

Net Operating Losses

01/20/2025

Introduction

Weather, disease and variable prices for inputs and commodities cause farmer's 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. In some cases, the leveling technique is 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 effect of the dips below zero can be managed with the net operating loss (NOL) rules discussed in this fact sheet.

The concept of the NOL rules is quite simple. Taxpayers are allowed to carry business losses from the loss year to offset taxable income in other tax years. A farm loss can be carried back and/or forward.

To have an NOL, your loss must generally be caused by deductions from your:

- Trade or business,
- Work as an employee (although not usually deductible for 2018 through 2025),
- Casualty and theft losses resulting from a federally declared disaster,
- Rental property
- Moving expenses (although not generally deductible for 2018 through 2025)

A loss from operating a business is the most common reason for an NOL. Partnerships and S Corporations cannot use an NOL. However, partners or shareholders can use their separate shares of the partnership's or S corporations' business income and business deductions to figure their individual NOLs.

Planning Pointer: The NOL rules **do not** make the best use of business deductions. Therefore, farmers should first try to level their taxable income with leveling techniques. When those techniques are not sufficient to avoid negative taxable income, the NOL rules make the best of an unfortunate situation.

Annual Losses Limited

Excess business losses for noncorporate taxpayers are limited for tax years beginning after 2020 and ending before 2029. Generally, any disallowed loss is treated as an NOL carryover to later years. Also, excess business losses are now computed without regard to any deduction allowed under IRS section 172 or 199A and without regard to any deductions, gross income, or gains attributable to any trade or business of performing services as an employee. You can't deduct net losses in excess of a threshold amount in the current year. For 2024, excess means total (modified) business deductions over the sum of total gross business income plus \$305,000 ((\$610,000 for joint returns). The excess is treated as an NOL to be carried forward. Further, when carryforwards can be used, they can only offset 80% of taxable income in future years.

Carrying Rules

Unlike most NOLs, a farm NOL is carried back 2 years unless the taxpayer elects to forgo the carryback. If it is not fully absorbed (used up) in the second carryback year, the excess is carried to the first prior year. If an NOL remains after being carried to the first year before the loss year, the balance is carried to the year after the loss year and then to subsequent years until it is fully absorbed. The NOL can be carried forward indefinitely until it is absorbed. Farmers had a 5-year carryback rule in the past but do not have it under current law.

Example 1:

Pete Moss started his horticulture farm in 2018 as a sole proprietor and had several good years as his business blossomed through 2024. A late frost in 2024 followed by a late June hail storm and a drought in August led to an \$80,000 farm loss that year. He had no other income or losses that year. Pete carried his \$80,000 farm NOL back to 2022, which absorbed \$32,000 of the NOL. The remaining \$48,000 is carried to 2023 and subsequent years as shown below.

Carryback or Carryforward Year	Year	NOL Carryback or Carryforward	NOL Absorbed	NOL Remaining
Second year	2022	80,000	32,000	48,000

before loss year				
First year before loss year	2023	48,000	28,000	20,000
First year after loss year	2025	20,000	13,000	7,000

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

Although the principle of NOLs is simple, actual computation of NOL deductions can be complex. Complexity arises because the NOL is limited to business losses that are not carried to other years under other tax rules such as the capital loss carryover rules. These limitations require taxpayers to add back some expenses and losses that were deducted to compute their taxable income. The NOL computations are further complicated by modifications that are required to compute taxable income in the years to which the NOL is carried.

Computing the NOL

One way to compute an NOL is to start with negative taxable income for the year and add back the deductions that are not allowed to be included in the NOL.

Note. If you have positive taxable income for a tax year, you do not have an NOL for that year even if your business has a net loss. Positive taxable income indicates that you have income from other sources (such as wages, non-business income, or income from other businesses) that use up all of the business loss, so there is nothing left to carry to another tax year.

Items Not Included in NOL

Several items that are included in the calculation of taxable income are not included in the NOL calculation. These usually are excluded from the NOL computation for one of two reasons.

