

Chapter 7: Net Operating Losses

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Corrections were made to this workbook through January of 2010. No subsequent modifications were made.

INTRODUCTION¹

The economic downturn of 2008 and 2009 has been called the Great Recession. A significant number of formerly profitable businesses are experiencing losses, some for the first time.

NOLs are created when business losses exceed business and nonbusiness income. If the taxpayer is an individual, the loss may be from Schedules C, F, E, or A, and the related forms. However, not all deductions are allowed in computing the amount of NOL. Items **not** allowed include the following:

- The deduction for personal exemptions,
- Capital losses in excess of capital gains,
- Any IRC §1202 exclusion of 50% of the gain from the sale of qualified small business stock,
- Any nonbusiness deductions in excess of nonbusiness income, and
- The IRC §199 domestic production activities deduction.

Typically, Schedule A deductions are nonbusiness deductions. However, this is not true in all cases. Casualty and theft losses appearing on Schedule A, state income taxes on business profits, and employee business expenses are business deductions.

Taxpayers with NOLs may be able to get refunds of taxes paid in prior years. They may also be able to apply the losses against taxable income in future years. Due to the current economic downturn and the new law changing available carryback years for 2008 NOLs, the IRS anticipates that a record number of small businesses are eligible for NOL-related refunds.²

It is vital for practitioners to be aware of the opportunities and pitfalls created by an NOL. Practitioners must be able to explain NOL-related choices to their clients so that taxpayers can accurately decide what is best for them. Too many taxpayers lose the benefits of the special provisions of the Code relating to NOLs because their practitioners fail to present all options or simply fail to apply an NOL to other tax years.

¹ The primary source for material in this chapter is IRS Pub. 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts*, revised Mar. 24, 2009.

² IRS News Rel. IR-2009-26 (Mar. 16, 2009, updated Apr. 24, 2009).

The basic concepts for applying an NOL are simple. A taxpayer who has an NOL may **carry back** the loss against income reported in previous years or may elect to **carry forward** this loss against future years. The carryback allows the taxpayer to receive a refund of prior year taxes. The carryforward allows the taxpayer to reduce future tax liability.

The default choice is to carry the loss back two years. The loss is applied against the earliest year first and any unused loss is carried to the next taxable year. If there is any remaining unused loss, the loss is carried forward for up to 20 years until it is depleted.

Example 1. Zoe incurs an NOL on her 2009 income tax return. She carries the loss back to 2007 first and then to her 2008 return. If any loss remains, it will be carried forward for up to 20 years. Any remaining loss is forfeited at the end of 2029.

Taxpayers may elect to **forgo** the carryback and apply the entire loss to future years. **This election must be made when the return is filed or within six months of the original due date of the return.**

Once made, the election to waive the carryback cannot be revoked without the IRS's consent. Therefore, practitioners are advised to discuss the options with their clients so that elections are made with the client's full consent and understanding. A client may prefer extra working capital during lean times even if this means forgoing tax deductions during times of abundance and higher marginal tax rates.

There are five basic steps to using an NOL:

1. Complete the current year tax return.
2. Calculate the NOL.
3. Determine what options are best for using the NOL: Does it qualify for an exception to the 2-year carryback? How will the available carryback(s) be used? Should the taxpayer forgo the carryback(s) and carry the NOL forward to next year?
4. Deduct the NOL in the carryback or carryforward year.
5. Determine if there is any unused NOL to carry back to another year or carry forward to future years.

The challenge is in the details. Because the carryback and carryforward rules generally apply to all taxpayers, this chapter discusses these rules first. The next section explains the effect of excluding discharge of indebtedness income from gross income on NOLs. Finally, individuals, estates and trusts, and C corporations each have separate sections which covers rules specific to them.

CARRYBACK AND CARRYFORWARD RULES

The rules governing carrybacks and carryforwards generally apply to all taxpayers regardless of whether the taxpayer is an individual, corporation, partnership, trust, or estate. However, there are some types of activities, such as farming, and some types of losses, such as disaster losses, that qualify for different carryback periods.

The NOL year is the year in which the loss occurred. The default election is to carry the loss back two years. If the NOL year is 2009, the loss is applied first to tax year 2007. Any remaining loss is applied to 2008. After that, any remainder is carried forward up to 20 years. The last year to which the 2009 NOL can be applied is 2029.

When the NOL is carried back to a year that is closed by the statute of limitations, only the changes arising from the NOL can be included in the calculation of the refund claim.

Example 2. In July 2009, Jean is hired by a local company to replace its previous tax preparer. While reviewing the prior year returns, Jean realizes that the company had an NOL in 2006 and that the previous accountant had not taken advantage of it. Since there was no election made to forgo the carryback, the only choice remaining is to carry the NOL back two years to 2004. Although the time for amending the 2004 return expired in 2008, the statute of limitations is still open for the 2006 return. Therefore, the taxpayer is still allowed to file an amended return for 2004 to claim the NOL deduction.

While preparing the amended return for 2004 to claim the NOL carryback, Jean realizes that the company's charitable contributions were omitted from the return. Unfortunately, the taxpayer may not claim the omitted contributions because the 2004 return is closed.

Note. The above example is not uncommon. If the 2006 tax year was also closed by the statute of limitations, the taxpayer would have lost all the tax benefits of the carryback NOL. As a result, the original tax preparation firm might be liable for damages related to the lost tax benefits.

Taxpayers may waive the carryback period and instead carry forward the NOL against future income. Often, this choice is made when the NOL is small or when the taxpayer anticipates significantly higher income in the future compared to the available carryback years. For individuals, estates, and trusts, the election to forgo the carryback period is made by attaching a statement to the original return for the NOL year.

SAMPLE ELECTION

The taxpayer, _____, hereby elects to forgo the carryback period pursuant to IRC §172(b)(3) for the NOL incurred in tax year 2009.

For C corporations, the election to waive the carryback period is made by checking the box on 2009 Form 1120, Schedule K, line 11.

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 forgo 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 will not be valid.

12 Enter the available NOL carryover from prior tax years (do not reduce it by any deduction on line 29a.): \$ _____

Are the corporation's total receipts (line 1a plus lines 4 through 10 on page 1) for the tax year and its total assets at the end of the

The return must be filed by the due date, including extensions, in order to make the election to waive the carryback. However, if the return is filed timely without the election, an amended return to make the election may be filed within six months of the original due date of the return. In this situation, "Filed pursuant to §301.9100-2" should be entered at the top of the election statement.

Once made, this election is irrevocable. The election applies for both regular tax and AMT purposes.³

³. Rev. Rul. 87-44, 1987-1 CB 3.

EXCEPTIONS TO THE 2-YEAR CARRYBACK PERIOD

Real estate investment trusts (REITs) are not allowed to carry back losses.⁴ They may, however, carry losses forward for up to 20 years. There are a number of special rules relating to REIT NOLs. For more information, see the Instructions for Form 1120-REIT, *U.S. Income Tax Return for Real Estate Investment Trusts*.

Specific types of losses have different carryback periods. The following losses qualify for **longer carryback** periods:

- Eligible small business losses — 3, 4, or 5 years
- Casualty and theft losses — 3 years
- Losses attributable to federally-declared disasters — 3 years
- Qualified disaster losses — 5 years
- Farming losses — 5 years
- Specified liability losses — 10 years
- Qualified GO Zone losses — 5 years
- Qualified recovery assistance losses — 5 years
- Qualified disaster recovery assistance losses — 5 years

Note. Information is available in various IRS publications pertaining to the following types of losses:

- **GO Zone losses.** See IRS Pub. 4492, *Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma*
- **Recovery assistance losses.** See IRS Pub. 4492-A, *Information for Taxpayers Affected by the May 4, 2007, Kansas Storms and Tornadoes*
- **Disaster recovery assistance losses.** See IRS Pub. 4492-B, *Information for Affected Taxpayers in the Midwestern Disaster Area*

Eligible Small Business Losses⁵

The American Recovery and Reinvestment Act of 2009 (ARRA) revised the carryback period for small businesses with **2008 NOLs** to **three, four, or five years**.

Note. For **calendar-year** taxpayers, the last date to make the election to use an alternative carryback period was **October 17, 2009**.

For fiscal-year filers, the revised rules may be applied to either the fiscal year ending in 2008 or the one beginning in 2008. The election to treat a fiscal year beginning in 2008 as the NOL year is made by attaching a statement to the return which indicates the taxpayer is choosing under IRC §172(b)(1)(H) to treat the NOL as a 2008 NOL. This election is irrevocable. If the taxpayer has already used the ARRA rules to carry back the NOL from the tax year **ending** in 2008, the NOL from the tax year **beginning** in 2008 cannot be carried back using the ARRA rules.

⁴ IRC §172(b)(1)(B)(i).

⁵ Rev. Proc. 2009-26, 2009-19 IRB (May 11, 2009).

An eligible small business (ESB) is one whose average annual gross receipts are \$15 million or less for the 3-year period ending with the tax year of the NOL. In determining whether a partnership, corporation, or sole proprietorship qualifies as an ESB, the gross receipts test applies at the entity or sole proprietorship level. If an entity is a member of a group of companies treated as a single employer under the Code,⁶ aggregation rules⁷ apply to determine whether the partnership, corporation, or sole proprietorship meets the gross receipts test.

The election to use a carryback of more than two years for an ESB may be made by one of two methods.

Method 1. For the year in which the NOL arises, a statement is attached to the timely-filed return, **including** extensions. The statement must state that the taxpayer is electing to apply IRC §172(b)(1)(H) and specify the length of the NOL carryback period elected by the taxpayer, either three, four, or five years.

Method 2. If the return was filed without an election to apply the new law and the return did not include an election to forgo the carryback period, the IRS permits the taxpayer to make the election by filing one of the appropriate forms applying the NOL carryback period chosen by the taxpayer. This form must be filed within **six months** of the due date of the return **excluding** extensions.

For the following types of taxpayers, the appropriate forms are:

- **For corporations:** Form 1139, *Corporation Application for Tentative Refund*, or Form 1120X, *Amended U.S. Corporation Income Tax Return*, for the earliest tax year of the carryback period.
- **For individuals:** Form 1045, *Application for Tentative Refund*, or Form 1040X, *Amended U.S. Individual Income Tax Return*, for the earliest tax year of the carryback period.
- **For estates or trusts:** Form 1045, or an amended Form 1041, *U.S. Income Tax Return for Estates and Trusts*, for the earliest tax year of the carryback period.

The law provides a remedy for returns that were filed with an election to forgo the carryback period. However, the deadline for changing this election was April 17, 2009.

The IRS published a Questions and Answers article related to this issue. It may be viewed at www.irs.gov/newsroom/article/0,,id=205331,00.html.

Casualty and Theft Losses

For individuals incurring NOLs due to casualties or thefts, the carryback period is three years.⁸ Only the portion of the NOL relating to the casualties/thefts qualifies for the 3-year carryback. This is not an election. It is the statutory default period for these types of losses. Individuals may not elect to use a different carryback period for casualty/theft NOLs, but they may choose to forgo the carryback period.

If the losses qualify for one of the other exceptions to the 2-year carryback rule, the carryback period for that exception can be used.

Example 3. Torrance suffers a casualty loss when his barn burns. Because this is part of a farm loss, he uses the 5-year carryback period applicable to farm losses.

⁶ IRC §§52(a), 52(b), 414(m), or 414(o).

⁷ See IRC §448(c)(2) for aggregation rules.

⁸ IRC §172(b)(1)(F)(ii)(I).

Federally-Declared Disaster Losses

For small businesses incurring NOLs due to federally-declared disasters, the carryback period is three years.⁹ Only the portion of the NOL relating to the disaster qualifies for the 3-year carryback. This is not an election. It is the statutory default period for these losses. Businesses may not elect to use a different carryback period for these NOLs. However, they may choose to forgo the carryback period.

If the losses qualify for one of the other exceptions to the 2-year carryback rule, the taxpayer may use the carryback period for that exception.

Qualified Disaster Losses

Qualified disaster losses result from specific types of expenses incurred as a result of a federally-declared disaster. The disaster must occur before January 1, 2010, for the expenses to qualify for this extended carryback period. The portion of an NOL that is made up of these expenses has a 5-year carryback period. IRS Pub. 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts*, contains additional information about the types of expenses that qualify for this carryback period. It is possible that a company in a disaster area may have an NOL that qualifies for several different carryback periods, based on the mix of expenses in the NOL.

The 5-year carryback can be waived in favor of the normal 2-year carryback, or both carrybacks can be waived with an election to carry the loss forward.

Note. For more information and a list of areas that qualify as federally-declared disaster areas, see www.irs.gov/newsroom/article/0,,id=108362,00.html.

Farming Losses

Farming operations qualify for a special 5-year carryback period.¹⁰ A farming loss is the smaller of:

1. The amount that would be the NOL for the tax year if only income and deductions attributable to farming operations were taken into account, or
2. The NOL for the tax year.

A farming operation involves:

- Cultivation of land;
- Raising or harvesting any agricultural or horticultural commodity;
- Operating a nursery or sod farm;
- Raising or harvesting trees; or
- Raising, shearing, feeding, caring for, training, or managing of animals.

A farming business does **not** include contract harvesting of a commodity grown by someone other than the taxpayer. It also does not include buying or selling farm products raised or grown by others.

