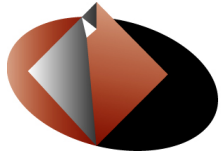


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Nothing Ventured Nothing Lost: You Still Have Two Days to Carry Back Your NOLs All The Way to 2003!

by David Herzog, Associate

April 15. There, I said it. For those of you who have filed and put that behind you, congratulations! For those of you who had a business loss (aka a net operating loss, or NOL), and want to use it against profit for better years, you have until April 17 2009 (yes, a whole two days from now) to elect to go back 5 years, all the way to 2003, to use your loss. Read on!

Introduction

Are you the owner of a small business who had a loss for 2008? It's a little like asking if you owned a small business in 2008, period. If your business has been operating since at least 2005, then a new tax rule regarding your business's operating losses may help you.

As a part of the stimulus package signed into law in February, small businesses may now elect to carryback 2008's net operating loss ("NOL") as far back as 5 years, to 2003.

What's an NOL?

An NOL is, in tax terms, what a business has if, generally speaking, its expenses exceed its income. The business may have income, but it does not have a profit. Because some businesses, especially new ones, incur a tax loss for its first few years, Congress enacted rules which allowed businesses to spread that loss over several years, giving a business the opportunity to reduce its taxes in good years by "saving up" its losses from its bad years. Businesses can carry forward their NOLs for 20 years, and, before the new rules, could carry back their NOLs for two years. So an NOL in 2008 could be used to reduce a profit in 2006, 2007, 2008, and forward. The new rule allows for the NOL to be carried back as far as 2003.

What's a "Small Business"?

The rule is relatively simple. So long as your business's gross receipts over the past three years do not exceed \$15 million, then the business qualifies. The calculation is made by looking at the annual gross receipts of the three years ending with the tax year in which the loss arose. So, for a 2008 NOL carryback, receipts would need to be a total of \$15 million or less for the combined years of 2006, 2007, and 2008. There is room for the argument that the 3-year qualifying period might be the three years prior to the NOL year, that is, 2005, 2006, and 2007. It is expected that the IRS is likely to publish guidance on

this ambiguity.

Why Would You Do This?

If your business had a good year, a profit, say in 2004, the business (or you if the profit was passed through to you via a partnership or S Corporation) paid tax. By carrying back the NOL to a year in which a tax was paid, the carryback produces a refund to the business (or its pass-through shareholders or partners).

How Far Back Should You Go?

Start with a review of your business's tax returns for the past five years. If your business had some good years back to and including 2003, then this new election may be for you. However, there are a few things to look out for.

Some Warnings

You will be tempted to go all the way back to 2003 if you had a profit that year that might produce a refund. You need to do a brief analysis, since tax rates may effect how you apply the election. As a general rule, add up your business's taxable income for the third, fourth, and fifth years before the year in which the NOL arose. If the NOL is more than that number, then you will probably be safe in carrying back to the NOL all the way to the fifth year. On the other hand, if the NOL is less than that combined income number, you may want to consider carrying back the NOL only to the year(s) in which the income was taxed at the highest rate, which would result in the highest refund. In fact, the election to carry back the NOL three to five years may not be for you at all if simply going back the past two tax years may produce the biggest refund.

In addition, once you make the election to go back to a certain year, you can't cherry pick the years after that. If you go back four years, then the NOL must be carried back and through all of the last four years. This is why it is important to do the math for all prior years combined, not just one particular year.

And finally, on the off-chance that you think that 2009 might be your business's lucky year, you may want to preserve your NOL to carry it forward for future years. Even if you gamble wrong, the NOL stays alive for 20 years.

The Election.

To elect to carryback the NOL, the election must be made by the due date (including extensions) for filing the business's tax return for the tax year of the NOL. And be careful, because once the election is made, it is irrevocable.

What If You Already Elected to Go Back Two Years?

You have 60 days from the date the stimulus bill was enacted (enacted February 17, 2009), or April 17, 2009 to revoke your 2-year election, and make an election for a longer period.

Are You in a Hurry for the Refund?

Presumably you are. You should use the tentative (or "quick") carryback procedures. Under those procedures, taxpayers can recover a refund attributable to an NOL carryback before the IRS processes the return filed for the year the NOL arises to expedite the recovery of the refund. That way, the taxpayer won't have to wait until the IRS processes

the return for the NOL year to get the refund.

In Summary

If your business had good years in the past, do the math. Due to the recent change in the law, there's likely a refund waiting for you.

The legal caveat: This article is intended as a general guideline. The rules are complex, and changing continually. Please consult your tax advisor.

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