- Generally, only **business** losses can be carried from one year to another; therefore, with a few exceptions, non-business deductions in excess of business income are not included in the NOL.

- Items that **carry to another tax year** under another carryover rule—such as capital loss carryovers—are excluded from the NOL calculation to avoid duplication.

The following items are examples of deductions that are excluded from the NOL by adding them back to the taxpayer's negative taxable income:

1. Dependent and personal exemptions deduction (currently zero until 2026)

Note. Tax law changes in 2017 made dependent and personal exemption deductions zero until 2026. Since we anticipate them coming back in that year, this discussion refers to them although the current IRS Publication 536, *Net Operating Losses (NOLs) for Individuals, Estates and Trusts*, generally does not address them. It can be accessed from the IRS website, www.irs.gov.

1. Non-business deductions (such as itemized deductions or the standard deduction, alimony paid, health savings and Archer medical savings account deductions, and the deduction for contributions to a retirement plan) in excess of non-business income (such as interest, dividends, taxable social security benefits, taxable IRA distributions, and pension benefits)
2. Capital losses in excess of capital gains
3. An NOL deduction carried from another year
4. The section 199A deduction for qualified business income (QBI)

Example 2:

Paige Turner's taxable income for 2024 (before deducting exemptions, currently zero until 2026) is a negative \$10,000 due to both business losses and non-business deductions. If her non-business deductions exceed her non-business income by \$6,000, she must add that \$6,000 back to her negative \$10,000 taxable income, which reduces her NOL to \$4,000.

If Paige's non-business deductions exceed her non-business income by more than her \$10,000 negative taxable income, she does not have an NOL.

Business Income and Deductions

Business income and deductions are defined broadly for purposes of the NOL calculation. They include not only the ordinary income and deductions from a trade or business but also gain or loss from the disposition of both real property used in a trade or business and depreciable

property used in a trade or business. Being employed is treated as a trade or business, which means wages are business income and deductible employee expenses are business deductions.

An exception to the business-connection requirement is that deductions attributable to casualty and theft losses from property held for personal use or for investment are treated as business losses for the NOL calculation even though they are not connected with a trade or business.

Note. Classifying **ordinary income and capital gain as non-business** is advantageous to the taxpayer because it reduces the amount of non-business deductions that must be added back to compute the NOL. Similarly, classifying **deductions and capital losses as business** is advantageous to the taxpayer.

Example 3:

Neil Down, who is not married and does not itemize deductions, realized a

\$15,000 loss from his sole-proprietor farming business in 2024. However, due to other income and deductions as shown below, his taxable income for 2024 was a negative \$22,600.

Income or Deduction	Amount
Business loss	(\$15,000)
Wage income	6,000
Investment income	<u>1,000</u>
Adjusted gross income	(\$8,000)
Personal exemption deduction	(0)
Standard deduction	(14,600)
Taxable income	(\$22,600)

In calculating his NOL, Neil is not allowed to deduct his personal exemption deduction (which is zero until the law changes it in 2026). He can deduct \$1,000 of his standard deduction because he has \$1,000 of non-business (investment) income. Consequently, Neil adds back his zero personal exemption deduction and \$13,600 (\$14,600 – \$1,000) of his standard deduction to his negative \$22,600 taxable income to compute his \$9,000 (\$22,600 – \$0 – \$13,600) NOL.

Note. Note that the \$9,000 NOL equals the sum of Neil's negative \$8,000 AGI and the \$1,000 portion of his standard deduction that is allowed by his \$1,000 investment income. His NOL could also be viewed as his \$15,000 business loss reduced by his \$6,000 of wage income.

Carrying the NOL Back or Forward

Most NOLs are carried forward only. However, NOLs from a farming business qualify for a 2-year carryback period.

