NOL Part 2 - Examples
June 21, 2017

NOL Importance

• Allows taxpayers to maximize the use of deductions and losses – not limiting them to a single year
• A bit of history

First We Calculate the NOL
Example 1 - Josh

- Josh is in the retail record business
- He is single and has the following income and deductions on his Form 1040 for 2017
- **INCOME**
  - Wages from part-time job $1,225
  - Interest on savings $425
  - Net long-term capital gain on sale of real estate used in business $2,000
  - Josh’s total income $3,650

Example 1 - Josh

- **DEDUCTIONS**
  - Net loss from business (gross income of $67,000 minus expenses of $72,000) - $5,000
  - Net short-term capital loss on sale of stock $1,000
  - Standard deduction $6,350
  - Personal exemption $4,050
  - Josh total deductions $16,400
  - Josh’s deductions exceed his income by $12,750 ($16,400 - $3,650)

Example 1 - Josh – AGI and Tax and Credits

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>AGI</td>
</tr>
<tr>
<td>2</td>
<td>Tax and Credits</td>
</tr>
<tr>
<td>3</td>
<td>Itemized deduction (or standard deduction of $6,350)</td>
</tr>
<tr>
<td>4</td>
<td>Exemptions, personal, dependency, and veterans</td>
</tr>
<tr>
<td>5</td>
<td>Net capital gain or loss from sale of stock, business, or other asset</td>
</tr>
<tr>
<td>6</td>
<td>Standard deduction (or AGI)</td>
</tr>
<tr>
<td>7</td>
<td>Personal exemption</td>
</tr>
<tr>
<td>8</td>
<td>Total deductions</td>
</tr>
</tbody>
</table>

Center for Agricultural Law & Taxation
Example 1 - Josh

- However, to figure whether he has an NOL, certain deductions are not allowed
- He uses Form 1045, Schedule A, to figure the NOL

Example 1 - Josh

- The following items are not allowed on Form 1045, Schedule A
  - Nonbusiness net short-term capital loss $1,000
  - Nonbusiness deductions (standard deduction, $6,350) minus nonbusiness income (interest, $425) = $5,925
  - Deduction for personal exemption $4,050
  - Total adjustments to net loss $10,975
Example 1 - Josh

Therefore, Josh’s NOL for 2017 is figured as follows:

- Josh’s total 2017 income - $3,650
- Less:
  - Josh’s original 2017 total deductions - $16,400
  - Reduced by the disallowed items - ($10,975)
- Josh’s NOL for 2017 $5,425

For 2017, Josh can carry back his NOL 2 years under the general 2 year carryback rule.

The current 2017 Form 1040 is not available but we will use 2017 amounts.

---

Example 1 - Josh Form 1040 Income

---

Example 1 - Josh – AGI and Tax and Credits
**Example 1 - Josh – Schedule A NOL**

<table>
<thead>
<tr>
<th>Step</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>16.</td>
<td>Enter the loss, if any, from line 16 of your 2017 Schedule D (Form 1045). Enter a positive number. If you don’t have a loss on that line and don’t have a section 1231 exclusion, skip lines 18 through 21 and enter on line 22 the amount from line 16.</td>
</tr>
<tr>
<td>17.</td>
<td>Section 1231 exclusion Enter as a positive number.</td>
</tr>
<tr>
<td>18.</td>
<td>Subtract line 17 from line 16, if zero or less, enter 0.</td>
</tr>
<tr>
<td>19.</td>
<td>Enter the loss, if any, from line 21 of your 2017 Schedule D (Form 1045). Enter as a positive number.</td>
</tr>
<tr>
<td>20.</td>
<td>Enter line 18 or line 19, if zero or less, enter 0.</td>
</tr>
<tr>
<td>21.</td>
<td>Subtract line 18 from line 19. Enter as a positive number.</td>
</tr>
<tr>
<td>22.</td>
<td>Enter your line 21 as a positive number.</td>
</tr>
<tr>
<td>23.</td>
<td>Enter the lesser of line 19 or line 22.</td>
</tr>
<tr>
<td>24.</td>
<td>NOL, deduction for losses from other years Enter as a positive number.</td>
</tr>
<tr>
<td>25.</td>
<td>NOL, Combine lines 1. 10, and 24 through 24. If the result is a line that zero, enter 0 here and on line 26. If the result is a line that is more than zero, you don’t have an NOL.</td>
</tr>
</tbody>
</table>

---

**Let’s Calculate the Form 1045 Tentative Refund**
Example 1 - Josh

- For 2017, Josh can carry back his NOL 2 years under the general 2 year carryback rule.