The 5-year carryback period may be waived by attaching a statement to the timely-filed return electing to forgo the 5-year carryback period for farming losses. If this election is made, the 2-year carryback period applies unless the taxpayer also makes an election to forgo it. Elections to waive the carryback periods are irrevocable.

⁹ IRC §§172(b)(1)(F)(ii)(II) and (III).

¹⁰ IRC §172(b)(1)(G).

If the return is filed without the election to forgo the 5-year carryback, an amended return to make the election may be filed within six months of the original due date of the return. “Filed pursuant to §301.9100-2” should be entered at the top of the election statement in this situation. If the taxpayer wishes to forgo all carrybacks and only use the carryforwards, an election to forgo the 2-year carryback should also be made.

Specified Liability Losses

There are two types of specified liability losses. Both qualify for a 10-year carryback period. The first type of loss arises from product liability. The second type arises from specific classes of liabilities under federal or state law and is only applicable to accrual-basis taxpayers. This carryback period can be waived in favor of the 2-year carryback period, or both carrybacks can be waived with an election to carry the loss forward.

FORM 982 ADJUSTMENTS TO NOLs

BACKGROUND

Income from discharge of indebtedness is usually taxable.¹¹ However, debt forgiveness is **not** taxable when:

1. The debt is discharged in a **bankruptcy** proceeding,¹²
2. The forgiveness occurs while the taxpayer is **insolvent**,¹³
3. The debt is **qualified farm indebtedness**,¹⁴
4. The debt is **qualified real property business indebtedness**,¹⁵
5. The debt is **qualified principal residence indebtedness**, which is discharged prior to January 1, 2013,¹⁶ or
6. The debt is a **student loan** forgiven in exchange for working a certain number of years in a particular area as part of a program designed to increase professionals in certain underserved communities.¹⁷

Note. See Chapter 13, Financial Distress, of the 2008 *University of Illinois Federal Tax Workbook*. This can be found on the accompanying CD.

When debt forgiveness income is excluded from taxation because of exceptions 1–5 above, the taxpayer is required to reduce certain tax attributes by the amount not included in income.¹⁸ Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness*, must be filed to report the reduction of the applicable attributes.

¹¹ IRC §61(a)(12).

¹² IRC §108(a)(1)(A).

¹³ IRC §108(a)(1)(B).

¹⁴ IRC §108(a)(1)(C).

¹⁵ IRC §108(a)(1)(D).

¹⁶ IRC §108(a)(1)(E).

¹⁷ IRC §108(f).

¹⁸ IRC §108(b).

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If the debt forgiveness is not taxable because of **exceptions 1–3** above, the **NOL for the tax year of the discharge and any NOL carryforwards to that year are reduced first before any other tax attributes.**

Note. Taxpayers may **elect** to first reduce the basis of depreciable property before reducing other tax attributes.¹⁹ IRC §1017 and Treas. Reg. §1.1017-1 include additional information about applying the reduction to basis of depreciable property.

If the debt forgiveness is not taxable by **exception 4** above, the basis in the depreciable real property of the taxpayer is reduced first.²⁰ If the debt forgiveness is not taxable by **exception 5** above, the basis of the taxpayer's principal residence is reduced first. If the debt reduction is not taxable due to **exception 6**, the Code does not require the reduction of any tax attributes.²¹

APPLYING THE TAX ATTRIBUTE REDUCTION TO NOLs

Reductions applied to NOLs are made **first to the current tax year**, then to the carryforwards in order of earliest to latest.

Example 4. Sparky's Motors, Inc., has been operating in the red for several years. In 2009, the company negotiates with its chief supplier to accept 50¢ on the dollar for the entire balance due the supplier. Prior to the agreement, Sparky's is insolvent by \$130,000; that is, its debts are \$130,000 more than the fair market value of its assets. The agreement allows the company to reduce its debt by \$100,000 and also to stay in business. Because the company is insolvent at the time the discharge occurs, it does not have to include the \$100,000 in 2009 gross income. (See exception 2 above.)

Sparky's has an NOL for 2009 of \$30,000 before any tax attributes are adjusted. It also has the following NOL carryforwards:

2006	\$20,000
2007	40,000
2008	75,000

The \$100,000 attribute reduction is applied in the following order to the NOLs:

	NOL	Reduction Applied	Remaining NOL	Remaining Reduction
Debt forgiven				\$100,000
2009	\$30,000	(\$30,000)	\$ 0	70,000
2006	20,000	(20,000)	0	50,000
2007	40,000	(40,000)	0	10,000
2008	75,000	(10,000)	65,000	0

The 2009 NOL is reduced first, then 2006 and 2007. After these reductions, there is \$10,000 remaining that reduces the NOL carryforward from 2008. Sparky's has \$65,000 remaining from the 2008 NOL that it may use in future years.

¹⁹. IRC §108(b)(5).

²⁰. IRC §108(c).

²¹. See IRC §108.

INDIVIDUALS

CALCULATING THE NOL

An individual's tax return **may** have an NOL if Form 1040, line 41 is a negative number. If the number is positive, the taxpayer does not have an NOL.

If the number on line 41 is negative, the income and losses on the return must be analyzed to determine if the taxpayer has an NOL. The first step is to separate the taxpayer's current year return into business and nonbusiness activities.

Tax-preparation software is able to categorize some of the activities; however, most programs require that the user manually allocate some of the income and expenses. The worksheets in **Example 5** show how the income and deductions are classified when computing the amount of the NOL. They also show which items the software may classify automatically and which items may require user intervention. On the worksheets, "xxxxxxx" means that an amount cannot be entered on that line.

Example 5. Lucy is an aspiring actor, ballet dancer, and burlesque comic. To support her artistic endeavors, she works at a prominent state university in the admissions office and is enrolled in the university's retirement plan. In 2009, her production company, a sole proprietorship, incurs a net loss of \$100,000. Wages from her part-time job in the candy factory, alimony, and some of the divorce settlement funds help support the struggling business. She also sells some stocks, incurring a \$5,000 loss on the sale.

Excerpts from her 2009 Form 1040 and the classification worksheets follow.

For Example 5

Form 1040		Department of the Treasury—Internal Revenue Service		U.S. Individual Income Tax Return 2009		(99) IRS Use Only—Do not write or staple in this space.																										
Label (See instructions on page 14.) Use the IRS label. Otherwise, please print or type.		For the year Jan. 1–Dec. 31, 2009, or other tax year beginning , 2009, ending , 20		OMB No. 1545-0074																												
L A B E L H E R E		Your first name and initial Lucy		Last name Richards		Your social security number 222 22 2222																										
		If a joint return, spouse's first name and initial		Last name		Spouse's social security number																										
		Home address (number and street). If you have a P.O. box, see page 14. 1 Ball Court		Apt. no.		You must enter your SSN(s) above.																										
		City, town or post office, state, and ZIP code. If you have a foreign address, see page 14. Chicago, IL 60606				Checking a box below will not change your tax or refund.																										
Presidential Election Campaign		Check here if you, or your spouse if filing jointly, want \$3 to go to this fund (see page 14) <input type="checkbox"/> You <input type="checkbox"/> Spouse																														
Filing Status		<div> <div>1 <input type="checkbox"/> Single</div> <div>2 <input type="checkbox"/> Married filing jointly (even if only one had income)</div> <div>3 <input type="checkbox"/> Married filing separately. Enter spouse's SSN above and full name here. ▶</div> <div>4 <input checked="" type="checkbox"/> Head of household (with qualifying person). (See page 15.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶ Rick</div> <div>5 <input type="checkbox"/> Qualifying widow(er) with dependent child (see page 16)</div> </div>																														
Exemptions		<div> <div>6a <input checked="" type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a</div> <div>b <input type="checkbox"/> Spouse</div> <div>c Dependents:</div> <table border="1"> <thead> <tr> <th>(1) First name</th> <th>Last name</th> <th>(2) Dependent's social security number</th> <th>(3) Dependent's relationship to you</th> <th>(4) <input checked="" type="checkbox"/> If qualifying child for child tax credit (see page 17)</th> </tr> </thead> <tbody> <tr><td> </td><td> </td><td> </td><td> </td><td><input type="checkbox"/></td></tr> <tr><td> </td><td> </td><td> </td><td> </td><td><input type="checkbox"/></td></tr> <tr><td> </td><td> </td><td> </td><td> </td><td><input type="checkbox"/></td></tr> <tr><td> </td><td> </td><td> </td><td> </td><td><input type="checkbox"/></td></tr> </tbody> </table> <div>d Total number of exemptions claimed</div> </div>						(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> If qualifying child for child tax credit (see page 17)					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>					<input type="checkbox"/>
(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> If qualifying child for child tax credit (see page 17)																												
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				<input type="checkbox"/>																												
If more than four dependents, see page 17 and check here ▶ <input type="checkbox"/>		<div> <div>Boxes checked on 6a and 6b</div> <div>No. of children on 6c who:</div> <ul style="list-style-type: none"> • lived with you • did not live with you due to divorce or separation (see page 18) <div>Dependents on 6c not entered above</div> <div>Add numbers on lines above ▶ 1</div> </div>																														
Income		<div> <div>7 Wages, salaries, tips, etc. Attach Form(s) W-2</div> <div>8a Taxable interest. Attach Schedule B if required</div> <div>b Tax-exempt interest. Do not include on line 8a</div> <div>9a Ordinary dividends. Attach Schedule B if required</div> <div>b Qualified dividends (see page 22)</div> <div>10 Taxable refunds, credits, or offsets of state and local income taxes (see page 23)</div> <div>11 Alimony received</div> <div>12 Business income or (loss). Attach Schedule C or C-EZ</div> <div>13 Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ <input type="checkbox"/></div> <div>14 Other gains or (losses). Attach Form 4797</div> <div>15a IRA distributions</div> <div>16a Pensions and annuities</div> <div>17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E</div> <div>18 Farm income or (loss). Attach Schedule F</div> <div>19 Unemployment compensation in excess of \$2,400 per recipient (see page 27)</div> <div>20a Social security benefits</div> <div>21 Other income. List type and amount (see page 29)</div> <div>22 Add the amounts in the far right column for lines 7 through 21. This is your total income ▶</div> </div>																														
Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.		<div> <div>7 7,000</div> <div>8a 6,350</div> <div>9a</div> <div>10</div> <div>11 12,000</div> <div>12 (100,000)</div> <div>13 (3,000)</div> <div>14</div> <div>15a</div> <div>16a</div> <div>17</div> <div>18</div> <div>19</div> <div>20a</div> <div>21</div> <div>22 (77,650)</div> </div>																														
If you did not get a W-2, see page 22.		<div> <div>15b Taxable amount (see page 24)</div> <div>16b Taxable amount (see page 25)</div> <div>20b Taxable amount (see page 27)</div> </div>																														
Enclose, but do not attach, any payment. Also, please use Form 1040-V.		<div> <div>23 Educator expenses (see page 29)</div> <div>24 Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ</div> <div>25 Health savings account deduction. Attach Form 8889</div> <div>26 Moving expenses. Attach Form 3903</div> <div>27 One-half of self-employment tax. Attach Schedule SE</div> <div>28 Self-employed SEP, SIMPLE, and qualified plans</div> <div>29 Self-employed health insurance deduction (see page 30)</div> <div>30 Penalty on early withdrawal of savings</div> <div>31a Alimony paid b Recipient's SSN ▶</div> <div>32 IRA deduction (see page 31)</div> <div>33 Student loan interest deduction (see page 34)</div> <div>34 Tuition and fees deduction. Attach Form 8917</div> <div>35 Domestic production activities deduction. Attach Form 8903</div> <div>36 Add lines 23 through 31a and 32 through 35</div> <div>37 Subtract line 36 from line 22. This is your adjusted gross income ▶</div> </div>																														
Adjusted Gross Income		<div> <div>23</div> <div>24</div> <div>25</div> <div>26</div> <div>27</div> <div>28</div> <div>29</div> <div>30</div> <div>31a</div> <div>32</div> <div>33</div> <div>34</div> <div>35</div> <div>36</div> <div>37 (77,650)</div> </div>																														

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 87.

