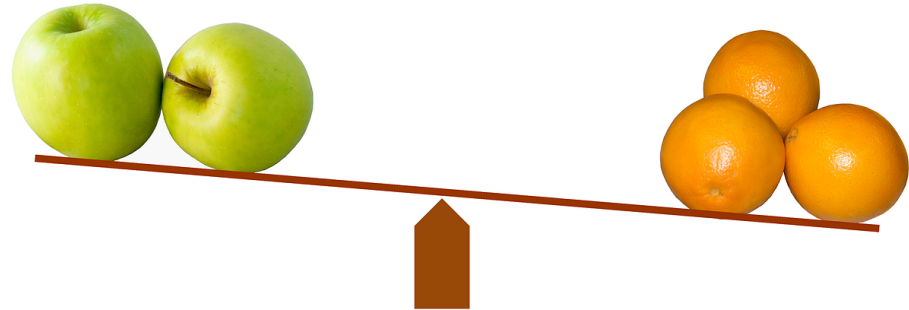
Dealing with ATNOL and Carrybacks



- Same issues exist for computation by tax software-if the software does it
- Should create separate computation and carryover schedule
- IRS does look for a Form 6251 when claiming NOL carryback and often rejects claims without it

Form 1045 vs. Form 1040X

Net Operating Losses - Dealing with the
Complexities



Show Me the Money – Claiming the Refund Due

- Taxpayer can claim refund one of two ways
- On a Form 1040X just like any claim for refund due on a prior Form 1040
- Asking for a “tentative refund” on Form 1045
- So what’s the difference?