Example 1 - Josh – Entity Section

Example 1 - Josh – 2015 Return

- Josh’s 2015 tax year information is as follows:
  - Adjusted Gross Income (AGI) = $50,000
  - Deductions = $13,250
  - Exemption for 2015 = $4,000
  - Taxable Income = $36,750
  - Tax = $5,053
  - Self-Employment Tax = $6,120
  - Total Tax from the Form 1040 = $11,173
Example 1 - Josh

Josh itemized deduction in 2015

Itemized deductions for 2015 – Before NOL:

- Medical expenses after the 10% adjustment = $2,250
- State income tax $2,000
- Real estate tax $4,000
- Home mortgage interest $5,000
- Total itemized deductions $13,250
- No Mortgage Insurance Premiums in this example
Example 1 - Josh

- Itemized deductions for 2015 – After NOL:
  - Medical expenses after the 10% adjustment = $2,438
  - State income tax $2,000
  - Real estate tax $4,000
  - Home mortgage interest $5,000
  - Total itemized deductions $13,483
  - No Mortgage Insurance Premiums in this example

Example 1 - Josh

- In this example the whole NOL has been used
  - A tax savings of $923

Example 2

Carryover - Review
How To Figure the NOL Carryover

Review

- If the NOL is more than the taxable income for the year to which it is carried to (figured before deducting the NOL), the client may have an NOL carryover
- You must make certain modifications to the taxable income to determine how much NOL will use up in that year and how much can be carried over to the next tax year

What is the Carryover?

- The carryover is the excess of the NOL deduction over the modified taxable income for the carryback or carryforward year
- If the NOL deduction includes more than one NOL, apply the NOLs against the modified taxable income in the same order in which they were incurred starting with the earliest

Modified Taxable Income

- The modified taxable income is the taxable income figured with the following changes
  1. The taxpayer cannot claim an NOL deduction for the NOL carryover that they are figuring or for any later NOL
  2. They cannot claim a deduction for capital losses in excess of the capital gains
     - They must increase the taxable income by the amount of any section 1202 exclusion
  3. They cannot claim the domestic production activities deduction
  4. They cannot claim a deduction for personal and other dependents
Modified Taxable Income

5. They must figure any item affected by the amount of the adjusted gross income after making the changes in (1), (2), and (3), and certain other changes to the adjusted gross income that result from (1), (2), and (3) changes.

This includes income and deduction items used to figure adjusted gross income (for example, IRA deductions), as well as certain itemized deductions.

Charitable Contributions

- To figure a charitable contribution deduction, do not include deductions for NOL carrybacks in the change in (1) but do include deductions for NOL carryforwards from tax years before the NOL year.

Form 1045 Schedule B

- Complete and file this schedule to determine the NOL deduction for each carryback year and the amount to be carried forward, if not fully absorbed.
- In most cases, if an NOL is more than the modified taxable income for the earliest year to which it is carried, you must file Schedule B to figure the amount of the NOL to be carried to the next tax year.
- The amount of the carryback is in most cases the excess, if any, of the NOL carryback over the modified taxable income for that earlier year.
- Modified taxable income is the amount figured on line 9 of Schedule B.
Reminder

- If the client carries two or more NOLs to a tax year, figure the modified taxable income by deducting the NOLs in the order in which they were incurred
- First, deduct the NOL from the earliest year, then the NOL from the next earliest year, etc
- After deducting each NOL, there will be a new, smaller, modified taxable income to compare to any remaining NOL

Form 1045 Schedule B

- The taxable income as modified cannot be less than zero
- Use Form 1045, Schedule B, to figure the modified taxable income for carryback years and the carryover from each of those years
- If the taxable income is shown as zero on the tax return (or as previously adjusted) for any carryback year, refigure it without limiting the result to zero, and enter it on line 2 as a negative number