Cat. No. 11320B

Form **1040** (2009)

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For Example 5

Form 1040 (2009) **Lucy Richards** 222-22-2222 Page 2

Tax and Credits	38	Amount from line 37 (adjusted gross income)	38	(77,650)
	39a	Check <input type="checkbox"/> You were born before January 2, 1945, <input type="checkbox"/> Blind. <input type="checkbox"/> Spouse was born before January 2, 1945, <input type="checkbox"/> Blind. Total boxes checked 39a		
Standard Deduction for— • People who check any box on line 39a, 39b, or 40b or who can be claimed as a dependent, see page 35. • All others: Single or married filing jointly	b	If your spouse itemizes on a separate return or you were a dual-status alien, see page 35 and check here 39b		
	40a	Itemized deductions (from Schedule A) or your standard deduction (see left margin)	40a	8,350
	b	If you are increasing your standard deduction by certain real estate taxes, new motor vehicle taxes, or a net disaster loss, attach Schedule L and check here (see page 35) 40b		
	41	Subtract line 40a from line 38	41	(86,000)
	42	Exemptions. If line 38 is \$125,100 or less and you did not provide housing to a Midwestern displaced individual, multiply \$3,650 by the number on line 6d. Otherwise, see page 37	42	3,650
	43	Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	43	0
	44	Tax (see page 37). Check if any tax is from: a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972	44	0
	45	Alternative minimum tax (see page 40). Attach Form 6251	45	0
	46	Add lines 44 and 45		

NOL Worksheet 1

Allocation of Income between Business Income and Nonbusiness Income

Location on 2009 Form 1040	Item	Amount on Tax Return	Disposition	Amount as Business	Amount as Nonbusiness	AMT Nonbusiness
A. Line 7	Wages, salary, etc.	7,000	Business	7,000	XXXXXXXX	XXXXXXXX
B. Line 8a	Taxable interest	6,350	Nonbusiness	XXXXXXXX	6,350	
C. Line 8b	Tax-exempt interest		Nonbusiness ^a	XXXXXXXX	XXXXXXXX	
D. Line 9a	Ordinary dividends		Nonbusiness	XXXXXXXX		
E. Line 10	Taxable refunds		Allocate ^b			
F. Line 11	Alimony	12,000	Nonbusiness	XXXXXXXX	12,000	
G. Line 12	Business income (loss)					
	Schedule C	(100,000)	Business	(100,000)	XXXXXXXX	XXXXXXXX
H. Line 14	Form 4797 gain (loss)		Business		XXXXXXXX	XXXXXXXX
I. Line 15b	Taxable amount of IRA distributions		Nonbusiness	XXXXXXXX		
J. Line 16b	Taxable amount of pensions		Nonbusiness	XXXXXXXX		
K. Line 17	Rents, royalties, and partnership income		Usually business			
L. Line 18	Farm income (loss)		Business		XXXXXXXX	XXXXXXXX
M. Line 19	Unemployment compensation		Business		XXXXXXXX	XXXXXXXX
N. Line 20b	Taxable social security benefits		Nonbusiness	XXXXXXXX		
O. Line 21	Other income		Allocate			
P. Total		(74,650)		(93,000)	18,350	

^a Nontaxable interest is nonbusiness income for AMT purposes only.

^b The state and local income tax refund is to be allocated between business and nonbusiness income according to the income of the year that created the refund. For this allocation, salaries and wages are treated as business income. State and local income tax refunds are not included when calculating AMT.

NOTE: "XXXXXXXX" means that an amount cannot be added on that line.

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NOL Worksheet 2

Allocation of **Deductions** between Business Deductions and Nonbusiness Deductions

Location on 2009 Form 1040	Item	Amount on Tax Return	Disposition	Amount as Business	Amount as Nonbusiness	AMT Nonbusiness
A. Line 23	Educator expenses		Business		xxxxxxx	xxxxxxx
B. Line 24	Business expense of reservists, etc. ^a		Business		xxxxxxx	xxxxxxx
C. Line 25	HSA & MSA ded.		Nonbusiness	xxxxxxx		
D. Line 26	Moving expenses		Business		xxxxxxx	xxxxxxx
E. Line 27	SE tax deduction		Business		xxxxxxx	xxxxxxx
F. Line 28	SEP, SIMPLE, & qualified plans		Nonbusiness	xxxxxxx		
G. Line 29	SE health insurance		Business		xxxxxxx	xxxxxxx
H. Line 30	Penalty, early withdrawal		Nonbusiness	xxxxxxx		
I. Line 31a	Alimony		Nonbusiness	xxxxxxx		
J. Line 32	IRA deduction		Nonbusiness	xxxxxxx		
K. Line 33	Student loan interest ded.		Nonbusiness	xxxxxxx		
L. Line 34	Tuition & fee deduction		Nonbusiness	xxxxxxx		
M. Line 40a	Standard deduction (if claimed)	8,350	Nonbusiness	xxxxxxx	8,350	xxxxxxx ^b

Schedule A (Form 1040) (Itemized deductions, if claimed)

N. Line 4	Medical		Nonbusiness	xxxxxxx		c
O. Line 9	Taxes		Allocate ^d			xxxxxxx
P. Line 15	Interest		Nonbusiness	xxxxxxx		e
Q. Line 19	Contributions		Nonbusiness	xxxxxxx		
R. Line 20	Casualty		Business		xxxxxxx	xxxxxxx
S. Line 27	Misc. (2% floor)		Allocate ^f			xxxxxxx
T. Line 28	Other misc.		Allocate ^g			
U. Total		8,350			8,350	

^a Include only "other" items such as unreimbursed expenses of artists (IRC §62(b)) and jury duty pay turned over to taxpayer's employer. Do not include amounts reported on lines 23 through 35.

^b If the standard deduction was claimed for the regular tax, neither the standard deduction nor the itemized deductions can be claimed for the AMT.

^c The medical deduction floor is 10% of the adjusted gross income for AMT purposes.

^d The state and local income taxes paid are allocated between business and nonbusiness deductions according to the income of the year that created the taxes. For this allocation, salaries and wages are treated as business income. Taxes are not allowed as a deduction when calculating AMT.

^e The alternative minimum tax interest deduction is the same as the regular tax interest deduction except for the following adjustments: (1) if debt on a personal residence has been refinanced, interest on debt in excess of the debt before refinancing cannot be deducted for AMT purposes; and (2) the investment interest deduction must be recalculated to include income from private activity bonds in investment income and the expenses on those bonds in investment expenses.

^f Since the amount on line 27, Schedule A, is reduced by 2% of AGI, the amounts allocated to business and nonbusiness must be reduced on a pro-rata basis. Therefore, the amount in the business column should be the amount from line 27, Schedule A, multiplied by the total business miscellaneous deductions subject to the 2% floor and divided by the total miscellaneous deductions subject to the 2% floor. The amount in the nonbusiness column should be the amount from line 27, Schedule A, multiplied by the total nonbusiness deductions subject to the 2% floor and divided by the total miscellaneous deductions subject to the 2% floor. Miscellaneous itemized deductions are not allowed as a deduction when calculating AMT.

^g Deductions allowable for impairment-related work expenses are business deductions. Other deductions reported on line 28, Schedule A, are nonbusiness deductions.

NOTE: "xxxxxxx" means that an amount cannot be added on that line.

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On the classification worksheet (shown next), the \$5,000 capital loss is allocated to the nonbusiness column. This is because the stock sale was not related to the business operation. For this purpose, the full \$5,000 is used, not just the \$3,000 capital loss that appears on Form 1040, line 13.

NOL Worksheet 3

Allocation of Capital Losses between Business Capital Losses and Nonbusiness Capital Losses

Where Loss Is Reported on 2009 Sched. D (Form 1040) ^a	Amount Reported on Tax Return	Disposition	Business	Nonbusiness
A. Lines 1 and 2, column f		Allocate ^b		
B. Line 4, column f		Allocate ^b		
C. Line 5, column f		Allocate ^c		
D. Line 6, column f		Allocate ^d		
E. Lines 8 and 9, column f	5,000	Allocate ^b		5,000
F. Line 11, column f		Allocate ^b		
G. Line 12, column f		Allocate ^c		
H. Line 14, column f		Allocate ^d		
I. Total	5,000			5,000

^a Enter the amount from the designated lines on Schedule D only if they are losses. Enter the amounts as positive numbers.

^b In most cases, losses reported on lines 1, 2, 4, 8, 9, and 11 of Schedule D (Form 1040) are nonbusiness capital losses for purposes of the NOL calculation, since losses from property used in a trade or business are reported on Form 4797 and are treated as ordinary deductions. However, losses reported on those lines can be business capital losses if the asset on which the loss was realized was an IRC §1221 asset rather than an IRC §1231 asset but was purchased for a trade or business reason rather than for investment. For example, loss realized on stock in another company that is purchased to enhance the taxpayer's business would be reported on one of those lines but would be treated as a business capital loss for purposes of the NOL calculation. See *Tammel Crow*, 79 TC 541 (1982).

^c The character of the loss reported on line 5 or 12 of Schedule D (Form 1040) is determined by the character of the loss to the partnership, S corporation, or fiduciary. In most cases, losses reported on lines 5 and 12 of Schedule D (Form 1040) are nonbusiness capital losses, but see footnote "a" for a discussion of when losses from an IRC §1221 asset may be treated as a business capital loss for purposes of the NOL calculation.

^d Capital loss carryovers must be allocated between business and nonbusiness capital losses according to the proportionate contribution of business and nonbusiness capital losses to the capital loss carryover.

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NOL Worksheet 4

Allocation of Capital Gains between Business Capital Gains and Nonbusiness Capital Gains

Where Gain Is Reported on 2009 Sched. D (Form 1040) ^a	Amount Reported on Tax Return	Disposition	Business	Nonbusiness
A. Line 1, column f		Allocate ^b		
B. Line 2, column f		Allocate ^b		
C. Line 4, column f		Allocate ^b		
D. Line 5, column f		Allocate ^c		
E. Line 8, column f		Allocate ^b		
F. Line 9, column f		Allocate ^b		
G. Line 11, column f		Allocate ^d		
H. Line 12, column f		Allocate ^c		
I. Line 13, column f		Allocate ^b		
J. Total				

^a Enter the amounts from the designated lines only if they are gains.

^b In most cases, gains reported on lines 1, 2, 4, 8, 9, and 13 of Schedule D (Form 1040) are nonbusiness capital gains for purposes of the NOL calculation, because gains from property used in a trade or business are reported on Form 4797 and are carried to Line 11 of Schedule D (Form 1040) if they are treated as long-term capital gain. However, gains reported on lines 1, 2, 4, 8, 9, and 13 of Schedule D (Form 1040) can be business capital gains if the asset on which the gain was realized was an IRC §1221 asset rather than an IRC §1231 asset but was purchased for a trade or business reason rather than for investment. For example, gain realized on stock in another company that is purchased to enhance the taxpayer's business would be reported on one of those lines but would be treated as a business capital gain for purposes of the NOL calculation. See *Trammel Crow*, 79 TC 541 (1982).

^c The character of the gain reported on line 5 or 12 of Schedule D (Form 1040) is determined by the character of the gain to the partnership, S corporation, or fiduciary. In most cases, gains reported on lines 5 and 12 of Schedule D (Form 1040) are nonbusiness capital gains, but see footnote "b" for a discussion of when gains from an IRC §1221 asset may be treated as a business capital gain for purposes of the NOL calculation.

^d Gain from Form 4797, Part I, is business gain. Gain from Form 2439, Form 4684, Form 6252, Form 6781, or Form 8824 is nonbusiness gain in most cases. See footnote "b" for a discussion of when gains from an IRC §1221 asset may be treated as a business capital gain for purposes of the NOL calculation.

Once the income and expenses are properly classified, Form 1045, Schedule A–NOL, is used to calculate the amount of the current year NOL.

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Example 6. Use the same facts as **Example 5**. Lucy's accountant, Fred, prepares Form 1045, Schedule A–NOL, and is surprised that the amount of the NOL (\$83,000) is not equal to Form 1040, line 41 (\$86,000). After reviewing the schedule, he realizes that the allowed capital loss of \$3,000 shown on Form 1040 is not included in the NOL. This makes sense because the entire capital loss of \$5,000 carries over to 2010.²² Lucy's 2009 NOL is \$83,000. The calculation on Schedule A is shown following.

Form 1045 (2009) **Lucy Richards**

222-22-2222

Page **2**

Schedule A—NOL (see page 7 of the instructions)

	1	Enter the amount from your 2009 Form 1040, line 41, or Form 1040NR, line 38, minus any amount on Form 8914, line 6. Estates and trusts, enter taxable income increased by the total of the charitable deduction, income distribution deduction, and exemption amount	1	(86,000)
WKSHT 3 --	2	Nonbusiness capital losses before limitation. Enter as a positive number	2	5,000
WKSHT 4 --	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	5,000
	5	If line 3 is more than line 2, enter the difference; otherwise, enter -0-	5	0
WKSHT 2 --	6	Nonbusiness deductions (see page 7 of the instructions)	6	8,350
WKSHT 1 --	7	Nonbusiness income other than capital gains (see page 8 of the instructions)	7	18,350
	8	Add lines 5 and 7.	8	18,350
	9	If line 6 is more than line 8, enter the difference; otherwise, enter -0-	9	0
	10	If line 8 is more than line 6, enter the difference; otherwise, enter -0-. But do not enter more than line 5	10	0
WKSHT 3 --	11	Business capital losses before limitation. Enter as a positive number	11	
WKSHT 4 --	12	Business capital gains (without regard to any section 1202 exclusion)	12	
	13	Add lines 10 and 12.	13	0
	14	Subtract line 13 from line 11. If zero or less, enter -0-	14	0
	15	Add lines 4 and 14.	15	5,000
	16	Enter the loss, if any, from line 16 of your 2009 Schedule D (Form 1040). (Estates and trusts, enter the loss, if any, from line 15, 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	5,000
	17	Section 1202 exclusion. Enter as a positive number	17	
	18	Subtract line 17 from line 16. If zero or less, enter -0-	18	5,000
	19	Enter the loss, if any, from line 21 of your 2009 Schedule D (Form 1040). (Estates and trusts, enter the loss, if any, from line 16 of Schedule D (Form 1041).) Enter as a positive number	19	3,000
	20	If line 18 is more than line 19, enter the difference; otherwise, enter -0-	20	2,000
	21	If line 19 is more than line 18, enter the difference; otherwise, enter -0-	21	0
	22	Subtract line 20 from line 15. If zero or less, enter -0-	22	3,000
	23	Domestic production activities deduction from your 2009 Form 1040, line 35, or Form 1040NR, line 33 (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	(83,000)

Form **1045** (2009)

²² IRC §1212(b).

