RURAL TAX EDUCATION

RTE/2026-10

July 2026 RuralTax.org

Net Operating Loss Rules for Farm Businesses [*]

JC Hobbs, *Associate Extension Specialist*
Agricultural Economics Department, Oklahoma State University

Introduction

Variable input and commodity prices, weather, disease, and casualties cause farm income to fluctuate from one year to the next. Farmers can minimize their income tax liability by managing the timing of their income and deductions to keep their taxable income level from one year to the next. In some situations, leveling techniques are not enough to avoid a spike in taxable income or a dip that causes taxable income to go below zero. The tax effect of the spikes can be minimized with income averaging rules. The tax impact of the dips below zero is determined by the net operating loss (NOL) rules applicable to farm businesses, which are discussed in this fact sheet.

A loss from operating a business is the most common reason for an NOL. The concept of the NOL rules is quite simple, but special rules do apply to farm NOLs. Taxpayers are allowed to carry NOLs from the loss year to offset taxable income in other tax years. In the case of a farm loss, it can be carried back 2 years and/or forward indefinitely. Only farmers have the ability to carry a net operating loss back, all other taxpayers must carry a net operating loss forward to future years.

Planning Pointer: The NOL rules **do not** make the best use of business deductions. Also, the NOL carryback or carryforward amount will not reduce the amount of self-employment tax owed. In addition, the taxpayer's standard deduction or itemized deduction, whichever is larger, is disallowed for the NOL calculation. Therefore, farmers should first try to level their taxable income with leveling techniques such as using a slower write-off depreciation method. When

[*] **This material is based upon work supported by the U.S. Department of Agriculture, under agreement number FSA21CPT0012032. Any opinions, findings, conclusions, or recommendations expressed in this publication are those of the author(s) and do not necessarily reflect the views of the U.S. Department of Agriculture. In addition, any reference to specific brands or types of products or services does not constitute or imply an endorsement by the U.S. Department of Agriculture for those products or services.**

This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.

those techniques are not sufficient to avoid negative taxable income, the NOL rules make the best of an unfortunate situation.

Net Operating Loss Limitation

If you have a net operating loss attributable to your farming business, you must first carry it back two years; any remaining amount is carried forward. Taxpayers with a farming NOL can elect to forgo the carryback requirement and carry forward the farm net operating loss to future tax years. Once the carryback requirement is waived, the election is generally irrevocable.

If you choose to carry an NOL back, it must first be applied to earliest of the 2 years and if the NOL is not fully absorbed in that year it is applied to the next earliest year. Using the following example (Example 1), the loss year is 2025 so the NOL must first be carried back to 2023. Since the NOL was not fully used up in 2023, the remaining amount is carried to 2024. Any remaining amount of the NOL is then carried forward to 2026 and into future years until it fully offsets taxable income.

Example 1:

April May started her horticulture farm in 2020 as a sole proprietor and had several good years as her business blossomed through 2024. In 2025, a late frost, followed by a June hailstorm and a drought in August, led to an $80,000 farm loss that year. She had no other income or losses that year. April carried her $80,000 farm NOL back to 2023, which absorbed $32,000 of the NOL. The remaining $48,000 is carried to 2024 and subsequent years as shown below.

Carryback or Carryforward Year	Year	NOL Carryback or Carryforward	NOL Absorbed	NOL Remaining
Second year before loss year	2023	80,000	32,000	48,000
First year before loss year	2024	48,000	28,000	20,000
First year after loss year	2026	20,000	13,000	7,000

The $7,000 NOL remaining may be carried forward indefinitely or until fully absorbed.

A net operating loss may occur when the deductions, including casualty and theft loss deductions, are greater than the income for the year. Adjustments and limitations must be taken into consideration to determine if an NOL exists. In addition, for NOLs that are created in 2018 or later, the NOL is subject to an 80% of taxable income limit in the year that it is carried to. Refer to the following example (Example 2), which illustrates the amount of the annual NOL deduction utilizing the carryback rules.

This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.