Example: Vicky

- Vicky runs a small second hand clothing shop
- In 2017, she has an NOL of $36,000 that she wants to carry back to 2015 to utilize
- She has no other carrybacks or carryforwards
- Vicky’s adjusted gross income in 2015 was $35,000, consisting of her salary of $36,000 minus a $1,000 capital loss deduction
- She is single and claimed only one personal exemption of $4,000
Vicky 2015 Tax Return

- During 2015 she gave:
  - $1,450 in charitable contributions, not limited as were less than 50% of AGI
  - Medical expenses were $6,500, limited to expenses over 10% of adjusted gross income (.10 × $35,000 = $3,500 - $6,500 = $3,000)
  - Taxes of $1,650
  - $3,125 in home mortgage interest
  - A personal exemption deduction of $4,000
  - She had no other deductions in 2015
  - Her taxable income (figured without the NOL deduction) for the year was $21,775

Vicky’s Form 1040 for 2015

Vicky’s Form 1040 for 2015
Vicky's adjusted gross income in 2016 was $9,325, consisting of net business income from the clothing shop of $12,325 and a net capital loss of $3,000.

- She did not itemize her deductions in 2016.
- She deducted the standard deduction of $6,300 and the personal exemption deduction of $4,050.
- She had no other deductions in 2016 (other than the NOL deduction).
2015 Income Information

- Her taxable income, therefore was ($925)
- Vicky’s $36,000 carryback will result in her having 2016 taxable income of zero

Vicky’s 2016 Form 1040

Vicky’s 2016 Form 1040
Schedule B Form 1045

- She then completes the column for the first preceding tax year ended 12/31/16 on Form 1045, Schedule B

Vicky Has a Carryforward

- $11,750
Election to Forgo Any Carryback

- If a taxpayer does not elect out of the carryback, the NOL is absorbed by the carryback years whether or not the NOL deduction is claimed for those years
- The burden is on the taxpayer to show the amount of NOL that is available to deduct in a carryforward year
- If a taxpayer did not deduct an NOL in a closed year, the taxpayer must still keep records of the NOL absorption to verify the NOL carried to each tax year

Carrying the NOL Forward

- If the taxpayer has an NOL deduction carried forward from a year prior to 2017 that results in having taxable income on the 2017 return of zero (of less than zero, if an estate or trust), complete Table 1, Worksheet for NOL Carryover From 2016 to 2017
- It will help figure the NOL to carry to 2018
- Keep the worksheet in records

Carryforward Worksheet

Multiple Carryforwards
John – Carryforward

- John runs a auto repair business
- In 2015, his taxable income is $5,000 before the NOL deduction
- The carryover amount is made up of carryovers of $2,000 from 2013 and a carryforward from 2014 of $7,000
- He does not itemize deductions and has no income adjustments
- He is single and claimed only one personal exemption of $4,000

Carryforward (FIFO)

- Subtract the 2013 NOL of $2,000 from $5,000 of taxable income
- This gives you taxable income of $3,000
- The 2013 NOL is now completely used
- Subtract the $7,000, 2014 NOL from $3,000
- This gives you taxable income for 2015 of ($4,000)
- Now complete the worksheet to determine any carryover to 2016

NOL Worksheet – Publication 536

Table 1. Worksheet for NOL Carryover From 2014 to 2017 (For an NOL Year Before 2014)

- Enter your adjusted gross income (AGI) from Form 1040, line 19, box 1.
- Enter your tax liability from Form 1040, line 21, box 1.
- Enter any personal or dependency exemptions from Form 1040, line 24, box 1.
- Enter any adjustments to income or deductions from Form 1040, line 28, box 1.
- Enter any credits for foreign earned income or foreign housing expenses from Form 1040, line 29, box 1.
- Enter any deductions for miscellaneous items from Form 1040, line 30, box 1.
- Enter any adjustments for capital gains and losses from Form 1040, line 31, box 1.
- Enter any adjustments for investment income from Form 1040, line 32, box 1.
- Enter any other adjustments to income or deductions from Form 1040, line 36, box 1.
- Subtract the amount in line 4 from the amount in line 3 to determine any carryover to 2016.
Form 1045

Remember

- The taxpayer is making the required adjustments in the current year when carrying forward
- When carryback you adjust the prior years with the required adjustments