USING THE NOL

Once the tax preparer knows the amount of the NOL for the current tax year, the preparer must determine if the loss is from an activity that qualifies for a special carryback period. The previous two or more years' tax returns from the carryback period should be compared to the taxpayer's projected future income and tax liabilities. Using the information gathered, a decision must be made regarding the optimum application of the NOL. The ultimate decision is the responsibility of the taxpayer.

Caution. Practitioners should consult with the taxpayer at this stage and fully document the results of the consultation. Although it may be in the taxpayer's best interest to choose one option over the others, the taxpayer may prefer a short-term reward to a long-term benefit. Failure to adequately reflect the taxpayer's wishes can result in legal entanglements.

NOL CARRYBACKS

Individual taxpayers have the option of filing for a refund using Form 1045 or filing amended returns for each year in the carryback period.

Advantages of Using Form 1045

1. The IRS has only 90 days to process the form.
2. One claim can be submitted for all of the carryback years.
3. The form clearly shows which prior year items are adjusted as a result of the NOL.

Disadvantages of Using Form 1045

1. The form must be filed within one year of the last day of the year in which the NOL arose. The deadline for using Form 1045 for a calendar-year taxpayer with a 2009 NOL is December 31, 2010.
2. Processing of the form and paying the requested refund does not signify that the IRS accepted the application as correct.²³ The IRS may impose additional taxes, penalties, and interest after the refund is issued.
3. If the application is disallowed, no suit challenging the disallowance may be brought in any court. The claim for refund must be resubmitted on Form 1040X to be eligible for legal remedy.
4. Any amount applied, credited, or refunded based on the form 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.

Advantages of Using Form 1040X

1. 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 2007 to claim a refund generated by a 2009 NOL is April 15, 2013. **If the 2009 return is filed with a valid extension, the deadline is October 15, 2013.**
2. If the IRS does not process the claim within six months from the date filed, the taxpayer may file suit in court.
3. If the IRS disallows the claim, the taxpayer has two years from the date of disallowance to file suit.

²³ 2008 Instructions to Form 1045, *Application for Tentative Refund*.

Disadvantages of Using Form 1040X

1. Separate returns must be prepared for each carryback year.
2. It may take more than 90 days for the IRS to process the returns and issue refunds.
3. Preparers using software to prepare the return must manually adjust for some of the deductions that are based on AGI. For example, limitations on charitable deductions are not recalculated even though the carryback amount changes the AGI on the amended return.

Applying the NOL to Past Returns

The first step in applying the NOL to past returns is to recalculate the AGI for the earliest carryback year. The AGI that results after applying the NOL deduction is used to recompute income or deduction items that are based on, or limited to, a percentage of AGI. The following items are adjusted in the order listed:

1. The special allowance for passive activity losses from rental real estate activities
2. Taxable social security and tier 1 railroad retirement benefits
3. IRA deductions
4. Excludable savings bond interest
5. Excludable employer-provided adoption benefits
6. The student loan interest deduction
7. The tuition and fees deduction

For each item in the above list, the AGI after applying the NOL and any previous items is used.

After all items are refigured, the following deductions are recalculated based on AGI:

1. Medical expenses
2. Qualified mortgage insurance premiums
3. Casualty losses
4. Miscellaneous itemized deductions
5. Overall limit on itemized deductions
6. Phaseout of exemptions

The deduction for charitable contributions is **not** recalculated.

The final step in the applying the NOL to past returns is that taxes and credits are recalculated. **SE tax is not affected by NOL carrybacks and carryforwards.**

Example 7. Use the same facts as **Example 5**. Fred computed various carryback and carryforward scenarios for Lucy's review. After ample discussion, Lucy decides that she prefers to carry back the NOL rather than carry it forward. Since Lucy's NOL does not qualify for any of the exceptions to the 2-year carryback rule, her 2009 NOL is carried back to 2007.

Selected portions of Lucy's 2007 return are shown below. The IRA worksheet found in the 2007 Form 1040 instructions, which calculates the nondeductible portion of the \$4,000 contribution Lucy made to her traditional IRA for 2007, is also shown.

IRA Deduction Worksheet—Line 32

Keep for Your Records




*If you were age 70½ or older at the end of 2007, you cannot deduct any contributions made to your traditional IRA or treat them as nondeductible contributions. **Do not** complete this worksheet for anyone age 70½ or older at the end of 2007. If you are married filing jointly and only one spouse was under age 70½ at the end of 2007, complete this worksheet only for that spouse.*

Before you begin:		Your IRA		Spouse's IRA	
<p>1a. Were you covered by a retirement plan (see above)?</p> <p>b. If married filing jointly, was your spouse covered by a retirement plan?</p> <p>Next. If you checked "No" on line 1a (and "No" on line 1b if married filing jointly), skip lines 2 through 6, enter the applicable amount below on line 7a (and line 7b if applicable), and go to line 8.</p> <ul style="list-style-type: none"> • \$4,000, if under age 50 at the end of 2007. • \$5,000, if age 50 or older but under age 70½ at the end of 2007. <p>Otherwise, go to line 2.</p> <p>2. Enter the amount shown below that applies to you.</p> <ul style="list-style-type: none"> • Single, head of household, or married filing separately and you lived apart from your spouse for all of 2007, enter \$62,000 • Qualifying widow(er), enter \$103,000 • Married filing jointly, enter \$103,000 in both columns. But if you checked "No" on either line 1a or 1b, enter \$166,000 for the person who was not covered by a plan • Married filing separately and you lived with your spouse at any time in 2007, enter \$10,000 <p>3. Enter the amount from Form 1040, line 22</p> <p>4. Enter the total of the amounts from Form 1040, lines 23 through 31a, plus any write-in adjustments you entered on the dotted line next to line 36</p> <p>5. Subtract line 4 from line 3. If married filing jointly, enter the result in both columns</p> <p>6. Is the amount on line 5 less than the amount on line 2?</p> <p><input type="checkbox"/> No. STOP None of your IRA contributions are deductible. For details on nondeductible IRA contributions, see Form 8606.</p> <p><input checked="" type="checkbox"/> Yes. Subtract line 5 from line 2 in each column. Follow the instruction below that applies to you.</p> <ul style="list-style-type: none"> • If single, head of household, or married filing separately, and the result is \$10,000 or more, enter the applicable amount below on line 7 for that column and go to line 8. <ul style="list-style-type: none"> i. \$4,000, if under age 50 at the end of 2007. ii. \$5,000, if age 50 or older but under age 70½ at the end of 2007. <p>Otherwise, go to line 7.</p> • If married filing jointly or qualifying widow(er), and the result is \$20,000 or more (\$10,000 or more in the column for the IRA of a person who was not covered by a retirement plan), enter the applicable amount below on line 7 for that column and go to line 8. <ul style="list-style-type: none"> i. \$4,000, if under age 50 at the end of 2007. ii. \$5,000 if age 50 or older but under age 70½ at the end of 2007. <p>Otherwise, go to line 7.</p> 	<p>1a. <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>1b. <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>2a. 62,000</p> <p>2b. </p> <p>3. 60,000</p> <p>4. 0</p> <p>5a. 60,000</p> <p>5b. </p> <p>6a. 2,000</p> <p>6b. </p>	<p>1a. <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>1b. <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>2a. </p> <p>2b. </p> <p>3. </p> <p>4. </p> <p>5a. </p> <p>5b. </p> <p>6a. </p> <p>6b. </p>	<p>1a. <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>1b. <input type="checkbox"/> Yes <input type="checkbox"/> No</p> <p>2a. </p> <p>2b. </p> <p>3. </p> <p>4. </p> <p>5a. </p> <p>5b. </p> <p>6a. </p> <p>6b. </p>		

For Example 7

IRA Deduction Worksheet—Line 32 (continued)

		Your IRA	Spouse's IRA
7.	Multiply lines 6a and 6b by the percentage below that applies to you. If the result is not a multiple of \$10, increase it to the next multiple of \$10 (for example, increase \$490.30 to \$500). If the result is \$200 or more, enter the result. But if it is less than \$200, enter \$200.		
	<ul style="list-style-type: none"> • Single, head of household, or married filing separately, multiply by 40% (.40) (or by 50% (.50) in the column for the IRA of a person who is age 50 or older at the end of 2007) • Married filing jointly or qualifying widow(er), multiply by 20% (.20) (or by 25% (.25) in the column for the IRA of a person who is age 50 or older at the end of 2007). But if you checked "No" on either line 1a or 1b, then in the column for the IRA of the person who was not covered by a retirement plan, multiply by 40% (.40) (or by 50% (.50) if age 50 or older at the end of 2007) 	7a. 800	7b.
8.	Enter the total of your (and your spouse's if filing jointly):		
	<ul style="list-style-type: none"> • Wages, salaries, tips, etc. Generally, this is the amount reported in box 1 of Form W-2. See page 27 for exceptions • Alimony and separate maintenance payments reported on Form 1040, line 11 • Nontaxable combat pay. This amount should be reported in box 12 of Form W-2 with code Q 	8. 60,000	
9.	Enter the earned income you (and your spouse if filing jointly) received as a self-employed individual or a partner. Generally, this is your (and your spouse's if filing jointly) net earnings from self-employment if your personal services were a material income-producing factor, minus any deductions on Form 1040, lines 27 and 28. If zero or less, enter -0-. For more details, see Pub. 590	9.	
10.	Add lines 8 and 9	10. 60,000	
 <p><i>If married filing jointly and line 10 is less than \$8,000 (\$9,000 if one spouse is age 50 or older at the end of 2007; \$10,000 if both spouses are age 50 or older at the end of 2007), stop here and see Pub. 590 to figure your IRA deduction.</i></p>			
11.	Enter traditional IRA contributions made, or that will be made by April 15, 2008, for 2007 to your IRA on line 11a and to your spouse's IRA on line 11b	11a. 4,000	11b.
12.	On line 12a, enter the smallest of line 7a, 10, or 11a. On line 12b, enter the smallest of line 7b, 10, or 11b. This is the most you can deduct. Add the amounts on lines 12a and 12b and enter the total on Form 1040, line 32. Or, if you want, you can deduct a smaller amount and treat the rest as a nondeductible contribution (see Form 8606)	12a. 800	12b.