Example 2:

In 2025, April May had an $80,000 net operating loss. She decided to carry the loss back to 2023 and 2024. Her 2023 taxable income before carrying back the 2025 NOL was $40,000, so only $32,000 ($40,000 ×80%) of the $80,000 NOL could be absorbed. April had $35,000 of taxable income in 2024, which absorbed another $28,000 ($35,000 × 80%) of the NOL. Since 2025 was the loss year, no deduction is allowed, and the remaining $7,000 of the NOL is then carried forward to 2026 and future years if the NOL is not fully absorbed in 2026. The 80% limitation of taxable income also applies to the future years.

If a farmer elects out of the carryback of the NOL and simply carries it forward to future years, the 80% limitation of taxable income applies to each year that the NOL is carried to.

Note. If a taxpayer does not elect out of the carryback, **the NOL is absorbed by the carryback years, whether or not the NOL deduction is claimed for those years**.

Claiming an NOL Deduction

A taxpayer with an NOL which is carried back to prior years should claim the deduction by either filing an amended tax return (*Form 1040-X, Amended U.S. Individual Income Tax Return*) for each carryback year or by filing *Form 1045, Application for Tentative Refund* to claim the refund for both carryback years at the same time. For a calendar year taxpayer, *Form 1045, Application for Tentative Refund* must generally be filed by December 31 of the year following the year of loss. Farmers who decide to forgo the carryback periods must attach a statement with the original return for the loss year indicating that they are waiving the carryback period. The original return must be filed by the due date (including extensions) for the NOL year.

Example 3:

Continuing with the same facts as Example 2, when carrying back her farm NOL, April has two options to claim a refund of income taxes paid in 2023 and 2024. The first option is to file an amended return (*Form 1040-X, Amended U.S. Individual Income Tax Return*) for 2023 and an amended return for 2024. Her alternative option is to file *Form 1045, Application for Tentative Refund* to claim a refund for both 2023 and 2024. If she chooses the second option, *Form 1045, Application for Tentative Refund* must be filed by December 31, 2026.

This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.

Summary

Planning the timing of income, deductions, gains, and losses can maximize the benefit of the NOL rules.

It is helpful to keep in mind that certain tax benefits are removed to determine the NOL carried to the first eligible year, and the NOL carried to each subsequent year. Therefore, whether the NOL is expressed as a positive number (i.e., as a deduction) or a negative number (i.e., as the taxable loss), removal of the other tax benefits decreases the NOL.

It is also important to remember that the NOL deduction claimed in any carryback or carryforward year is not necessarily the amount of the NOL that is absorbed that year. A year to which the NOL is carried can use up more of the NOL than that year's taxable income before modifications.

IRS Publications

IRS forms and publications can be found by going to www.irs.gov and typing in the name of the publication/form or the publication/form number in the search bar toward the top of the webpage. Publications may be viewed online or downloaded.

- **IRS Form 172 and Instructions for Form 172: Net Operating Losses (NOLs) for Individuals, Estates and Trusts**. These items provide more information on net operating losses.

Additional Topics

This fact sheet was written as part of Rural Tax Education, a national effort including Cooperative Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets, and additional information related to agricultural income tax, please see RuralTax.org.

Fact sheets that might be of interest include
- Tax Planning for Farmers
- Managing Income Taxes Before Year End
- Managing Income Taxes Before Year End

This information is intended for educational purposes only. You are encouraged to seek the advice of your tax or legal advisor, or other authoritative sources, regarding the application of these general tax principles to your individual circumstances. Pursuant to Treasury Department (IRS) Circular 230 Regulations, any federal tax advice contained here is not intended or written to be used, and may not be used, for the purpose

This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.

of avoiding tax-related penalties or promoting, marketing or recommending to another party any tax-related matters addressed herein.

USDA is an equal opportunity provider, employer, and lender. Rural Tax Education is part of the National Farm Income Tax Extension Committee. The land-grant universities involved in Rural Tax Education are affirmative action/equal opportunity institutions.

This information is intended for educational purposes only. Seek the advice of your tax professional regarding the application of these general principles to your individual circumstances.