Form 1040X

Form 1040X Department of the Treasury - Internal Revenue Service		Amended U.S. Individual Income Tax Return		OMB No. 1545-0047	
(Rev. December 2014) Information about Form 1040X and its separate instructions is at www.irs.gov/form1040x.					
This return is for calendar year <input type="checkbox"/> 2014 <input type="checkbox"/> 2013 <input type="checkbox"/> 2012 <input type="checkbox"/> 2011					
Other year. Enter one calendar year or fiscal year (month and year ended):					
Your first name and initial		Last name		Your social security number	
If a joint return, spouse's first name and initial		Last name		Spouse's social security number	
Current home address (number and street). If you have a P.O. box, see instructions.				Apt. no. Your phone number	
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).					
Foreign country name		Foreign province/state/country		Foreign postal code	
Amended return filing status. You must check one box even if you are not changing your filing status. Caution. In general, you cannot change your filing status from joint to separate returns after the due date.					
<input type="checkbox"/> Single <input type="checkbox"/> Qualifying widow(er) <input type="checkbox"/> Married filing jointly			<input type="checkbox"/> Married filing separately <input type="checkbox"/> Head of household (if the qualifying person is a child but not your dependent, see instructions.)		
<input type="checkbox"/> Yes <input type="checkbox"/> No			Full-year coverage. If all members of your household have full-year minimal essential health care coverage, check "Yes." Otherwise, check "No." (See instructions.)		
Use Part III on the back to explain any changes					
Income and Deductions		A. Original amount or as previously reported (see instructions)		B. Net change—amount of increase or decrease (explain in Part III)	
1 Adjusted gross income. If net operating loss (NOL) carryback is included, check here <input type="checkbox"/>		1			
2 Remeasured deductions or standard deduction		2			
3 Subtract line 2 from line 1		3			
4 Exemptions. If changing, complete Part I on page 2 and enter the amount from line 29		4			
5 Taxable income. Subtract line 4 from line 3		5			
Tax Liability					
6 Tax. Enter method(s) used to figure tax (see instructions)		6			
7 Credits. If general business credit carryback is included, check here <input type="checkbox"/>		7			
8 Subtract line 7 from line 6. If the result is zero or less, enter -0-		8			
9 Health care: individual responsibility (see instructions)		9			
10 Other taxes		10			
11 Total tax. Add lines 8, 9, and 10		11			
Payments					
12 Federal income tax withheld and excess social security and tier 1 RRATA tax withheld (if changing, see instructions)		12			
13 Estimated tax payments, including amount applied from prior year's return		13			
14 Earned income credit (EIC)		14			
15 Refundable credits from: <input type="checkbox"/> Schedule EIC <input type="checkbox"/> Form 8839 <input type="checkbox"/> Form 8833 <input type="checkbox"/> Form 8865 <input type="checkbox"/> Form 8892 <input type="checkbox"/> Form 8893 <input type="checkbox"/> Form 8894 <input type="checkbox"/> Form 8895 <input type="checkbox"/> Form 8896 <input type="checkbox"/> Form 8897 <input type="checkbox"/> Form 8898 <input type="checkbox"/> Form 8899 <input type="checkbox"/> Form 8903 <input type="checkbox"/> Form 8904 <input type="checkbox"/> Form 8905 <input type="checkbox"/> Form 8906 <input type="checkbox"/> Form 8907 <input type="checkbox"/> Form 8908 <input type="checkbox"/> Form 8909 <input type="checkbox"/> Form 8910 <input type="checkbox"/> Form 8911 <input type="checkbox"/> Form 8912 <input type="checkbox"/> Form 8913 <input type="checkbox"/> Form 8914 <input type="checkbox"/> Form 8915 <input type="checkbox"/> Form 8916 <input type="checkbox"/> Form 8917 <input type="checkbox"/> Form 8918 <input type="checkbox"/> Form 8919 <input type="checkbox"/> Form 8920 <input type="checkbox"/> Form 8921 <input type="checkbox"/> Form 8922 <input type="checkbox"/> Form 8923 <input type="checkbox"/> Form 8924 <input type="checkbox"/> Form 8925 <input type="checkbox"/> Form 8926 <input type="checkbox"/> Form 8927 <input type="checkbox"/> Form 8928 <input type="checkbox"/> Form 8929 <input type="checkbox"/> Form 8930 <input type="checkbox"/> Form 8931 <input type="checkbox"/> Form 8932 <input type="checkbox"/> Form 8933 <input type="checkbox"/> Form 8934 <input type="checkbox"/> Form 8935 <input type="checkbox"/> Form 8936 <input type="checkbox"/> Form 8937 <input type="checkbox"/> Form 8938 <input type="checkbox"/> Form 8939 <input type="checkbox"/> Form 8940 <input type="checkbox"/> Form 8941 <input type="checkbox"/> Form 8942 <input type="checkbox"/> Form 8943 <input type="checkbox"/> Form 8944 <input type="checkbox"/> Form 8945 <input type="checkbox"/> Form 8946 <input type="checkbox"/> Form 8947 <input type="checkbox"/> Form 8948 <input type="checkbox"/> Form 8949 <input type="checkbox"/> Form 8950 <input type="checkbox"/> Form 8951 <input type="checkbox"/> Form 8952 <input type="checkbox"/> Form 8953 <input type="checkbox"/> Form 8954 <input type="checkbox"/> Form 8955 <input type="checkbox"/> Form 8956 <input type="checkbox"/> Form 8957 <input type="checkbox"/> Form 8958 <input type="checkbox"/> Form 8959 <input type="checkbox"/> Form 8960 <input type="checkbox"/> Form 8961 <input type="checkbox"/> Form 8962 <input type="checkbox"/> Form 8963 <input type="checkbox"/> Form 8964 <input type="checkbox"/> Form 8965 <input type="checkbox"/> Form 8966 <input type="checkbox"/> Form 8967 <input type="checkbox"/> Form 8968 <input type="checkbox"/> Form 8969 <input type="checkbox"/> Form 8970 <input type="checkbox"/> Form 8971 <input type="checkbox"/> Form 8972 <input type="checkbox"/> Form 8973 <input type="checkbox"/> Form 8974 <input type="checkbox"/> Form 8975 <input type="checkbox"/> Form 8976 <input type="checkbox"/> Form 8977 <input type="checkbox"/> Form 8978 <input type="checkbox"/> Form 8979 <input type="checkbox"/> Form 8980 <input type="checkbox"/> Form 8981 <input type="checkbox"/> Form 8982 <input type="checkbox"/> Form 8983 <input type="checkbox"/> Form 8984 <input type="checkbox"/> Form 8985 <input type="checkbox"/> Form 8986 <input type="checkbox"/> Form 8987 <input type="checkbox"/> Form 8988 <input type="checkbox"/> Form 8989 <input type="checkbox"/> Form 8990 <input type="checkbox"/> Form 8991 <input type="checkbox"/> Form 8992 <input type="checkbox"/> Form 8993 <input type="checkbox"/> Form 8994 <input type="checkbox"/> Form 8995 <input type="checkbox"/> Form 8996 <input type="checkbox"/> Form 8997 <input type="checkbox"/> Form 8998 <input type="checkbox"/> Form 8999 <input type="checkbox"/> Form 9000		15			
16 Total amount paid with request for extension of time to file, tax paid with original return, and additional tax paid after return was filed		16			
17 Total payments. Add lines 12 through 16		17			
Refund or Amount You Owe (Note. Allow up to 16 weeks for Form 1040X to be processed.)					
18 Overpayment, if any, as shown on original return or as previously adjusted by the IRS		18			
19 Subtract line 18 from line 17 (if less than zero, see instructions)		19			
20 Amount you owe. If line 11, column C, is more than line 19, enter the difference		20			
21 If line 11, column C, is less than line 19, enter the difference. This is the amount overpaid on this return		21			
22 Amount of line 21 you want refunded to you		22			
23 Amount of line 21 you want applied to your (enter year):		23			