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2009 Workbook

For Example 7

Form 1040 Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return 2007		IRS Use Only—Do not write or staple in this space.																																																																																					
Label (See instructions on page 12.) Use the IRS label. Otherwise, please print or type. Presidential Election Campaign		For the year Jan. 1–Dec. 31, 2007, or other tax year beginning _____, 2007, ending _____, 20 OMB No. 1545-0074 Your first name and initial: Lucy Last name: Richards If a joint return, spouse's first name and initial: _____ Last name: _____ Home address (number and street). If you have a P.O. box, see page 12. Apt. no.: _____ 1 Ball Court City, town or post office, state, and ZIP code. If you have a foreign address, see page 12. Chicago, IL 60606 Your social security number: 222 22 2222 Spouse's social security number: _____ You must enter your SSN(s) above.																																																																																					
Filing Status Check only one box. 1 <input type="checkbox"/> Single 2 <input type="checkbox"/> Married filing jointly (even if only one had income) 3 <input type="checkbox"/> Married filing separately. Enter spouse's SSN above and full name here.		4 <input checked="" type="checkbox"/> Head of household (with qualifying person). (See page 13.) If the qualifying person is a child but not your dependent, enter this child's name here. Rick 5 <input type="checkbox"/> Qualifying widow(er) with dependent child (see page 14)																																																																																					
Exemptions 6a <input checked="" type="checkbox"/> Yourself. If someone can claim you as a dependent, do not check box 6a b <input type="checkbox"/> Spouse c Dependents: <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th>(1) First name</th> <th>Last name</th> <th>(2) Dependent's social security number</th> <th>(3) Dependent's relationship to you</th> <th>(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 15)</th> </tr> </thead> <tbody> <tr><td> </td><td> </td><td> </td><td> </td><td> </td></tr> <tr><td> </td><td> </td><td> </td><td> </td><td> </td></tr> <tr><td> </td><td> </td><td> </td><td> </td><td> </td></tr> <tr><td> </td><td> </td><td> </td><td> </td><td> </td></tr> </tbody> </table> If more than four dependents, see page 15. d Total number of exemptions claimed		(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> if qualifying child for child tax credit (see page 15)																					Boxes checked on 6a and 6b: 1 No. of children on 6c who: • lived with you _____ • did not live with you due to divorce or separation (see page 16) _____ Dependents on 6c not entered above _____ Add numbers on lines above: 1																																																												
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Income 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 page 19. Enclose, but do not attach, any payment. Also, please use Form 1040-V.		<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td>7</td><td>Wages, salaries, tips, etc. Attach Form(s) W-2</td><td>7</td><td>60,000</td></tr> <tr><td>8a</td><td>Taxable interest. Attach Schedule B if required</td><td>8a</td><td> </td></tr> <tr><td>b</td><td>Tax-exempt interest. Do not include on line 8a</td><td>8b</td><td> </td></tr> <tr><td>9a</td><td>Ordinary dividends. Attach Schedule B if required</td><td>9a</td><td> </td></tr> <tr><td>b</td><td>Qualified dividends (see page 19)</td><td>9b</td><td> </td></tr> <tr><td>10</td><td>Taxable refunds, credits, or offsets of state and local income taxes (see page 20)</td><td>10</td><td> </td></tr> <tr><td>11</td><td>Alimony received</td><td>11</td><td> </td></tr> <tr><td>12</td><td>Business income or (loss). Attach Schedule C or C-EZ</td><td>12</td><td> </td></tr> <tr><td>13</td><td>Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/></td><td>13</td><td> </td></tr> <tr><td>14</td><td>Other gains or (losses). Attach Form 4797</td><td>14</td><td> </td></tr> <tr><td>15a</td><td>IRA distributions</td><td>15a</td><td> </td></tr> <tr><td>b</td><td>Taxable amount (see page 21)</td><td>15b</td><td> </td></tr> <tr><td>16a</td><td>Pensions and annuities</td><td>16a</td><td> </td></tr> <tr><td>b</td><td>Taxable amount (see page 22)</td><td>16b</td><td> </td></tr> <tr><td>17</td><td>Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E</td><td>17</td><td> </td></tr> <tr><td>18</td><td>Farm income or (loss). Attach Schedule F</td><td>18</td><td> </td></tr> <tr><td>19</td><td>Unemployment compensation</td><td>19</td><td> </td></tr> <tr><td>20a</td><td>Social security benefits</td><td>20a</td><td> </td></tr> <tr><td>b</td><td>Taxable amount (see page 24)</td><td>20b</td><td> </td></tr> <tr><td>21</td><td>Other income. List type and amount (see page 24)</td><td>21</td><td> </td></tr> <tr><td>22</td><td>Add the amounts in the far right column for lines 7 through 21. This is your total income</td><td>22</td><td>60,000</td></tr> </table>		7	Wages, salaries, tips, etc. Attach Form(s) W-2	7	60,000	8a	Taxable interest. Attach Schedule B if required	8a		b	Tax-exempt interest. Do not include on line 8a	8b		9a	Ordinary dividends. Attach Schedule B if required	9a		b	Qualified dividends (see page 19)	9b		10	Taxable refunds, credits, or offsets of state and local income taxes (see page 20)	10		11	Alimony received	11		12	Business income or (loss). Attach Schedule C or C-EZ	12		13	Capital gain or (loss). Attach Schedule D if required. If not required, check here <input type="checkbox"/>	13		14	Other gains or (losses). Attach Form 4797	14		15a	IRA distributions	15a		b	Taxable amount (see page 21)	15b		16a	Pensions and annuities	16a		b	Taxable amount (see page 22)	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 (see page 24)	20b		21	Other income. List type and amount (see page 24)	21		22	Add the amounts in the far right column for lines 7 through 21. This is your total income	22	60,000
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For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 83.

Cat. No. 11320B

Form 1040 (2007)

2009 Workbook

For Example 7

Form 1040 (2007) **Lucy Richards** 222-22-2222 Page **2**

Tax and Credits Standard Deduction for— <ul style="list-style-type: none"> • People who checked any box on line 39a or 39b or who can be claimed as a dependent, see page 31. • All others: <ul style="list-style-type: none"> Single or Married filing separately, \$5,350 Married filing jointly or Qualifying widow(er), \$10,700 Head of household, \$7,850 	38	Amount from line 37 (adjusted gross income)	38	59,200
	39a	Check <input type="checkbox"/> You were born before January 2, 1943, <input type="checkbox"/> Blind. Total boxes checked 39a		
		if: <input type="checkbox"/> Spouse was born before January 2, 1943, <input type="checkbox"/> Blind. checked 39b		
	b	If your spouse itemizes on a separate return or you were a dual-status alien, see page 31 and check here 39b		
	40	Itemized deductions (from Schedule A) or your standard deduction (see left margin)	40	10,360
	41	Subtract line 40 from line 38	41	48,840
	42	If line 38 is \$117,300 or less, multiply \$3,400 by the total number of exemptions claimed on line 6d. If line 38 is over \$117,300, see the worksheet on page 33	42	3,400
	43	Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	43	45,440
	44	Tax (see page 33). Check if any tax is from: a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972 c <input type="checkbox"/> Form(s) 8889	44	6,531
	45	Alternative minimum tax (see page 36). Attach Form 6251	45	
	46	Add lines 44 and 45	46	6,531
	47	Credit for child and dependent care expenses. Attach Form 2441	47	
	48	Credit for the elderly or the disabled. Attach Schedule R	48	
	49	Education credits. Attach Form 8863	49	
50	Residential energy credits. Attach Form 5695	50		
51	Foreign tax credit. Attach Form 1116 if required	51		
52	Child tax credit (see page 39). Attach Form 8901 if required	52		
53	Retirement savings contributions credit. Attach Form 8880	53		
54	Credits from: a <input type="checkbox"/> Form 8396 b <input type="checkbox"/> Form 8859 c <input type="checkbox"/> Form 8839	54		
55	Other credits: a <input type="checkbox"/> Form 3800 b <input type="checkbox"/> Form 8801 c <input type="checkbox"/> Form	55		
56	Add lines 47 through 55. These are your total credits	56		
57	Subtract line 56 from line 46. If line 56 is more than line 46, enter -0-	57	6,531	

Self-employment tax. Attach Schedule SE

SCHEDULES A&B (Form 1040) **Schedule A—Itemized Deductions** (Schedule B is on back) OMB No. 1545-0074

Department of the Treasury Internal Revenue Service **2007** Attachment Sequence No. 07

► Attach to Form 1040. ► See Instructions for Schedules A&B (Form 1040).

Name(s) shown on Form 1040: **Lucy Richards** Your social security number: **222 22 2222**

Medical and Dental Expenses Caution. Do not include expenses reimbursed or paid by others.	1	Medical and dental expenses (see page A-1)	1	8,000
	2	Enter amount from Form 1040, line 38	2	59,200
	3	Multiply line 2 by 7.5% (.075)	3	4,440
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	4	3,560
Taxes You Paid (See page A-2.)	5	State and local (check only one box): a <input checked="" type="checkbox"/> Income taxes, or	5	1,800
		b <input type="checkbox"/> General sales taxes		
	6	Real estate taxes (see page A-5)	6	5,000
	7	Personal property taxes	7	
	8	Other taxes. List type and amount	8	
	9	Add lines 5 through 8	9	6,800
	10	Home mortgage interest and points reported to you	10	

Using the information from 2007, Fred completes the first column of Form 1045, shown on the following page.

2009 Workbook

For Example 7

Form	1045	Application for Tentative Refund				OMB No. 1545-0098
		▶ See separate instructions. ▶ Do not attach to your income tax return—mail in a separate envelope. ▶ For use by individuals, estates, or trusts.				2009
Type or print	Name(s) shown on return Lucy Richards				Social security or employer identification number 222-22-2222	
	Number, street, and apt. or suite no. If a P.O. box, see page 4 of the instructions. 1 Ball Court				Spouse's social security number (SSN) :	
	City, town or post office, state, and ZIP code. If a foreign address, see page 4 of the instructions. Chicago, IL 60606				Daytime phone number ()	
1 This application is filed to carry back:		a Net operating loss (NOL) (Sch. A, line 25, page 2) \$ 83,000		b Unused general business credit \$		c Net section 1256 contracts loss \$
2a For the calendar year 2009, or other tax year beginning , 2009, and ending , 20				b Date tax return was filed 04/15/2010		
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 ▶						
7 Have you filed a petition in Tax Court for the year(s) to which the carryback is to be applied? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No						
8 Is any part of the decrease in tax due to a loss or credit from a tax shelter required to be registered? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> 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 page 4 of the instructions)? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No						
Computation of Decrease in Tax (see page 4 of the instructions)						
Note: If 1a and 1c are blank, skip lines 10 through 15.						
		2nd preceding tax year ended ▶ 12/31/07		1st preceding tax year ended ▶ 12/31/08		preceding tax year ended ▶
		Before carryback	After carryback	Before carryback	After carryback	Before carryback
		After carryback	After carryback	After carryback	After carryback	After carryback
10	NOL deduction after carryback (see page 4 of the instructions)	83,000		34,160		
11	Adjusted gross income	59,200	0	58,500	21,840	
12	Deductions (see page 6 of the instructions)	10,360	14,800	10,412	13,162	
13	Subtract line 12 from line 11	48,840	(14,800)	48,088	8,678	
14	Exemptions (see page 6 of the instructions)	3,400	3,400	3,500	3,500	
15	Taxable income. Line 13 minus line 14	45,440	(18,200)	44,588	5,178	
16	Income tax. See page 6 of the instructions and attach an explanation	6,531	0	6,206	518	
17	Alternative minimum tax	6,531	0	6,206	518	
18	Add lines 16 and 17					
19	General business credit (see page 7 of the instructions)					
20	Other credits. Identify				518	
21	Total credits. Add lines 19 and 20				518	
22	Subtract line 21 from line 18	6,531	0	6,206	0	
23	Self-employment tax					
24	Other taxes					
25	Total tax. Add lines 22 through 24	6,531	0	6,206	0	
26	Enter the amount from the "After carryback" column on line 25 for each year	0		0		
27	Decrease in tax. Line 25 minus line 26	6,531		6,206		
Payment of tax due to a claim of right adjustment under section 1341(b)(1) (attach computation)						

Note. Because the AGI is less on the carryback return, the medical deduction on Schedule A is larger. This results in a larger itemized deduction on line 12 for the second preceding year.

2009 Workbook

If the NOL is more than the modified AGI of the oldest carryback year, **Schedule B–NOL Carryover** is used to calculate how much of the NOL can be applied to the next oldest year. Although certain items are recomputed when applying the NOL for calculating the change in tax liability, those items are not recomputed when calculating the amount of NOL remaining after it is applied to the earliest year. Furthermore, the deduction for personal exemptions is added back to taxable income when applying the NOL deduction. Consequently, the taxpayer loses the benefit of those deductions in the carryback year.

Example 8. Use the same facts as **Example 7**. After completing page 1 of Form 1045, Fred completes Lucy's Schedule B–NOL Carryover. It is shown below. When recalculating the tax for 2007, Fred finds that all of Lucy's \$4,000 IRA contribution would have been deductible if the NOL subtraction had been included on the original return. However, when completing Schedule B, he realizes that Lucy does not get credit for the new deductible amount **for purposes of computing the amount of NOL applied to the 2007 income**. As shown below, \$34,160 of Lucy's 2009 NOL is still available to apply to her 2008 income.

Form 1045 (2009) **Lucy Richards** 222-22-2222 Page **3**

Schedule B–NOL Carryover (see page 8 of the instructions)

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

	<u>2nd</u> preceding tax year ended ► 12/31/07	<u>1st</u> preceding tax year ended ► 12/31/08	<u> </u> preceding tax year ended ►
1 NOL deduction (see page 8 of the instructions). Enter as a positive number	83,000	34,160	
2 Taxable income before 2009 NOL carryback (see page 8 of the instructions). Estates and trusts, increase this amount by the sum of the charitable deduction and income distribution deduction	45,440	44,588	
3 Net capital loss deduction (see page 8 of the instructions)			
4 Section 1202 exclusion. Enter as a positive number			
5 Domestic production activities deduction			
6 Adjustment to adjusted gross income (see page 8 of the instructions) . .			
7 Adjustment to itemized deductions (see page 8 of the instructions) . .			
8 Individuals, enter deduction for exemptions (minus any amount on Form 8914, line 6, for 2006; line 2 for 2005 and 2008). Estates and trusts, enter exemption amount	3,400	3,500	
9 Modified taxable income. Combine lines 2 through 8. If zero or less, enter -0-	48,840	48,088	
10 NOL carryover (see page 9 of the instructions). Subtract line 9 from line 1. If zero or less, enter -0-	34,160	0	
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 2009 NOL carryback			

7

2009 Workbook

Lucy's 2008 return is not shown. It is substantially the same as her 2007 return. On the first page of Form 1040, AGI on line 11 and deductions on line 12 are calculated as follows:

	2008 Original	2008 Recalculated
AGI:		
Wages	\$60,000	\$60,000
IRA deduction	(1,500)	(4,000)
NOL carryback		(34,160)
AGI on line 11	\$58,500	\$21,840
7.5% of AGI floor for medical	\$ 4,388	\$ 1,638
Itemized deductions:		
Medical	\$ 3,612 (\$8,000 – \$4,388)	\$ 6,362 (\$8,000 – \$1,638)
Taxes	6,800	6,800
Total deductions on line 12	\$10,412	\$13,162

Observations for Example 8

- As a result of Lucy's reduced AGI from the NOL carryback, she now qualifies for:
 - An increase in her IRA deduction.²⁴ Fred must attach a revised 2008 Form 8606, *Nondeductible IRAs*, to Form 1045 to report an adjusted basis in her IRAs.
 - An increase in medical deductions.²⁵ A revised Schedule A, *Itemized Deductions*, must also be attached to Form 1045.
 - The retirement savings credit,²⁶ which is shown on line 20 of Form 1045. Fred must attach a 2008 Form 8880, *Credit for Qualified Retirement Savings Contributions*, to Form 1045.
- Lucy does not qualify for the earned income credit (EIC) for 2008. The NOL adjustment lowers her AGI below the EIC ceilings, but the NOL does not lower her **earned income**,²⁷ which is too high to qualify for the credit.
- For purposes of recalculating her AGI for **2008**, Lucy is allowed to deduct more of her IRA contributions after the NOL reduced her AGI. However, the **2007** IRA deduction is **not** adjusted for **purposes of calculating the remaining carryforward**.²⁸
- The limits on charitable deductions that are based on AGI are not recalculated as a result of the NOL carryback.²⁹ For example, cash contributions to a qualified charity are limited to 50% of the taxpayer's AGI. This 50% limit is not adjusted after the NOL carryback.