Farming Loss

Taxpayers who have an NOL from a farming business can carry that NOL back 2 years and then forward indefinitely. A farming business is a trade or business involving cultivation of land, raising or harvesting of any agricultural or horticultural commodity, operating a nursery or sod farm, raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees. Raising, shearing, feeding, caring for, training, and management of animals are also farming businesses. A farming business does not include contract harvesting of an agricultural or horticultural commodity grown or raised by someone else, or a business in which the taxpayer merely buys or sells plants or animals grown or raised entirely by someone else.

Allocation of NOL that includes a farming loss

A farming loss is the lesser of two amounts:

1. The NOL computed for the tax year using only the income and deductions attributable to the farming businesses
2. The NOL for the tax year.

Therefore, the taxpayer's total NOL is allocated first to the farming loss and then to other losses.

Example 4:

Sandy Beach owns and operates a crop farm. Her husband, Rocky Beach, owns and operates a trucking business. They have no children and file a joint federal income tax return. In 2024, Sandy had a \$70,000 loss from her farming business and Rocky had a \$30,000 loss from his trucking business. Rocky earned \$20,000 in wages from a temporary job, and they earned \$5,500 of taxable interest on certificates of deposit. They file a joint federal

income tax return. Sandy and Rocky Beach's \$80,000 NOL for 2024 is calculated as shown below.

Income, Deduction or Loss	Amount
Wages	\$20,000
Taxable interest	5,500
Farming business loss	(70,000)
Trucking business loss	<u>(30,000)</u>
Adjusted gross income	(\$74,500)
Standard deduction	(29,200)
Personal exemption deductions	<u>(0)</u>
Taxable income	(\$103,700)
Add back excess standard deduction	
(\$29,200 – \$5,500 non-business income)	23,700
Add back personal exemption deductions	0
NOL	<u>(\$80,000)</u>

Question 1.

What is the NOL computed using only Sandy's farm income and expenses?

Answer 1.

It is the \$70,000 farm loss shown above. Therefore, \$70,000 of their total NOL is a farming NOL that is eligible for the 2-year carryback and the remaining \$10,000 NOL is treated as coming from Rocky's trucking business and is eligible for carryforward.

Question 2.

What if Rocky's wages are \$35,000 instead of \$20,000 so that their taxable income is increased by \$15,000?

Answer 2.

Their taxable income is now a negative \$88,700 (\$103,700 - \$15,000) and their total NOL is \$65,000 (\$88,700 - \$0 - \$23,700). The farming NOL is limited to the \$65,000 total NOL and there is no NOL treated as coming from Rocky's trucking business.

Election to Forgo Carryback

Farmers who decide to forgo the carryback periods must attach a statement with the original return for the loss year that they are waiving the carryback period. The original return must be filed by the due date (including extensions) for the NOL year. This statement must show that you are choosing to waive the carryback period under section 172(b). If the original return was filed by the unextended due date without the election statement, the taxpayer can make the election on an amended return that is filed within 6 months of the unextended due date. Attach a statement to your amended return, and write "Filed pursuant to section 301.9100-2" at the top of the statement. Once you choose to waive the carryback period, it is generally irrevocable. If not filed on time, you cannot waive the carryback period.

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.**

Example 5:

Sandy and Rocky from Example 4 decided to not carry their 2024 NOL back but failed to make the election to forgo the carryback on their 2024 income tax return or an amended return. Their \$70,000 NOL from 2024 is absorbed by their 2022 and 2023 modified taxable income as described in the next section whether or not they claim a refund for those years. As explained later in this chapter, Sandy and Rocky have until April 15, 2028 (October 15, 2028 if they extended the due date of their 2024 income tax return) to file amended returns for 2022 and 2023 to claim a refund from the NOL deductions for those years. If they do not claim the refund by that date, they are barred from claiming the refund even though the NOL is absorbed by those carryback years.

Note. The burden is on the taxpayer to show the amount of NOL that is available to deduct in a carryforward year. If a taxpayer did not deduct an NOL in a closed year, the

taxpayer must still keep records of the NOL absorption to verify the NOL carried to each tax year.