For Paperwork Reduction Act Notice, see instructions. Cat. No. 1360L Form 1040X (Rev. 12-2014)

- Represents a formal claim to be acted upon by the IRS
- Full §6213 procedures required later for IRS
 - Issuance of 90 day letter
 - Right to contest in Tax Court before payment
- Generally takes longer for the IRS to process (often much longer) than Form 1045
- Can be filed at any point while statute is open for the claim



Form 1045

- IRS required to act within 90 days (though delayed if filed before due date, including extensions)
- May get funds back by assessing and collecting immediately
- All affected years claims on one form
- Must be filed by end of year following year that generated the NOL

Form 1045 Application for Tentative Refund OMB No. 1545-0080

Department of the Treasury Internal Revenue Service

► Separate instructions and additional information are available at irs.gov/form1045.
► Do not attach to your income tax return. Mail in a separate envelope.
► For use by individuals, estates, or trusts.

2014

Name (print)
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 complete spaces below (see instructions). Daytime phone number
Foreign country name Foreign province/county Foreign postal code

1 This application is filed to carry back: a Net operating loss (NOL) (Sch. A, line 25, page 2) \$ _____ b Unused general business credit \$ _____ c Net section 1256 contracts loss \$ _____

2a For the calendar year 2014, or other tax year beginning _____, 2014, and ending _____, 20 _____ b Date 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 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 ► _____ Yes No

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)

	preceding tax year ended ►		preceding tax year ended ►		preceding tax year ended ►	
	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 Alternative minimum tax						
18 Add lines 16 and 17						
19 General business credit (see instructions)						
20 Other credits. Identify						
21 Total credits. Add lines 19 and 20						
22 Subtract line 21 from line 18						
23 Self-employment tax						
24 Other taxes						
25 Total tax. Add lines 22 through 24						
26 Enter the amount from the "After carryback" column on line 25 for each year						
27 Decrease in tax. Line 25 minus line 26						
28 Overpayment of tax due to a claim of right adjustment under section 1341(b)(1) (attach computation)						

Sign Here
Under penalty of perjury, I declare that I have examined this application and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete.
Your signature _____ Date _____
Spouse's signature, if Form 1045 is filed jointly, both must sign. _____ Date _____

Preparer Use Only
Print type preparer's name _____ Preparer's signature _____ Date _____ Check if self-employed
Firm's name _____ Firm's EIN _____
Firm's address _____ Phone no. _____

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see instructions. Cat. No. 1045A Form 1045 2014