Caution. Practitioners need to exercise caution when preparing returns with NOLs. As stated previously, the elections made for carryback periods cannot be revoked without the IRS's consent. Likewise, the absence of any election is binding on the taxpayer after the extended deadline for the return has passed.

²⁴ Instructions for Form 1045 (2008), p. 6.

²⁵ Treas. Reg. §1.172-5(a)(2)(ii).

²⁶ Instructions for Form 1045 (2008), p. 7.

²⁷ IRC §32(c)(2).

²⁸ Instructions for Form 1045 (2008), p. 8. The amount of the carryforward is the excess, if any, of the NOL carryback over the modified taxable income for that earlier year.

²⁹ IRC §170(b)(1)(G).

NOL CARRYFORWARDS

If the carryback period is waived or if there is any NOL remaining after the carryback is applied, the NOL carryforward is entered on the following year's return as a negative amount on Form 1040, line 21, Other income. After the following year's return is completed, Table 1 and the worksheet instructions in IRS Pub. 536 are used to calculate the remaining portion, if any, to carry forward to the next year. The NOL continues to carry forward until it is completely depleted or until it expires at the end of 20 years.

When losses from more than one NOL year are carried forward, the earliest year is utilized first.

Caution. Tax software may not perform this calculation correctly. Practitioners are advised to manually complete the Table 1 worksheet of IRS Pub. 536 to verify the calculation of the carryforward. Another way to verify the calculation is to complete Form 1045, *Schedule B–NOL Carryover*, for the carryforward year.

Observation. If the statute of limitations allows, the return should be amended to reflect the carryback. If the statute of limitations has expired, the NOL must be calculated and treated as if it **had been carried back**. The NOL carryforward must be reduced by the amount that should have been carried back.

The NOL carryforward should further be reduced by the amount of losses that would have been utilized in years that are now closed by the statute of limitations.

Example 9. Ethel has a 2008 NOL of \$50,000 and wages of \$20,000. She elects to forgo the carryback period. She reports the NOL as a negative amount on line 21 of her 2009 Form 1040. Her AGI is negative \$30,000.

Ethel's taxable income is:

Wages	\$20,000
NOL	(\$50,000)
AGI	(\$30,000)
Standard deduction	(8,350)
Personal exemption	(3,650)
Taxable income	(\$42,000)

Ethel uses Table 1 from IRS Pub. 536 to calculate the carryforward to 2010. She enters \$50,000 on line 1. She calculates line 2 by adding the NOL of \$50,000 to the taxable income of (\$42,000) shown above. She enters \$8,000 on line 2.

Ethel's income and deductions are not affected by her AGI. Consequently, she does not make any entries on lines 3 through 7. On line 8, she enters the amount of her personal exemption. Her modified taxable income on line 9 is subtracted from her 2008 NOL to yield her carryforward to 2010.

Table 1. **Worksheet for NOL Carryover From 2009 to 2010 (For an NOL Year Before 2009)***

For Use by Individuals, Estates, and Trusts (Keep for your records.)
See the instructions under *NOL Carryover From 2009 to 2010*.



NOL YEAR: 2008	
USE YOUR 2009 FORM 1040, FORM 1040NR (OR FORM 1041) TO COMPLETE THIS WORKSHEET:	
1. Enter as a positive number your NOL deduction for the NOL year entered above from line 21 (Form 1040 or Form 1040NR) or line 15a (Form 1041)	50,000
2. Enter your taxable income without the NOL deduction for 2009 (see instructions)	8,000
3. Enter as a positive number any net capital loss deduction	
4. Enter as a positive number any gain excluded on the sale or exchange of qualified small business stock	
5. Enter the amount of any domestic production activities deduction	
6. Enter any adjustments to your adjusted gross income (see instructions)	
7. Enter any adjustments to your itemized deductions from line 35 or line 47 (see instructions)	
8. Enter your deduction for exemptions from line 42 (Form 1040), line 39 (Form 1040NR), or line 20 (Form 1041),	3,650
9. Modified taxable income. Combine lines 2 through 8. Enter the result (but not less than zero)	11,650
10. NOL carryover to 2010. Subtract line 9 from line 1. Enter the result (but not less than zero) here and on the "other income" line of Form 1040 or Form 1040NR (or the line on Form 1041 for deductions NOT subject to the 2% floor) in 2010	38,350

CHANGE IN MARITAL STATUS

If the taxpayer's marital status is not the same for all the years involved in calculating the NOL carrybacks and carryforwards, only the spouse who had the loss can take the NOL deduction. On a joint return, the NOL carryback deduction is limited to the income of that spouse.

Example 10. Liz, a single taxpayer, has a 2009 NOL of \$200,000. In 2007, she filed a joint return with Michael, her former spouse. They reported the following income for 2007:

	Liz	Michael
Wages	\$50,000	\$300,000

The amount of the 2009 NOL that Liz can deduct against their 2007 income is limited to her wages of \$50,000.

The refund for a divorced person filing an NOL carryback against a joint return with a former spouse may be limited. It cannot be more than the taxpayer's contribution to the taxes paid on the joint return. The first calculation determines the portion of the joint liability allocated to the taxpayer with the NOL carryback. The steps for this calculation are as follows:

1. Calculate the tax in the carryback year for each spouse as if they filed MFS.
2. Figure each spouse's percentage of the total tax from the two MFS returns.
3. Multiply the recomputed tax on the joint return after the NOL carryback by the taxpayer's percentage of the total MFS tax. The result is the taxpayer's share of the joint tax liability.

Example 11. Use the same facts as **Example 10**. The tax on Liz and Michael's original return was \$90,331. After carrying back \$50,000 of Liz's 2009 NOL, the recomputed tax is \$73,233, which yields a potential refund of \$17,098. The following chart shows how Liz's portion of the recomputed 2007 joint liability is calculated.

	MFJ	Liz MFS	Michael MFS	Total MFS
Total income	\$300,000	\$0	\$300,000	\$300,000
Tax	73,233	0	88,834	88,834
Percentage of MFS tax		0%		
Liz's share of MFJ tax		\$0		

Only the amount of taxes paid that is attributed to the taxpayer may be refunded. Unless there is an agreement or clear evidence of each spouse's contributions toward the payment of the joint tax liability, the taxpayer's contribution is calculated using the following formula:³⁰

$$\begin{array}{r}
 \text{Any tax withholding from her income} \\
 + \text{ her share of any tax estimates} \\
 + \text{ her share of any balance due paid} \\
 - \text{ her share of previous refunds} \\
 \hline
 \text{Taxpayer's contribution}
 \end{array}$$

³⁰ IRS Pub. 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts* (revised Mar. 24, 2009).

Example 12. Use the same facts as **Example 11**. The following chart shows the joint liability that Liz and Michael reported on their 2007 return and their individual tax liability if each had filed MFS. Their original refund was \$7,169.

	MFJ	Liz MFS	Michael MFS	Total MFS
Total income	\$350,000	\$50,000	\$300,000	\$350,000
Tax	90,331	6,743	88,834	95,577
		÷ 95,577		
Percentage of MFS tax		7%		
Tax withholding		\$ 7,500		
Allocated portion of refund (\$7,169 original refund × 7%)		(502)		
Liz's contribution to tax paid		6,998		
Liz's portion of tax after NOL carryback		(0)		
Maximum refund available to Liz		\$ 6,998		

Even though the NOL carryback yields a potential refund of \$17,098, the maximum amount of refund that Liz can receive is \$6,998.³¹

Caution. The IRS issued the following rulings which modify these formulas for taxpayers in community property states:

- Rev. Rul. 2004-71, 2004-2, CB 74 — Arizona and Wisconsin
- Rev. Rul. 2004-72, 2004-2, CB 77 — California, Idaho, and Louisiana
- Rev. Rul. 2004-73, 2004-2, CB 80 — Nevada, New Mexico, and Washington
- Rev. Rul. 2004-74, 2004-2, CB 84 — Texas

CHANGE IN FILING STATUS

Special rules apply for calculating the NOL carrybacks and carryforwards of couples who are married to each other throughout the NOL carry years but who use a mix of MFJ and MFS as their filing statuses on the returns in the carryback or carryforward years.

Separate Returns to Joint Return

If the taxpayer files an MFS return for the NOL year, the loss is treated as a joint loss on the MFJ return(s) to which it is carried.

Joint Return to Separate Returns

If the taxpayers file a joint return for the NOL year, but are carrying the loss back/forward to an MFS return, the NOL must be calculated separately for each spouse. The NOL is recomputed as if each taxpayer filed MFS in the NOL year. The NOL calculated on the joint return is allocated proportionately to each spouse based on each person's share of the total NOL as computed with the status of MFS for the NOL year.

When both spouses have NOLs being carried to a joint return and not all of the NOLs are exhausted on that return, the carryforward of the remainder is allocated according to each spouse's share if separate returns were filed for the joint year.

³¹ Rev. Rul. 86-57.

DEATH OF THE TAXPAYER³²

Business losses sustained by a decedent before his death are deductible only on his final income tax return. No part of the NOL is deductible by the decedent's estate or carried over to subsequent years by a surviving spouse. However, the NOL may be carried back to prior years.

ALTERNATIVE MINIMUM TAX

If any of the taxpayer's income or deductions is subject to AMT adjustments, the NOL must be recalculated to determine the **alternative tax NOL** (ATNOL), which can be applied to the AMT calculation in prior or future years. ATNOL is only adjusted for tax preferences when the preferences increased the amount of the NOL for regular tax purposes.³³

Examples of differences that cause an ATNOL to be different from an NOL are:

- Regular depreciation versus AMT depreciation,³⁴
- Passive activities involving farming and farm syndicates,³⁵ and
- Limitations on itemized deductions.³⁶

The amount of the ATNOL deduction is limited³⁷ to the sum of Steps 1 and 2 shown below:

Step 1. The lesser of:

- The ATNOL, or
- 90% of the AMT income determined without regard to the IRC §199 domestic production activities deduction.

— PLUS —

Step 2. The lesser of:

- AMT income determined without regard to the domestic production activities deduction less the amount determined in Step 1, or
- The amount of such deduction attributable to carryforwards of 2001 and 2002 NOLs plus the amount of the qualified disaster losses.³⁸

Example 13. For 2009, Dizzy has an NOL carryforward from prior years. He applies the ATNOL to his 2009 return to determine if he owes any AMT.

Step 1:

- a. The ATNOL carryforward is \$80,000.
- b. His 2009 income for AMT purposes is \$70,000. Ninety percent of this is \$63,000. The lesser amount is \$63,000.

Step 2:

- c. AMT income of \$70,000 less the \$63,000 determined in Step 1 is \$7,000.
- d. Included in the ATNOL is \$20,000 from a qualified disaster loss. The lesser amount is \$7,000.

Dizzy's total ATNOL deduction for 2009 is \$70,000, the total of the amounts from Steps 1 and 2.

³² Rev. Rul. 74-175, 1974-1 CB 52.

³³ IRC §56(d)(2)(A).

³⁴ IRC §56(a)(1).

³⁵ IRC §58(a).

³⁶ IRC §56(b)(1).

³⁷ IRC §56(d)(1)(A).

³⁸ IRC §56(d)(3).

PASS-THROUGH ENTITIES

A shareholder in an S corporation or a partner in a partnership may realize an NOL as a result of business losses passed through to the owners. Elections, such as waiving the carryback period, are made at the individual return level. However, tests such as the gross receipts test for eligible small business carrybacks are applied at the entity level.³⁹ The nature of the loss is also determined at the entity level. For example, losses from a partnership in the business of farming would qualify for the special 5-year carryback provisions on the individual's return.

A copy of the Schedule K-1 and any related calculations from the NOL year should be attached to the carryback/forward returns.

Caution. Although the pass-through activities may generate NOLs for the partner or shareholder, the loss for any particular year may be limited by the basis, at-risk, and passive activity rules. A taxpayer in a recent court case, *Dean v. IRS*,⁴⁰ lost his NOL carryback when he could not prove that he spent more than 500 hours working for the partnership that generated the loss.

ESTATES AND TRUSTS⁴¹

CALCULATING THE NOL

An estate or trust tax return may have an NOL if line 21 on (2009) Form 1041 is a negative number. If the number is positive, the taxpayer does **not** have an NOL. If the taxable income is negative, the income and losses on the return must be analyzed to determine if the taxpayer has an NOL. The first step is to add back the deductions for the following:

- Charitable contributions
- Income distributions
- The exemption amount

If the resulting amount is still negative, the next step is to separate the taxpayer's current year return into business and nonbusiness activities. For estates and trusts, the separation is done using the same type of worksheet that is used for individuals. (See **Example 5**.)