How to Claim an NOL Deduction

If you have not already carried the NOL to an earlier year, your NOL deduction for tax years beginning after December 31, 2020, cannot exceed the sum of:

1. The NOLs carried to the year from tax years beginning before January 1, 2018; plus
2. The lesser of:
 - a. The NOLs carried to the year from tax years beginning after December 31, 2017, or
 - b. 80% of the excess (if any) of taxable income computed without regard to deductions for NOLs, or Qualified Business Income (QBI), or section 250 deductions, over the NOLs carried to the year from tax years beginning before January 1, 2018.

If you carried the NOL to an earlier year, your NOL deduction is the carried over NOL minus the NOL amount you used in the earlier year or years. If you carry more than one NOL to the same year, your NOL deduction is the total of these carrybacks and carryovers.

Absorbing the NOL

The amount of an NOL that is absorbed (used up) by a year to which it is carried is equal to that year's modified taxable income. Modified taxable income is taxable income figured with these changes:

1. You cannot claim an NOL deduction for the NOL carryover you are figuring or for any later NOL.
2. You cannot claim a deduction for capital losses in excess of your capital gains. Also, you must increase taxable income by the amount of any section 1202 exclusion.
3. You cannot claim a deduction for your exemptions for yourself, your spouse, or your dependents (zero until 2026).
4. You must figure any item affected by the amount of your AGI after making the changes in (1), (2), and (3) above and certain other changes to your AGI that result from them. This includes income and deduction items used to figure AGI (for example,

IRA deductions), as well as certain itemized deductions. To figure a charitable contribution deduction, do not include deductions for NOL carrybacks in the change in (1) but do include deductions for NOL carryforwards from tax years before the NOL year.

Your taxable income as modified cannot be less than zero. Worksheets in Publication 536 help figure an NOL as well as carryforward.

Therefore, the amount that is carried to the second eligible year is the beginning NOL minus the first eligible year's modified taxable income. The NOL carried to the third eligible year is the amount carried to the second year minus the second year's modified taxable income. This process is repeated until the NOL is fully absorbed.

Example 6:

Sandy and Rocky from Example 4 carried Sandy's \$70,000 farm NOL from 2024 back to 2022. Sandy and Rocky had \$50,000 of taxable income on their 2022 and 2023 income tax returns. Assume \$2,000 and \$3,000 adjustments for modified taxable income in 2022 and 2023. Note that the 80% NOL deduction limitation has an effect.

Sandy and Rocky can claim a \$70,000 NOL deduction on their 2022 income tax return, which reduces their taxable income to \$10,000 (80% of \$50,000, taxable income limitation). The 2022 year absorbs \$42,000 (\$40,000 of taxable income + \$2,000 adjustments for modified taxable income) of the \$70,000 NOL so they have \$28,000 of the NOL left to carry to 2023. Because their \$53,000 (\$50,000 taxable income + \$3,000) modified taxable income in 2023 is greater than the NOL carried to 2023, the \$28,000 remaining NOL is absorbed in 2023 and there is nothing to carry to 2025 and subsequent years.

Because modified taxable income is equal or greater than taxable income, more NOL may be absorbed in each year than the amount of taxable income offset by the NOL if it is greater. Therefore, some of the NOL deduction may be wasted by each intervening year to which the NOL is carried if the NOL is greater than the taxable income for that intervening year.

Example 7:

In Example 7, the NOL deduction on the 2022 income tax return reduced their

\$50,000 taxable income to \$10,000 but the 2022 year absorbed \$42,000 of the NOL carryover. Sandy and Rocky lost the benefit of \$2,000 of deductions.

Planning Pointer: Two planning techniques can reduce or eliminate the lost deductions.

1. Choose the first carryback or carryforward year so that the NOL is absorbed in as few intervening years as possible.
2. Avoid the NOL by spreading income evenly over several tax years.

Calculating Taxes in Carryback and Carryforward Years

If an NOL is carried back, it is claimed as a deduction that reduces taxable income and tax for the carryback year. The recalculation of tax in a carryback year is complicated because the NOL deduction reduces AGI and that reduction in AGI may affect itemized deductions and after 2025, personal and dependent exemption deductions. Consequently, the affected deductions must be recalculated.