Choosing Between the Two Options



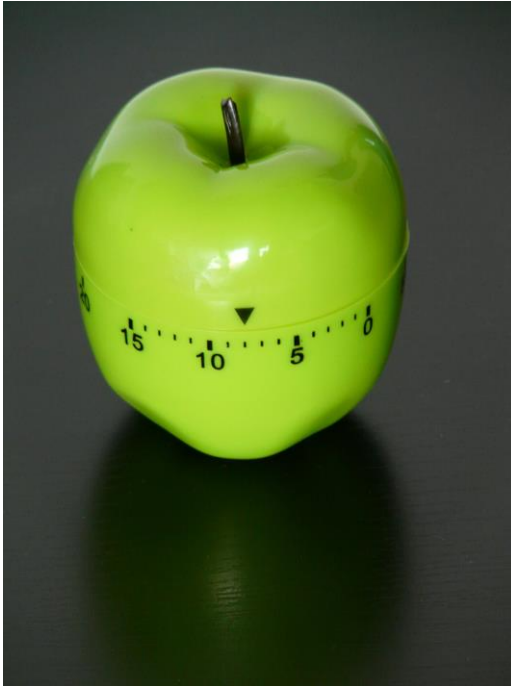
- Is the loss year calculation likely to lead to IRS challenge if an exam takes place?
- Does the taxpayer want/need the funds quickly?
- Are we still in the time period where the Form 1045 is an option?
- Are there other revisions for year being carried to?

Impact of Net Operating Losses on the Statute of Limitations

Net Operating Losses - Dealing with the Complexities

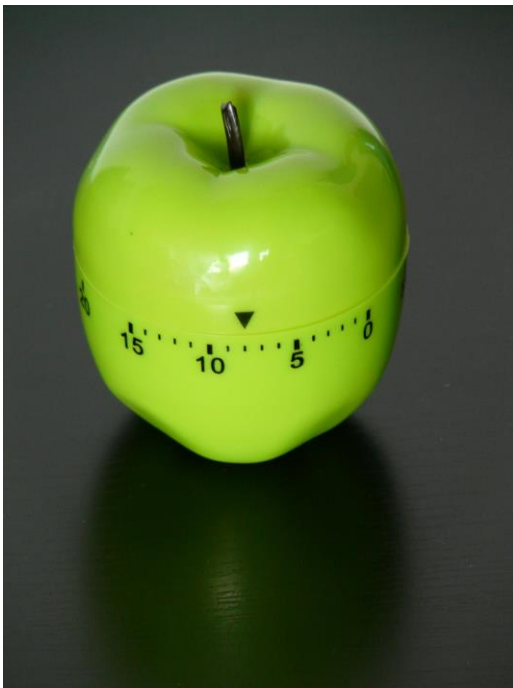


Statute of Limitations and Net Operating Losses



- Time to claim refund due to loss extended to
 - 3 years after due date of return generating NOL
 - Includes extensions actually requested [§6511(d)(2)]
- Note **not** linked to statute of limitations on return generating NOL

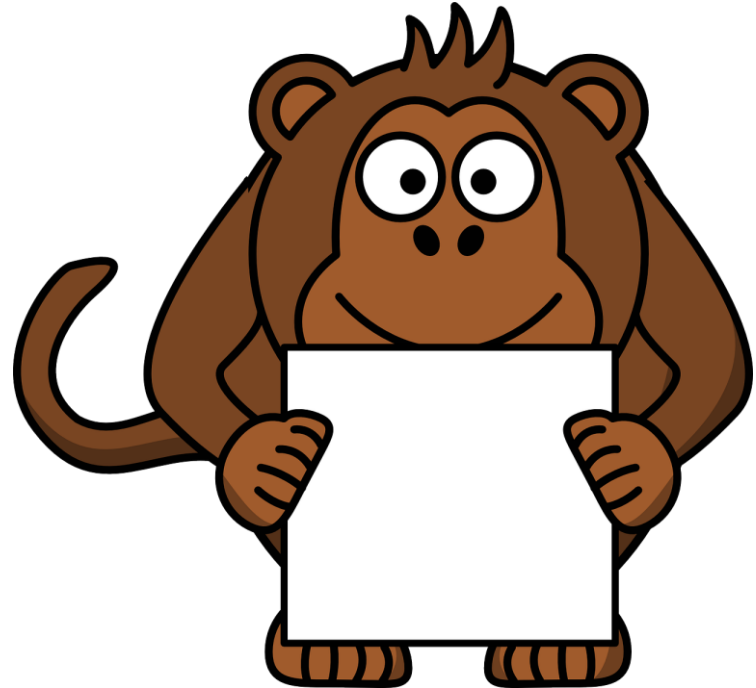
Statute of Limitations and Net Operating Losses