Deducting a Carryforward

- If the taxpayer carries forward the NOL to a tax year after the NOL year, list the NOL deduction as a negative figure on the “Other income” line of Form 1040 or Form 1040NR (line 21 for 2016)
- Estates and trusts include an NOL deduction on Form 1041 with other deductions not subject to the 2% limit (line 15b for 2016)
  - Taxable income must be increased by the sum of the charitable deduction and income distribution deduction
  - They must attach a statement that shows all the important facts about the NOL
  - The statement should include a computation showing how the NOL deduction was calculated
  - If they deduct more than one NOL in the same year, the statement must cover each of them
Calculating an NOL for a Corporation

- Calculating the NOL for a C corporation is easier than calculating the NOL for an individual
- The income and expenses of the corporation are not separated between business and nonbusiness transactions
- There are a few adjustments that must be made when calculating the NOL

Adjustments

- 1. The domestic production activities deduction under IRC §199 is not included in the NOL
- 2. The deductions for dividends received are computed without regard to the limits based on taxable income that normally apply
- 3. Interest expense on corporate equity reduction transactions is not included in the NOL
- Note: A personal service corporation may not carryback an NOL to or from any tax year in which an election applies to have a tax year other than a required tax year
Form 1040X or 1139

- The corporation may use Form 1120X, Amended U.S. Corporation Income Tax Return, or Form 1139, Corporation Application for Tentative Refund, to claim a refund for NOL carrybacks
- The deadline to use Form 1139 is no later than one year after the year that incurs the NOL, December 31 for calendar-year taxpayers
- If the corporation uses Form 1120X, the deadline is three years after the due date, including extensions, for the NOL year return

Where To File

- File Form 1139 with the Internal Revenue Service Center where the corporation files its income tax return
- Do not file Form 1139 with the corporation's income tax return

What To Attach

- Attach to Form 1139 copies of the following, if applicable, for the year of the loss or credit
- The first two pages of the corporation's income tax return
- All other forms and schedules from which a carryback results (for example, Schedule D (Form 1120), Capital Gains and Losses, Form 3800, General Business Credit, etc.).
- All Forms 8886, Reportable Transaction Disclosure Statement, attached to the corporation's tax return
- Any applicable election statement
- All carryback year forms and schedules for which items were refuged
Processing the Application

- The IRS will process this application within 90 days of the later of:
  - The date the corporation files the complete application, or
  - The last day of the month that includes the due date (including extensions) for filing the corporation’s income tax return for the year in which the loss or credit arose (or, for a claim of right adjustment, the date of the overpayment under §1341(b)(1)).

- The payment of the requested refund does not mean the IRS has accepted the application as correct.
- If the IRS later determines the claimed deductions or credits are due to an overstatement of the value of property, negligence, disregard of rules, or substantial understatement of income tax, the corporation may be assessed penalties.
- Interest is also charged on any amounts erroneously refunded, credited, or applied.
- The IRS may need to contact the corporation or its authorized representative for more information.
- To designate an attorney or representative, attach Form 2848, Power of Attorney and Declaration of Representative, to Form 1139.

Disallowance of the Application

- An application for a tentative refund is not treated as a claim for credit or refund.
- It may be disallowed if there are any 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 may be brought in any court.
- But the corporation can file a regular claim for credit or refund.
Excessive Allowances

- Any amount applied, credited, or refunded based on this application that the IRS later determines to be excessive may be billed as if it were due to a math or clerical error on the return.

Filing Form 1120X or Other Amended Return

- 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.
Procedures for Processing an Amended Return

- 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

Timeframe

- The carryback period for an NOL generally is 2 years
- Any loss not applied in the preceding years can be carried forward up to 20 years

Trek Abroad Corporation

- Trek Abroad, Inc., a calendar-year C corporation, is a travel company specializing in exotic locations
- Due to the high cost of airline travel and security issues, the company incurs a net loss of $300,000 in 2017
- Included in the computation of the net loss is $42,000 of dividends from TERM, a publicly-traded stock held by Trek Abroad
- To calculate the NOL available for carryback, the taxpayer must increase the NOL by the amount of the dividend exclusion, $42,000
- The company’s available NOL is $342,000 ($300,000 + $42,000)
Trek Abroad would have $17,000 that could be carried forward to 2018
Form 1138