Taxpayers can get a quick refund of taxes paid in prior years by filing Form 1045, Application for Tentative Refund, no later than the end of the tax year following the year the NOL occurred. For example, Sandy and Rocky in Example 6 have until December 31, 2025 to file a Form 1045 to claim a refund for the NOL carried back to 2022 and 2023.

Taxpayers can also claim a refund from carrying an NOL back by filing a Form 1040X, Amended U.S. Individual Income Tax Return, for each of the carryback years. Form 1040X must be filed within 3 years of the due date (including extensions) for the loss year tax return. For example, Sandy and Rocky from Example 6 have until April 15, 2028 (3 years after the April 15, 2025 due date of the 2024 return) to file amended returns for 2022 and 2023 to claim refunds from the NOL carried back from 2024. If they extended the due date of the 2024 return to October 15, 2025, they have until October 15, 2028 to amend the 2022 and 2023 tax returns.

Note. As noted earlier in this fact sheet, the election to forgo the carryback must be made on the tax return for the year the NOL occurred or on an amended return for that year filed within 6 months (excluding extensions) of the

due date for the original return. A calendar year taxpayer has until October 15, 2025, to elect on an amended return to forgo the carryback of a 2024 NOL. If this deadline is not met, the taxpayer cannot forgo the carryback.

NOL Carried Between Joint and Separate Returns

If the taxpayer's filing status is not the same in the loss year and in all of the carryback or carryforward years, allocations may be required. If a taxpayer and spouse were not married to each other in all years involved in figuring NOL carrybacks and carryovers, only the spouse who had the loss can take the NOL deduction. If filing a joint return, the NOL deduction is limited to the income of that spouse.

For example, if your marital status changes because of death or divorce, and in a later year you have an NOL, you can carry back that loss only to the part of the income reported on the joint return (filed with your former spouse) that was related to your taxable income. After you deduct the NOL in the carryback year, the joint rates apply to the resulting taxable income.

Refund Limit

If you are not married in the NOL year (or are married to a different spouse), and in the carryback year you were married and filed a joint return, your refund for the overpaid joint tax may be limited. You can claim a refund for the difference between your share of the refigured tax and your contribution toward the tax paid on the joint return. The refund cannot be more than the joint overpayment. Attach a statement showing how you figured your refund.

Separate to Joint Returns

If you and your spouse file a joint return for the tax year, and were married but filed separate returns for any of the tax years involved in figuring the NOL carryback or carryover, treat the separate carryback or carryover as a joint carryback or carryover.

Joint to Separate Returns

If you and your spouse file separate returns for a tax year, but filed a joint return for any or all of the tax years involved in figuring the NOL carryover, figure each of your carryovers separately, by separating the NOL portion for each spouse from within the joint return.

Because the joint NOL is being carried to a tax year involving separate returns, the separate NOL of each spouse must be figured.

Example 8:

Mark and Nancy are married and file a joint return for 2023. They have an NOL of \$5,000 from a farming business. They carry the NOL back to 2021, a year in which Mark and Nancy filed separate returns. Figured separately, Nancy's 2023 deductions were more than

her income, and Mark's income was more than his deductions. Mark does not have any NOL to carry back. Nancy can carry back the entire \$5,000 NOL to her 2021 separate return.

Example 9:

Assume the same facts as in Example 1, except that both Mark and Nancy had deductions in 2023 that were more than their income. Figured separately, his NOL is \$1,800 and her NOL is \$3,000. The sum of their separate NOLs (\$4,800) is less than their \$5,000 joint NOL because his deductions included a \$200 net capital loss that is not allowed in figuring his separate NOL. The loss is allowed in figuring their joint NOL because it was offset by Nancy's capital gains. Mark's share of their \$5,000 joint NOL is \$1,875 ($\$5,000 \times \$1,800/\$4,800$) and Nancy's is \$3,125 ($\$5,000 - \$1,875$).