Once the activities are separated, Form 1045, Schedule A–NOL, is used to calculate the NOL. (See **Example 6**.)

USING THE NOL

The special carryback periods related to certain types of losses also apply to activities of estates and trusts. Estates and trusts may use Form 1045 to claim refunds related to NOL carrybacks, or they may file an amended Form 1041 for each carryback year. The deadline for filing Form 1045 is one year after the last day of the year in which the NOL arose. The deadline for filing amended returns is three years from the due date of the return for the NOL year.

Estates and trusts also have the option of forgoing the carryback period. The election to forgo the carryback is shown in the section on carryback and carryforward rules at the beginning of the chapter.

The NOL deduction from a carryback or carryforward is included on line 15a on the (2009) Form 1041.

³⁹ Rev. Proc. 2009-26, IRB 2009-19 (May 11, 2009).

⁴⁰ *Dean v. IRS*, KTC 2009-63 (9th Cir. 2008).

⁴¹ IRS Pub. 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts* (revised Mar. 24, 2009).

The worksheet shown in **Example 8** is also used by estates and trusts to calculate the amount of unused NOL to carry forward. However, estates and trusts must substitute **modified adjusted gross income** in place of AGI when recalculating certain deductions for this purpose.

FINAL YEAR OF THE ESTATE OR TRUST

Only on the **final return** of the estate or trust does any unused NOL flow to the beneficiaries. The instructions for Form 1041, Schedule K-1, *Beneficiary's Share of Income, Deductions, Credits, etc.*, advise beneficiaries filing Form 1040 how to report the NOL on their returns. However, the preparer of Form 1041 must use the proper codes on the K-1 in order to apply the instructions correctly.

Generally, an unused NOL from the current year and from any carryforward years is reported to the beneficiaries on the Schedule K-1 as a Code **D** on line 11, Final year deductions. For individual beneficiaries, these deductions flow to Form 1040, line 21.

However, if the final year of the estate or trust is **also** the last year of the NOL carryforward period, the unused NOL is classified as an excess deduction and reported as a Code **A** on line 11 of Schedule K-1. Code A deductions flow to Form 1040, Schedule A, line 23 (miscellaneous itemized deductions subject to the 2% limitation). **For 2009 returns, this provision applies to unused NOLs originating in 1994, which have a 15-year carryforward.**

C CORPORATIONS

Note. At the federal level, S corporations and partnerships generally do not qualify for NOL carrybacks and carryforwards because the income taxes are paid at the individual level. However, at the state level, the entity may be subject to other taxes that are based on income. Each state has its own laws regarding the carryback and carryforward of losses for pass-through entities. Because the practitioner is not applying the federal NOL at the entity level, it is easy to forget to apply the state NOL when appropriate.

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.⁴² However, there are a few adjustments that must be made when calculating the NOL:

1. The domestic production activities deduction under IRC §199 is not included in the NOL.⁴³
2. The deductions for dividends received are computed without regard to the limits based on taxable income that normally apply.⁴⁴
3. Interest expense on **corporate equity reduction transactions** is not included in the NOL.⁴⁵

In general, a corporate equity reduction transaction is a major stock acquisition or an excess distribution. The interest portion of an NOL created by such a transaction is subject to its own carryback and carryforward rules. However, under the de minimis rules, only interest in excess of \$1 million is subject to these provisions.

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.

Note. Special rules apply to REITs and public utilities. They are not discussed in this chapter.

⁴² IRC §172(d)(4).

⁴³ IRC §172(d)(7).

⁴⁴ IRC §172(d)(5).

⁴⁵ IRC §172(h).

NOL CARRYBACKS⁴⁶

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.

Note. The advantages and disadvantages of using Form 1139 are similar to those of Form 1045 for individuals, which were discussed earlier in the chapter.

Example 14. Universe Xpress, Inc., a calendar-year C corporation, is a delivery company specializing in hazardous waste transportation. Collected waste is shot into space monthly. Due to the high cost of rocket fuel and other factors, the company incurs a net loss of \$300,000 in 2009. After several years of unusually high profits, the loss is particularly painful for the owner, Professor Barnsworth, who was hoping to use this year's profits to manufacture his smell-o-scope. The professor instructs the company's accountant, Himmes, to maximize any refunds available.

Included in the computation of the net loss is \$60,000 of dividends from SLIRM, a publicly-traded stock that is held by the corporation. To calculate the NOL available for carryback, Himmes increases the NOL by the amount of the dividend exclusion, \$42,000 ($\$60,000 \times 70\%$), using the exclusion rate for less-than-20%-owned domestic corporations. The company's available NOL is \$342,000 ($\$300,000 + \$42,000$).

Himmes prepares the following Form 1139.

⁴⁶ IRS Pub. 542, *Corporations* (2006).

2009 Workbook

For Example 14

Form 1139 (Rev. August 2006) Department of the Treasury Internal Revenue Service	Corporation Application for Tentative Refund ▶ See separate instructions. ▶ Do not file with the corporation's income tax return—file separately.	OMB No. 1545-0582
Name Universe Xpress		Employer identification number 10: 1010101
Number, street, and room or suite no. If a P.O. box, see instructions. 47 Bender Way		Date of incorporation 03/28/1999
City or town, state, and ZIP code Newest York, NY 10101		Daytime phone number ()
1 Reason(s) for filing. See instructions— attach computation	a Net operating loss (NOL) . . . ▶ \$ 342,000 b Net capital loss ▶ \$	c Unused general business credit ▶ \$ d Other ▶ \$
2 Return for year of loss, unused credit, or overpayment under section 1341(b)(1) ▶	a Tax year ended 12/2009	b Date tax return filed 03/15/2010 c Service center where filed Cincinnati, OH 45999-0012
3 If this application is for an unused credit created by another carryback, enter ending date for the tax year of the first carryback. ▶		
4 Did a loss result in the release of a foreign tax credit, or is the corporation carrying back a general business credit that was released because of the release of a foreign tax credit (see instructions)? If "Yes," the corporation must file an amended return to carry back the released credits. <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		
5a Was a consolidated return filed for any carryback year or did the corporation join a consolidated group (see instructions)? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		
b If "Yes," enter the tax year ending date and the name of the common parent and its EIN, if different from above (see instructions) ▶		
6a If Form 1138 has been filed, was an extension of time granted for filing the return for the tax year of the NOL? . . <input type="checkbox"/> Yes <input type="checkbox"/> No		
b If "Yes," enter the date to which extension was granted ▶ c Enter the date Form 1138 was filed, ▶		
d Unpaid tax for which Form 1138 is in effect, ▶ \$		
7 If the corporation changed its accounting period, enter the date permission to change was granted ▶		
8 If this is an application for a dissolved corporation, enter date of dissolution ▶		
9 Has the corporation filed a petition in Tax Court for the year or years to which the carryback is to be applied? . . <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		
10 Does this application include a loss or credit from a tax shelter required to be registered? If "Yes," attach Form(s) 8271 <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No		
Computation of Decrease in Tax See instructions.	2nd preceding tax year ended ▶12/31/07	1st preceding tax year ended ▶12/31/08
Note: If only filing for an unused general business credit (line 1c), skip lines 11 through 15.	(a) Before carryback	(b) After carryback
(c) Before carryback	(d) After carryback	(e) Before carryback
(f) After carryback		
11 Taxable income from tax return . . .	250,000	250,000
12 Capital loss carryback (see instructions)		
13 Subtract line 12 from line 11 . . .	250,000	75,000
14 NOL deduction (see instructions) . .	342,000	92,000
15 Taxable income. Subtract line 14 from line 13	0	0
16 Income tax	80,750	0
17 Alternative minimum tax	80,750	0
18 Add lines 16 and 17	0	13,750
19 General business credit (see instructions)		
20 Other credits (see instructions) . . .		
21 Total credits. Add lines 19 and 20 . .		
22 Subtract line 21 from line 18	80,750	0
23 Personal holding company tax (Sch. PH (Form 1120))		
24 Other taxes (see instructions)	80,750	0
25 Total tax liability. Add lines 22 through 24	0	0
26 Enter amount from "After carryback" column on line 25 for each year . . .	0	0
27 Decrease in tax. Subtract line 26 from line 25	80,750	13,750
28 Overpayment of tax due to a claim of right adjustment under section 1341(b)(1) (attach computation)		
Sign Here Under penalties 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.		
Keep a copy of this application for your records.	Signature of officer	Date
Preparer Other Than Taxpayer	Name ▶ Self-prepared Address ▶	Date

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 11170F

Form **1139** (Rev. 8-2006)

CARRYBACK EXPECTED⁴⁷

A corporation that expects to have an NOL in its current year can automatically extend the time for paying all or part of its income tax for the immediately preceding year. It does this by filing Form 1138, *Extension of Time for Payment of Taxes by a Corporation Expecting a Net Operating Loss Carryback*. The payment of tax that may be postponed cannot exceed the expected overpayment from the carryback of the NOL.

To calculate the portion of the tax liability qualifying for extension, **amounts paid or required to have been paid** are subtracted from the total due. For this purpose, only taxes shown on a return or assessed as a deficiency are required to be paid. Estimated tax payments are not included in the requirement. Deficiency assessments are not included in the requirement if the Form 1138 is filed within 10 days of the deficiency notice.

The extension is in effect until the end of the month in which the return for the NOL year is due, including extensions. If the corporation filed Form 1139, *Corporation Application for Tentative Refund*, before this date, the extension will continue until the date the IRS notifies the corporation that its Form 1139 is allowed or disallowed.

Example 15. Use the same facts as **Example 14**. For the tax year 2008, Universe Xpress had not paid any estimated taxes. Himmes prepares the 2008 return in February of 2009. Himmes has already projected a massive loss for tax year 2009. He is certain that the 2009 losses will enable him to file for a refund of prior year taxes in excess of the unpaid 2008 liability. To help preserve the company's cash flow, Himmes files Form 1138 and does not pay any of the 2008 tax.

In theory, Himmes has until March 31, 2010, to pay the 2008 tax. However, when he files the Form 1139 for the 2009 NOL carryback, he extends the time for payment until the IRS approves or disapproves the Form 1139. When the form is approved, the 2008 tax is paid from the refund shown on Form 1139.

⁴⁷ IRC §6164. See also IRS Pub. 542, *Corporations* (2006).

For Example 15

Form 1138 (Rev. 12-2005)

Page **2**

General Instructions

Section references are to the Internal Revenue Code.

Purpose of form. 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.

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.

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.

When and where to file. File Form 1138 after the start of the tax year of the expected NOL but before the tax of the preceding tax year is required to be paid. Generally, file Form 1138 with the Internal Revenue Service Center where the corporation files its income tax return.

A corporation can file Form 1138 separately or with Form 7004, Application for Automatic 6-Month Extension of Time To File Certain Business Income Tax, Information, and Other Returns. If Form 1138 and Form 7004 are filed together, Form 1138 will reduce or eliminate the amount of tax to be deposited when Form 7004 is filed. If Form 1138 is filed with Form 7004, then file Form 1138 with the Internal Revenue Service Center at the applicable address where the corporation files Form 7004.

Period of extension. In general, the extension for paying the tax expires at the end of the month in which the return for the tax year of the expected NOL is required to be filed (including extensions).

The corporation can further extend the time for payment by filing Form 1139, Corporation Application for Tentative Refund, before the period of extension ends. See the instructions for Form 1139. The period will be further extended until the date the IRS informs the corporation that it has allowed or disallowed the application in whole or in part.

Termination of extension. The IRS can terminate the extension if it believes that any part of the form contains erroneous or unreasonable information. The IRS can also terminate the extension if it believes it may not be able to collect the tax.

Interest. Interest is charged on postponed amounts from the dates that the payments would normally be due. The interest is figured at the underpayment rate specified in section 6621.

Specific Instructions

Address. Include the suite, room, or other unit number after the street address. If the Post Office does not deliver mail to the street address and the corporation has a P.O. box, show the box number instead.

If the corporation receives its mail in care of a third party (such as an accountant or attorney), enter on the street address line "C/O" followed by the third party's name and street address or P.O. box.

If your address is outside the United States or its possessions or territories, fill in the line for "City or town, state, and ZIP code" in the following order: city, province or state, and country. Follow the foreign country's practice for entering the postal code, if any. Do not abbreviate the country name.

Line 2. The amount of the expected NOL must be based on all of the facts relating to the operation of the corporation. Consider the following items when estimating the amount of the expected NOL:

1. The number and dollar amounts of the corporation's Government contracts that have been canceled,
2. Profit and loss statements, and
3. Other factors peculiar to the corporation's operations.

See section 172, Pub. 542, Corporations, and Pub. 536, Net Operating Losses for Individuals, Estates, and Trusts, to help determine the amount of the expected NOL. Limitations apply to (a) the amount of taxable income of a new loss corporation for any tax year ending after an ownership change that may be offset by any pre-change NOLs and (b) the use of preacquisition losses of one corporation to offset recognized built-in gains of another corporation. See sections 382 and 384 for details.

