

NEW JERSEY

CPA

Magazine of the

New Jersey Society of Certified Public Accountants

Nov • Dec 2009

## Tax Matters

---

Tax Update:  
What a Difference  
a Year Makes

New Jersey Nexus  
Law Encourages  
Business Growth

Malpractice Exposure  
in Tax Engagements

Will Sun-Setting Provisions  
Lead to Additional Tax Changes?



# Net Operating Loss Rules to Live By

BY WILLIAM SCHWARZ, CPA, MEISEL, TUTEUR & LEWIS, P.C.

The current economic downturn has caused many taxpayers to sustain net operating losses (NOLs) over the past few years. Financial advisors must carefully examine the rules governing the carryback and carryover of NOLs in order to help clients make the proper decisions related to their particular situation.

## General NOL Treatment

A net operating loss is defined under Internal Revenue Code (IRC) §172(c) as “the excess of deductions over gross income.” The code does make modifications to this definition, most notably for other NOLs carried to the current year, capital losses, personal exemptions and non-business deductions. Since 1997, an NOL can usually be carried back two years and any remaining loss is then carried forward 20 years. A taxpayer can also forgo the carryback, causing the NOL only to be carried forward.

## 2008 NOLs of Eligible Small Businesses

The American Recovery and Reinvestment Tax Act of 2009 extended the carryback period to three, four or five years for applicable 2008 NOLs of eligible small businesses. An applicable 2008 NOL is one

for any tax year ending in 2008. However, fiscal year taxpayers can elect to treat an NOL for any tax year beginning in 2008 as an applicable 2008 NOL. An eligible small business is one that meets an average \$15 million (or less) gross-receipts test for the tax year in which the loss arose. The election is currently only available to one year and is irrevocable. The election must be made by the filing due date, including extensions. Internal Revenue Service Revenue Rule 2009-9 states that the three-, four- or five-year election can be made related to NOLs generated by the highly publicized Madoff Ponzi scheme.

## Federally Declared Disasters

The Emergency Economic Stabilization Act of 2008 added a five-year carryback for qualified disaster losses. A qualified disaster loss is defined as the lesser of the sum of losses in a disaster area and attributable to a federally declared disaster occurring after 2007 and before 2010, plus the qualified expenses deduction allowable for the tax year; or the NOL for the year. Any excess NOL for the year in question will be subject to the general carryback rule. The qualified disaster loss is treated as a separate NOL taken into account after the



general NOL for the year and may not include the loss from certain types of property.

## Farming Losses

An NOL attributable to the income and deductions of a farming business may be carried back for five years, for tax years beginning after 1997. For ordering purposes, the farming loss is treated as a separate NOL taken into account after the general NOL for the year. The taxpayer may elect to apply the general two-year carryback.

## Other Special Situations

IRC §172 also has special NOL provisions related to casualty and theft losses, Gulf Opportunity Zone losses, 2007 Kansas Disaster-Area losses, 2008 Midwestern-Area losses and specified liability (product liability) losses, among others. In addition, IRC §381 governs the carryover of NOLs in corporate mergers and liquidations of subsidiaries, while IRC §382 limits the carryover in a corporate acquisition situation.

## New Jersey Treatment

Since New Jersey personal income taxes are based on gross income, there is no

provision for a personal NOL in the state. However, a corporation filing form CBT-100 may generally carry an NOL forward – not back – seven years (20 years for tax years ending after June 30, 2009). No NOL carryover deduction was allowed for tax years beginning in 2002 or 2003, and the deduction was limited to 50 percent of corporate income for years beginning in 2004 and 2005. The seven-year carryover periods were extended for these suspension periods. For a corporate merger, New Jersey only allows the surviving corporation to carryover the NOLs that it generated.

Many individuals and corporations are generating NOLs during these rough economic times. Taxpayers and their advisors need to properly evaluate all options commensurate to their situation in order to properly determine which alternative will yield the best result. ■

---

*William Schwarz, CPA, M.S.T., is a partner at Meisel, Tuteur & Lewis, P.C. He is also a member of the New Jersey Society of CPAs. Schwarz can be reached at bschwarz@mtlcpa.com or 973-228-4600.*