See *IRS Pub 536 for explanation to figure these numbers*

Making Optimal Use of an NOL Deduction

The tax benefit of an NOL can be squandered if other tax benefits are used in the loss year or in a year the NOL deduction is claimed.

Other tax benefits may waste NOLs in two ways.

1. They may reduce an NOL in a loss year, even though they do not reduce taxable income in that or any other year.
2. In years that an NOL deduction is claimed (carryback and carryforward years), other tax benefits may reduce the NOL to be carried to subsequent years even though they do not reduce taxable income in that year or any other year.

Because some of those tax benefits could be shifted to another tax year, it is useful to know which of them waste NOLs.

Excess Non-Business Deductions and Losses

If non-business deductions exceed non-business ordinary income plus excess non-business capital gains in an NOL year, **the excess non-business deductions will never provide a tax benefit.**

Shifting Non-Business Deductions Away from Loss Year

One way to get a tax benefit from the excess non-business deductions is to shift them to another tax year.

- If those deductions are shifted to a year that has no NOL, they will offset taxable income in that year.
- If they are shifted to a year when there is an NOL but non-business ordinary income plus net non-business capital gains exceed non-business deductions, they will increase the NOL.

Shifting excess non-business deductions involves the same kind of planning as bunching itemized deductions every other year and claiming the standard deduction in the alternate years. Therefore, deductions you can shift away from the NOL year include medical expenses, taxes, interest expenses, charitable contributions, and miscellaneous deductions. If you are making less than the maximum retirement plan contributions, contributions could be bunched in the years where they would offset taxable income or add to the NOL.

Example 10:

Guy and Barb Wire's tax advisor projects that they will have a \$40,000 NOL for 2024. Included in that projection are \$34,000 of itemized deductions of which \$4,000 is real estate taxes that can be paid in 2024 or postponed until 2025. Their non-business income is \$2,000 of interest income.

The \$32,000 of itemized deductions in excess of their \$2,000 of interest income provide no tax benefit—they do not increase their 2024 NOL and they do not reduce taxable income in 2024. If Guy and Barb postpone paying the \$4,000 of real estate taxes until 2025 and have \$4,000 or more of taxable income in 2025, they can preserve the tax benefit of deducting the payment of those taxes.

Shifting the \$4,000 payment to 2025 does not affect their 2024 NOL (it is still \$40,000) and it allows them to deduct the \$4,000 from their 2025 taxable income. If they are in the 12% federal income tax bracket in 2025, the deduction will save them \$480 ($\$4,000 \times 12\%$) of federal income taxes.

Barb and Guy could further reduce their 2025 taxable income without decreasing their 2024 NOL by shifting other non-business deductions to 2025.

Shifting Non-Business Income to Loss Year

The problem of losing the benefits of a deduction because non-business deductions in excess of non-business ordinary income plus excess non-business capital gains can also be alleviated by increasing the total amount of non-business ordinary income and non-business capital gains in the loss year. Such an increase will be effectively tax-free until the sum of non-business ordinary income and excess non-business capital gains equals non-business deductions.

If non-business ordinary income or non-business capital gains are shifted from a year without an NOL to an NOL year in which non-business deductions exceed the total of non-business ordinary income and net non-business capital gains, the shifted income is tax-free. The same result occurs if non-business ordinary income is shifted from an NOL year with an excess of non-business ordinary income and net non-business capital gains over non-business deductions.

Example 11:

Guy and Barb Wire from Example 10 have 100 shares of XYZ stock that has a \$45,000 income tax basis and is currently worth \$50,000. If they sell that stock in 2024, the \$5,000 of capital gain ($\$50,000 - \$45,000$) does not increase their income taxes for 2024 and does not reduce their 2024 NOL. Therefore, the \$5,000 gain is effectively tax free.

Guy and Barb could repurchase \$50,000 of XYZ stock or make another investment. In either case, they would have a \$50,000 income tax basis in the new investment. If they later sold the new investment for \$50,000 or more, their gain would be \$5,000 less than the gain would have been if they kept the original XYZ stock (with a \$45,000 income tax basis) and sold it for the same amount.