Line 3. Enter the reduction of previously determined tax attributable to the carryback, for tax years before the tax year of the NOL. Previously determined tax is generally:

1. The amount shown on the return, plus any amounts assessed as deficiencies before Form 1138 is filed, minus
2. Any abatements, credits, or refunds allowed or made before Form 1138 is filed.

See section 1314(a).

Attach a schedule showing how the reduction was figured. See the instructions for the corporate income tax return for information on figuring the NOL deduction and recomputing the tax.

Line 6a. For the year shown on line 4, enter on line 6a the total of:

1. The total tax shown on the return, plus
2. Any amount assessed as a deficiency (or as interest or a penalty) prior to the filing of this Form 1138.

Line 6b. Enter the total of the following:

1. The amount of tax paid or required to be paid before the date this form is filed. This includes any amount assessed as a deficiency or as interest or a penalty if this form is filed more than 21 calendar days after notice and demand for payment was made (more than 10 business days if the amount for which the notice and demand for payment was made equals or exceeds \$100,000). An amount of tax for which the corporation has received an extension of time to pay (under section 6161) is not considered required to be paid before the end of the extension, plus
2. The amount of refunds, credits, and abatements made before the date this form is filed.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping 3 hr., 21 min.
Learning about the law or the form 42 min.
Preparing and sending the form to the IRS 47 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave. NW, IR-6406, Washington, DC 20224. Do not send Form 1138 to this office. Instead, see *When and where to file*, above.



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NOL CORPORATE CARRYFORWARDS⁴⁸

NOLs may be carried forward until the entire NOL has been used or for 20 years, whichever is sooner. When the available NOL is more than the taxable income for the carryforward year, the remainder is carried to the next year. The amount to carry forward is the excess of the available NOL over the modified taxable income for the carryforward year.

Modified taxable income is the taxable income for that year with the following exceptions:

1. Only the NOLs for years prior to the NOL year whose carryforward is being calculated are deducted. The earlier year NOLs reduce taxable income but do not eliminate it. Therefore, they are included in modified taxable income when determining how much from the NOL year is needed to reduce taxable income to zero.
2. The deduction for charitable contributions is calculated without consideration of any NOL carrybacks.

Example 16. Use the same facts as **Example 14**. After completion of Form 1139, Himmes realizes he has \$17,000 left of the NOL to carryforward to 2010.

Total 2009 NOL	\$342,000
Less carryback to 2007	(250,000)
Less carryback to 2008	(75,000)
Carryforward to 2010	\$ 17,000

On the 2008 original return, the company deducted \$1,000 of charitable contributions to Penguins Unlimited Federation. Although charitable contributions are limited to 10% of the corporation's taxable income, the deduction for charitable contributions was not recalculated when the NOL was applied to 2008 on Form 1139.

He reports the NOL carryforward on Form 1120, Schedule K, line 12. The portion that can be used to offset 2010 taxable income carries to line 29a on the front page of the tax return.

the election will not be made.

12 Enter the available NOL carryover from prior tax years (do not reduce it by any deduction on line 29a.) ► \$ **17,000**

13 Are the corporation's total receipts (line 1a plus lines 4 through 10 on page 1) for the tax year **and** its total assets at the end of the tax year less than \$250,000? **Yes**

If "Yes," the corporation is not required to complete Schedules L, M-1, and M-2 on page 5. Instead, enter the total amount of cash distributions and the book value of property distributions (other than cash) made during the tax year. ► \$

Form **1120** (2009)

Deductions (\$)

26	Other deductions (see instructions)	26	
27	Total deductions. Add lines 12 through 26	27	10,000
28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11	28	50,000
29	Less: a Net operating loss deduction (see instructions)	29a	17,000
	b Special deductions (Schedule C, line 20)	29b	
		29c	17,000

Income. Subtract line 29c from line 28 (see instructions).

OWNERSHIP CHANGES

A profitable company might purchase another corporation with cumulative losses simply for the tax deduction from NOL carryforwards. However, Congress stopped this strategy in 1940 by limiting the amount of the existing NOL that can be used after certain changes in ownership.

⁴⁸ IRS Pub. 542, *Corporations* (2006).

ARRA created an exception for ownership changes occurring after February 17, 2009. To qualify for the exception, the change must be pursuant to a restructuring plan required by an agreement with the Treasury Department.⁴⁹

Note. See IRC §§269, 381–384, and the related regulations for more information about ownership changes.

ALTERNATIVE MINIMUM TAX⁵⁰

In general, a corporation's NOL must be recalculated for AMT purposes using the AMT rules to determine the amount of the NOL that can be subtracted from AMT income. This recalculated NOL is abbreviated as the ATNOL.

However, small corporations and all corporations in their first tax year are exempt from corporate AMT.⁵¹ The AMT adjustments of the NOL apply only to NOLs incurred in tax years after the corporation ceases to be a small corporation.

Example 17. Prior to 2009, the Darkmatter Sales Corp qualified as a small corporation. It has an NOL carryforward from 2008 to 2009. In 2009, it ceased to be a small corporation. The 2008 NOL is **not** recalculated before it is subtracted from AMT income to determine if any AMT is due.

Note. In general, a corporation is considered a small corporation if its average annual gross receipts for the three prior tax years did not exceed \$7.5 million. However, if a corporation has more than \$5 million in gross receipts in its first year of business, it does not qualify as a small corporation.

Some of the deductions that must be adjusted for AMT purposes when determining the amount of the ATNOL are:

1. Depreciation,
2. Dividends received deductions, and
3. Long-term contracts.

An election to forgo the carryback period for regular tax purposes also applies to AMT.⁵² To determine the amount of the ATNOL that remains to carry forward, the ATNOL must be reduced by the corporation's AMT income. This is true even if the ATNOL does not benefit the taxpayer in the current year.

CHANGE IN CORPORATE STATUS⁵³

A C corporation that elects S corporation status cannot carry any NOL losses forward or back to the S corporation year. Likewise, if a corporation terminates its S status, no carryforward or carryback from an S year is allowed to a C year. This is the case because the loss from the S year was already passed through to the shareholders in the loss year.

The years that a corporation is an S corporation count against the taxable years that a loss arising in a C year can be carried forward.

Example 18. The Elzaberg Club incorporated on July 1, 2007. Belatedly, after being in business for twelve months, the shareholders realize that the business would continue to lose money for several years. They decide to elect to be taxed as an S corporation beginning January 1, 2009.

The NOLs incurred for 2007 and 2008 cannot be applied to the taxable income of any future years in which the company is still an S corporation. Regardless, the 2007 NOL expires in 2027 and could be used should they ever terminate the S corporation election.

⁴⁹ IRC §382(n).

⁵⁰ IRC §56(g).

⁵¹ IRC §55(e).

⁵² Rev. Rul. 87-44, 1987-1 CB 3.

⁵³ IRC §1371(b).

CONSOLIDATED GROUPS⁵⁴

A group of affiliated C corporations may file a consolidated return instead of filing separate returns. Advantages of filing a consolidated return include the following:⁵⁵

- Current year NOLs of one corporation offset operating profits of another.
- NOL carryforwards from one corporation may be applied against the income of the consolidated group.
- Capital losses of one corporation offset capital gains of another.
- Dividends received from other corporations in the group qualify for a 100% deduction because they are intercompany dividends.

Disadvantages of filing a consolidated return include the following:

- Compliance with complex regulations is mandatory.
- Tax credits may be limited by operating losses of other members.
- The election to file consolidated returns is binding for future years and may only be terminated by disbanding the group or by the IRS's consent.

An affiliated group includes corporations connected through stock ownership with a common parent corporation.⁵⁶ The common parent must own at least 80% of the voting stock of one of the children corporations, and the stock must have a value equal to at least 80% of the total value of the stock of the offspring. The other children in the group must also meet the 80% tests with respect to the parent or to any sibling corporations.

Note. Consolidated groups with member corporations that are subject to the rules for ownership changes should consult Treas. Reg. §1.1502-21 for more information. The regulations for these groups are not included in this chapter.

The consolidated net operating loss (CNOL) deduction for any consolidated return year consists of:

1. Any CNOLs of the consolidated group, plus
2. Any NOLs of the members arising in separate return years.

NOL carryforwards and carrybacks are generally absorbed in the order of the taxable years in which they arose. CNOLs are attributed to each member in the loss year and absorbed pro rata based on the beginning of the year balance assigned to each member. If members of the consolidated group file separate returns for the NOL year, the NOLs are absorbed on consolidated returns on a pro-rata basis.

In general, any CNOL that is attributable to a member may be carried to a separate return year of the member. Only the amount of the loss apportioned to the member may be used by that member.

In the case of a member that has been part of the consolidated group continuously since its inception, the CNOL attributable to the member is included in the carrybacks to consolidated return years before the member's existence. If the group did not file a consolidated return for a carryback year, the loss may generally be carried back to a separate return year of the common parent.

⁵⁴ Treas. Reg. §1.1502-21.

⁵⁵ *SmartTaxInfo.com*. 2004. [www.smarttaxinfo.com/smallbiz/constaxreturns.html] Accessed on May 22, 2009.

⁵⁶ IRC §1504(a).

Example 19. Leihla owned 100% of two corporations, Nibbler's Popplers (Nibbler's) and Bifocal Ltd. (Bifocal). In 2007, she filed separate corporate returns for each company. In 2008, Nibbler's formed a third corporation, Waste Exploitation (Waste). For 2008, Nibbler's and Waste filed a consolidated return, and Bifocal filed a separate return.

At the beginning of 2009, Nibbler's acquires all the stock of Bifocal from Leihla. All of the companies are now members of the same group. In 2009, all three companies incur losses. The losses are attributable as follows:

Nibbler's	\$ 200
Waste	300
Bifocal	600
Total CNOL	<u>\$1,100</u>

The NOLs that may be carried back to Nibbler's 2007 return total \$500. This includes Nibbler's \$200 loss and the \$300 loss from its offspring corporation, Waste.

Bifocal's loss does not qualify for carryback to Nibbler's return because it was not a member of the consolidated group for the entirety of its existence. Bifocal's loss is carried back to its separate 2007 return. After applying the carryback to 2007 and 2008, \$111 of the NOL remains to carry forward to 2010.

If a corporation ceases to be a member during a consolidated return year, NOL carryforwards attributable to the member are first carried to the consolidated return year and are then subject to reduction under IRC §§108 and 28 (regarding discharge of indebtedness income that is excluded from gross income). The carryforward is then subject to reduction under Treas. Reg. §1.1502-36 (regarding transfers of loss shares of subsidiary stock). Only the amount that is neither absorbed by the group in that year nor reduced under the above rules may be carried to the member's first separate return year.

Example 20. The facts are the same as **Example 19**. On June 30, 2010, Nibbler's sells all of the stock of Bifocal. The group's consolidated return for 2010 includes Bifocal's income through the date of sale. Bifocal files a separate return for the period from July 1, 2010, through December 31, 2010.

The \$111 remaining of Bifocal's NOL from 2009 is applied first to the 2010 consolidated return. Any portion of the loss still remaining is carried to Bifocal's separate return for 2010.

To determine the amount of the CNOL attributable to each member, the NOL for each member is calculated separately. Each member's separate NOL is divided by the total NOLs of the members with losses to determine the percentage attributable to each. The resulting percentage is multiplied by the CNOL.

Example 21. Three corporations are members of a consolidated group. In 2009, one of the companies has income and the other two have losses as follows:

Slurm, Inc.	\$3,000
Mom's Ltd.	(4,000)
Buggoolo Corp.	<u>(1,000)</u>
CNOL	<u>(\$2,000)</u>

The losses are allocated accordingly:

		Percentage of Losses	Allocated CNOL
Mom's Ltd.	\$4,000	80%	\$1,600 (80% of \$2,000)
Buggoolo Corp.	<u>1,000</u>	<u>20%</u>	<u>400 (20% of \$2,000)</u>
Total losses	<u>\$5,000</u>	<u>100%</u>	<u>\$2,000</u>

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A group may make an irrevocable election to relinquish the entire carryback period with respect to a CNOL for any consolidated return year. Generally, the election may not be made separately for any member. The election is filed with the group's consolidated return for the NOL year.

SAMPLE ELECTION:

This is an election under Treas. Reg. §1.1502-21(b)(3)(i) to waive the entire carryback period pursuant to IRC §172(b)(3) for the 2009 CNOLs of the consolidated group of which Mom's Ltd. (FEIN: 12-3456789) is the common parent.

CONCLUSION

Calculating and applying NOLs can be complex. After being immersed in the details, practitioners may want to “step back” and review the big picture. Some questions that practitioners may want to address prior to filing the return for the NOL year include:

1. Is the return for the NOL year being filed timely? If not, the taxpayer cannot elect out of the carryback.
2. What is the proper carryback period?
3. What are the projected tax savings from carrying back the NOL?
4. Has the practitioner consulted with the taxpayer concerning future plans that might affect the projections? For example, does the taxpayer plan to get married or divorced? Will the business be liquidated?
5. What are the projected tax savings from electing out of the carryback period and carrying the NOL forward instead? If the tax rates and tax laws are scheduled to change significantly in the future, are these changes incorporated into the projection?
6. Has the taxpayer been fully informed of the choices?
7. If the taxpayer chooses to carry back the NOL, is it better to use Form 1045 or file amended returns for the carryback years?
8. If there is any NOL carryforward, is it clearly documented so that it will not be overlooked next year?