- A corporation that expects a net operating loss (NOL) in the current tax year can file Form 1138 to extend the time for payment of tax for the immediately preceding tax year
- This includes extending the time for payment of a tax deficiency
- The payment of tax that can be postponed cannot exceed the expected overpayment from the carryback of the NOL

Form 1138

- Only payments of tax that are required to be paid after the filing of Form 1138 are eligible for extension
- Do not file this form if all the required payments have been paid or were required to have been paid
Form 1138

- If the corporation previously filed Form 1138 and later finds information that will change the amount of the expected NOL, the corporation can file a revised Form 1138.
- If the amount of the NOL is increased based on the new information, the corporation can postpone the payment of a larger amount of tax as long as the larger amount has not yet been paid or is not yet required to be paid.
- If the amount of the NOL is reduced because of the new information, the corporation must pay the tax to the extent that the amount of tax postponed on the original filing exceeds the amount of tax postponed on the revised filing.

Why?

- Enhance corporations’ cash flow in a poor economic environment.
- If a corporation expects an NOL in a particular year (for example, 2010) that it expects to carry back to the immediately preceding year to obtain a refund, and its tax for the immediately preceding year is not yet due (normally, the tax for calendar 2009 would be due on March 15, 2010), the corporation may be able to obtain an extension to pay the tax.

Why?

- Otherwise, to avoid penalties, the corporation would have to pay the tax for the preceding year, file its return for the preceding year, wait until the end of the current year in which the NOL arose, file its tax return for that year, and then file Form 1139.
- While a refund should be forthcoming within 90 days after the Form 1139 is filed, the corporation could instead extend the payment period by filing Form 1138, Extension of Time for Payment of Taxes by a Corporation Expecting a Net Operating Loss Carryback.
- Interest is charged for the period the tax payment is extended.
Form 4466

• Besides NOL carrybacks, another procedure allows a corporation that has paid in more estimated tax for the current year than it needed to have paid, based on currently anticipated income (or loss) to obtain a quick refund of the overpaid estimated tax without waiting to file its tax return for the year and then waiting for its refund check several months thereafter.
• This refund can be obtained by filing a Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax.

Form 4466

• The Form 4466 must be filed after the close of the taxable year and before the 16th day of the third month after the end of the year (March 15 for calendar-year corporations).
• It must be filed before the corporation files its tax return.
• The expected overpayment of estimated tax must exceed 10% of the corporation’s expected tax liability and be greater than $500.
• The IRS will act on a properly filed Form 4466 within 45 days from the date it is filed.
• However, care should be exercised not to ask for too large a refund, as that could expose the corporation to a penalty for underpayment of estimated tax.

Form 4466:

Corporation Application for Quick Refund of Overpayment of Estimated Tax

<table>
<thead>
<tr>
<th>Corporation Name</th>
<th>Address 1</th>
<th>Address 2</th>
<th>City</th>
<th>State</th>
<th>Zip Code</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Estimated income tax paid during the year:

<table>
<thead>
<tr>
<th>Amount</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Estimated income tax liability for the year:

<table>
<thead>
<tr>
<th>Amount</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Adjust for: (check all that apply)

- NOL carrybacks
- Estimated tax paid
- Estimated tax liability

Date of application [  ]

Date of decision [  ]

Center for Agricultural Law & Taxation
Remember

- Form 1138 – Extension of Time for Payment of Taxes by a Corporation Expecting a Net Operating Loss Carryback
- A corporation (other than an S corporation) files Form 1139 to apply for a quick refund of taxes from:
  - The carryback of an NOL (or a loss from operations of a life insurance company),
  - The carryback of a net capital loss,
  - The carryback of an unused general business credit, or
  - An overpayment of tax due to a claim of right adjustment under section 1341(b)(1)

When To File

- Generally, the corporation must file Form 1139 within 12 months of the end of the tax year in which an NOL, net capital loss, unused credit, or claim of right adjustment arose
- The corporation must file its income tax return for the tax year no later than the date it files Form 1139

Where To File

- File Form 1139 with the Internal Revenue Service Center where the corporation files its income tax return
The Scoop – Upcoming Dates

• 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

Upcoming Webinars
http://www.calt.iastate.edu/calendar-node-field-seminar-date/month

• 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

Upcoming Seminars – Mark Your Calendar – Final Dates

• 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
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