Shifting Non-Business Capital Losses

Non-business capital losses in excess of non-business capital gains provide no tax benefit in an NOL year because they are not allowed as part of the NOL computation. If those capital losses are shifted to a year when there is no NOL, or to an NOL year that has excess non-business capital gains, the losses will provide a tax benefit.

Example 12:

The projected \$40,000 NOL for Guy and Barb Wire in Example 11 includes a planned sale of RST stock for a \$900 capital loss. Guy and Barb will get no tax benefit from that capital loss in 2024. It does not increase their 2024 NOL. It is not carried over as a capital loss carryover because Guy and Barb have business capital gains in 2024 that give them a net capital gain for 2024.

If Guy and Barb postpone the sale of the RST stock until 2025, they still have a \$40,000 NOL for 2024 and the \$900 capital loss in 2025 will reduce their taxable income.

Waiving Carryback May Reduce Tax Liability

In some cases, an NOL deduction is more useful to the taxpayer in the years following the NOL year than in the carryback years because of the higher tax rates imposed in high income years. If the carryback years have low income compared to carryforward years, forgoing the carryback is advantageous as long as the indefinite carryforward years will use most or all of the NOL.

Capital losses in carryback or carryforward years may keep the taxpayer from realizing the full benefit of the NOL deduction in those years. Similarly, the NOL deduction may cause the loss of a tax credit that cannot be carried beyond the carryback or carryforward year.

Finally, there may not be enough taxable income in the carryforward years to absorb the NOL. In those cases, the NOL should be carried back to the low-income years to reduce low-bracket income rather than be completely wasted.

Present Value of Carryforward

Because the timing of the tax savings differs between carrying an NOL back and carrying it forward, the present value of the tax savings should be computed to properly compare them. If the NOL is carried back, the tax savings will be received shortly after the refund claim is filed. The following discussion assumes that the request for refund is filed early in the year following the NOL year and the refund is received by April 15 of that year.

If the NOL is carried forward, the tax savings are realized when taxes would otherwise be paid in the carryforward years. The NOL deduction can be used to reduce quarterly estimated tax payments, or it can be used to reduce the tax paid or increase the refund received when the carryforward year return is filed. In either case, the present value is less than the face amount of the tax savings.

To compare the value of future tax savings with the value of refunds from previous years, the present value of future tax savings as of April 15 can be calculated. The tables in Figures 1 and 2 give discount factors for taxes saved in the 5 years following the NOL year.

- Figure 1 should be used if the tax savings are used to reduce estimated tax payments.
- Figure 2 should be used if the tax savings are used to reduce the tax paid with the return or increase the refund claimed on the return.

Figure 1. Factors for Calculating Present Value of Taxes Saved in Years Following NOL Year Assuming Savings Are Used to Reduce Quarterly Estimated Tax Payments

Interest Rate	Year 1 [*]	Year 2 ^{**}	Year 3 ^{**}	Year 4 ^{**}	Year 5 ^{**}
1%	0.9967	0.9868	0.9770	0.9674	0.9578
2%	0.9934	0.9739	0.9548	0.9361	0.9177
3%	0.9901	0.9613	0.9333	0.9061	0.8797
4%	0.9868	0.9489	0.9124	0.8773	0.8436
5%	0.9836	0.9368	0.8922	0.8497	0.8092
6%	0.9804	0.9249	0.8725	0.8232	0.7766
7%	0.9772	0.9133	0.8535	0.7977	0.7455

8%	0.9740	0.9019	0.8351	0.7732	0.7159
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*These factors were calculated using the following formula: Factor = $[1+(1+i/12)^{-2}+(1+i/12)^{-5}+(1+i/12)^{-9}]/4$, where i = interest rate divided by 100.

**These factors were calculated using the following formula: Factor = $F \times (1+i)^{-(n-1)}$, where F = the Year 1 factor, i = interest rate divided by 100 and n = year.