- Chief Counsel Advice 201515019 – not extended due to financial disability provision of §6511(h)
- Chief Counsel Advice 201517005 – not extended when taxpayer uses 10 year provision to change from foreign tax credit to deducting foreign taxes, leading to NOL

Documenting NOL Carryovers

- IRS can challenge NOL calculation so long as impacts a year where IRS can assess tax
- Thus a loss created on return filed five year ago is not “safe” or “protected”
- Similar rule applies to taxpayer if can show loss should be higher coming into open year



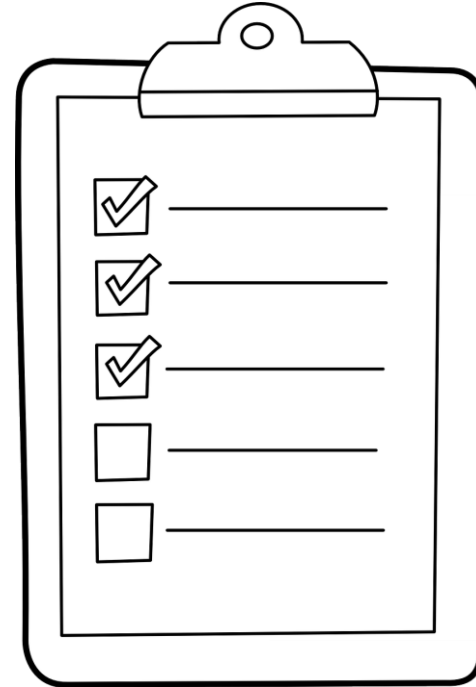
Example: *Boring v. Commissioner*, TC Summary 2014-105



- IRS had not challenged NOL carryover in prior years
- IRS questioned carryover into 2007 – taxpayer produced 1996-2006 tax return copies
- IRS not “stuck” with losses on those returns, regardless of how long ago file
- Entire NOL disallowed by Tax Court for lack of proof-burden remained on taxpayers

Advising Clients on Records and Claims

- Note the danger of giving “rules of thumb” for destroying records
- Need support for NOL year so long as a change could impact year open for assessment
- Remember that statute closes on NOL claim 3 years after return that generates NOL was due



What IRS Cannot Do When Taxpayer Carries Back Loss



- NOL claim only extends period for assessment on amount of refund
- IRS can challenge anything that increases tax
- But can only get refund amount back if year otherwise closed for assessment

NOLs and Change of Filing Status

Net Operating Losses - Dealing with the Complexities



Change in Filing Status

- Limits are imposed on losses if filing status different on returns
- If have loss entering marriage limited to offsetting income of spouse that brought loss into marriage
- If have loss after marriage need to limit claim to taxpayer's share of joint tax
- If have loss in marriage being carried out of marriage, have to allocate between spouses



Carryback to Joint Year



- Figure tax as if each filed MFS
- Combine taxes in the first step, determine ratio of tax
- Multiply ratio by joint tax to determine each spouse's share of tax
- Unless have agreement otherwise, split joint payments using same ratio
- Taxpayer only can get back his/her portion of tax from carryback of loss

Switching Between MFS and MFJ Returns

- Separate return to joint return – treat separate carryback or carryover as a joint carryback or carryover
- Joint return to separate return, figure each carryover separately



Switching Between MFS and MFJ Returns

- Splitting the Joint NOL
 - Figure each spouse's NOL as if filed separate return
 - If only one spouse has NOL entire joint NOL is that spouse's
 - If both have NOL, then use ratio of separate NOLs to divide



Example

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

Example

Same facts except that both Mark and Nancy had deductions that were more than their income. Figured separately, Mark's NOL is \$1,800 and Nancy's is \$3,000. (The sum of their separate NOLs is less than their \$5,000 joint NOL because Mark's 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.)

Example

Mark's share of their \$5,000 joint NOL is \$1,875 ($\$5,000 \times \$1,800/\$4,800$) and Nancy's share is \$3,125 ($\$5,000 - \$1,875$)

Questions?

<http://www.currentfederaltaxdevelopments.com>