

IRS PROVIDES GUIDANCE ON CLAIMING EXTENDED NOL CARRYBACKS

When the American Recovery and Reinvestment Act of 2009 (ARRA) was signed into law in February, it included a provision allowing eligible small businesses (ESBs) to carry back a 2008 net operating loss (NOL) for up to five years. Previously, ESBs generally could carry back an NOL only up to two years. As a result of the ARRA provision, companies with significant losses in 2008 may be able to benefit fully from those losses now.

The IRS recently released guidance, which modifies and clarifies making the NOL carryback election.

NOL BASICS

To qualify for an NOL deduction, a business must have expenses in excess of income, though certain modifications apply. Generally, once a business incurs an NOL, it has three options:

1. Carry back the NOL as far as possible and then carry forward any remaining amount.
2. Elect to waive the carryback and to carry forward the entire loss.
3. Elect to carryback to a year within the five year period.

QUALIFYING AS AN ESB

To qualify as an ESB, a company must satisfy the “gross receipts test.” Under the test, a business must have no greater than an average of \$15 million in annual gross receipts during a three-year-period ending with the tax year of the NOL.

Companies with more than \$15 million in average annual gross receipts under the test can still qualify to carry back their 2008 NOL for two years.

MAKING THE ELECTION

Eligible calendar-year filers can elect the extended carryback only for their 2008 tax years. Eligible fiscal-year filers can make the election for a tax year either beginning or ending in 2008.

Under the IRS’ recently released guidance, ESBs may make the election on:

The original federal income tax return. An ESB may attach a statement to its timely filed tax return for the taxable year in which the applicable 2008 NOL arises. The statement is required to say that the company is electing to apply Internal Revenue Code Section 172(b)(1)(H) and it must specify the length of the carryback period elected (three, four or five years).

An appropriate form. If the ESB didn’t make the election on its tax return for the NOL year — and didn’t elect to waive the NOL carryback period — it may make the election by filing the appropriate form, depending on the type of taxpayer.

ESBs must file the appropriate forms on or before the date that is six months after the due date (excluding extensions) for filing the return for the NOL taxable year. Thus, under the ARRA provision, a company seeking to make a timely election using those forms or an amended return must file in advance of the ordinary due date.

MAKING THE ELECTION AS A PARTNER, SHAREHOLDER OR SOLE PROPRIETOR

Taxpayers that are a partner in a partnership ESB, a shareholder in an S corporation ESB or an owner of a sole proprietorship ESB also can make the election.

To determine whether a partnership, S corporation or sole proprietorship qualifies as an ESB, the gross receipts test is applied at the partnership, corporate or sole proprietorship level and the related company aggregation rules apply.

These ESBs are subject to a limitation on the amount of applicable 2008 NOL they can carry back. The amount is limited to the lesser of 1) the ESB's items of income, gain, loss or deduction that are allowed in calculating the taxpayer's applicable 2008 NOL and are from one or more ESB partnerships, S corporations or sole proprietorships, or 2) the ESB's applicable 2008 NOL.

THE CLOCK IS TICKING

Time is limited for calendar year taxpayers with the approaching deadline of September 15, 2009.

The extended NOL carryback period can provide a much-needed cash flow boost to many businesses and business owners. But the rules surrounding it are complex, and you need to act soon. If you'd like to learn whether you can benefit or would like assistance claiming the extended carryback, please contact us. We'd be pleased to help.

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