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TAX & ESTATES DEPARTMENT

ALERT

Time Is Running Out to Take Advantage of Extended Net Operating Loss Carryback Benefits Under the Worker, Homeownership and Business Assistance Act of 2009

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The Worker, Homeownership and Business Assistance Act of 2009 (Pub. L. No. 111-92, 123 Stat. 29840) (the Act) was signed into law by President Obama late last year. However, it is important for taxpayers to be fully acquainted with certain benefits available under the Act, because the deadlines for claiming these benefits are impending. Of particular importance are the changes made to section 172 of the Internal Revenue Code, which extended the number of years to which net operating losses may be carried back.

Generally, for federal income tax purposes, section 172 allows taxpayers to deduct against a particular year's taxable income the aggregate of the net operating loss carryovers and carrybacks that are carried over to the particular year. In other words, a taxpayer that has a net operating loss may carry that loss over to other taxable years and deduct the loss against the taxable income of the taxable year to which the loss was carried. Net operating losses may ordinarily be carried back to the two taxable years preceding the year of the loss and forward to each of the 20 years following the year of the loss. A carryforward will only be available in two circumstances: (1) if the net operating loss is not deducted in its entirety against the taxable income of the carryback years, the remaining net operating loss may be carried forward; and (2) a taxpayer may elect to waive the two-year carryback period and therefore, only carry the loss on a forward basis.

Losses that are carried back or forward must be carried over to the earliest taxable year to which they may be carried. For example, if a taxpayer incurs a net operating loss in 2010, that loss may be carried back first to 2008 and then to 2009 if no election is made to relinquish the carryback period. If the loss is not fully utilized in 2008 and 2009, the remaining loss may be carried forward to 2011 and subsequent years in seriatim until the loss is completely utilized. In this example, the loss cannot be carried beyond 2030, which is the end of the 20-year carryforward period for losses arising in 2010.

Under the relevant portion of the Act, a taxpayer can elect, with respect to an "applicable net operating loss," to carryback the loss for up to five years (i.e., the taxpayer elects whether to carry the loss back for three, four or five years). This extended carryback period is available only for "applicable net operating losses," which are net operating losses that arise in a taxable year ending in either 2008 or 2009. Taxpayers must elect which year's net operating loss they wish to carry back as the election can be made with respect to only one year (i.e., 2008 or 2009). And if the five-year carryback period is elected, there is a limitation on the net operating losses that may be carried back to the fifth year. The losses carried back to the fifth year may not exceed 50 percent of the taxpayer's fifth-year taxable income as determined under applicable rules.

The due date for making an election to make use of the extended carryback period is the due date for the taxpayer's 2009 return including filing extensions. For C corporations, the deadline for making the election is September 15, 2010, regardless of whether a federal income tax return for 2009 has already been filed. Individuals have until October 15, 2010, to make the election, again, regardless of whether a federal income tax return for 2009 has already been filed. The Internal Revenue Service (IRS) has issued guidance and procedures for making the election in cases where the 2009 return has not yet been filed and where the return has already been filed. In order to make a valid election, it is imperative all requirements for making the election be complied exactly as required by the IRS. Taxpayers should be aware that the election is not considered a claim for refund, and proper filings will have to be made to effectuate any election to carry net operating losses beyond the standard two-year period.

When determining the amount of any refund claim arising from the carryback of an "applicable net operating loss," taxpayers should keep in mind that the Act made conforming changes to the alternative minimum tax rules. These changes suspend the 90 percent limitation on the use of the net operating losses with respect to which a carryback election is made.

While the rules for carrying back net operating losses appear relatively simple, the determination of whether to make the election requires thorough analysis of a taxpayer's circumstances. In some cases, and considering that the current reduction in individual income tax rates is set to expire after 2010, it may not be advisable to make an election under the Act and may prove more efficient to waive the carryback period in its entirety. Further, any carryback elections under the Act must be made in accordance with the procedures established by the IRS, including Rev. Proc. 2009-52, 2009-49 IRB 744 and Notice 2010-58, 2010-37 IRB, the latter of which was recently issued by the IRS.

Taxpayers should consult with their tax advisors to determine whether they may make use of the extended carryback period and what the best tax strategy may be with respect to the taxpayer's particular circumstances.

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