Figure 2. Factors for Calculating Present Value of Taxes Saved in Years Following NOL Year Assuming Savings Are Used to Reduce Payment or Increase Refund with Tax Return

Interest Rate	Year 1 [*]	Year 2 [*]	Year 3 [*]	Year 4 [*]	Year 5 [*]
1%	0.9901	0.9803	0.9706	0.9610	0.9515
2%	0.9804	0.9612	0.9423	0.9238	0.9057
3%	0.9709	0.9426	0.9151	0.8885	0.8626
4%	0.9615	0.9246	0.8890	0.8548	0.8219
5%	0.9524	0.9070	0.8638	0.8227	0.7835
6%	0.9434	0.8900	0.8396	0.7921	0.7473
7%	0.9346	0.8734	0.8163	0.7629	0.7130
8%	0.9259	0.8573	0.7938	0.7350	0.6806

*These factors were calculated using the following formula: Factor = $(1+i)^{-n}$, where i = interest rate divided by 100 and n = the year.

The tax savings that result from carrying the NOL forward must be estimated for each year following the NOL year. Those tax savings are then multiplied by the appropriate factor from the applicable table. The interest rate is the opportunity cost of the taxpayer’s capital—that is, the after-tax rate the taxpayer is paying or would pay to borrow money. (If the taxpayer is not borrowing money, the appropriate rate is the after-tax rate the taxpayer is earning on investments.)

Example 13:

Scott and Erin Jackson had a \$45,000 NOL in 2024. Their income and deductions from 2022 and 2023 and their

expected income and deductions for 2025 are shown below.

Income	2022-First Carryback Yr	2023-Second Carryback Yr	2025- First Carryback Yr
Taxable interest	\$7,000	\$7,000	\$7,000
Business income	\$49,000	57,000	85,000
Total income (line 9, Form 1040)	\$56,000	\$64,000	\$92,000
Adjustments			
50% of SE Tax	3,462	4,027	6,005
Adjusted gross income	\$52,538	\$59,973	\$85,995
Standard deduction *	25,900	27,700	29,200
Personal exemptions deduction (currently zero)	0	0	0
	\$26,638	\$32,273	\$56,795
Qualified Business Income Deduction (20% set to expire at the end of 2025)	5,328	6,455	11,359
Taxable income	\$21,310	\$25,818	\$45,436

Income tax *	\$2,152	\$2,658	\$4,988
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* The deductions and income tax for 2025 are estimated using the deductions and tax rates in effect for 2024.

If Scott and Erin carry their \$45,000 2024 NOL back to 2022 and 2023, they will reduce their income taxes in those years to zero and \$213 so they can claim a \$4,598 refund (\$2,152 for 2022 + \$2,445 for 2023). The NOL would be fully absorbed in 2022 and 2023 so there would be no carryforward to 2025.

If Scott and Erin forgo the carryback, the \$45,000 2024 NOL will reduce their 2025 income taxes from \$4,988 to \$44. The NOL would be fully absorbed in 2025 so there would be no carryforward to 2026.

If Scott and Erin will realize the tax savings by reducing their estimated payments for 2025, the tax savings must be discounted by a factor from Figure 1. If their after-tax opportunity cost of capital is 5%, the appropriate factor is 0.9836, and the present value of the \$4,944 tax savings is \$4,862. Consequently, Scott and Erin should forgo the NOL carryback because the \$4,862 present value of the future tax savings from the carryforward option is greater than the \$4,598 refund received by using the carryback option.

To forgo the NOL carry back, Scott and Erin must attach the statement shown below to their timely filed (including extensions) 2024 income tax return.

Scott and Erin Jackson
SSN 172-09-1045

Taxpayers elect to forgo the net operating loss carryback period under I.R.C. § 172(b)(3)(C) for the net operating loss show on this return.

If Scott and Erin will realize the 2025 tax savings when their 2025 tax return is filed in 2026, the tax savings must be discounted by a factor from Figure 2. If their after-tax opportunity cost of capital is 5%, the appropriate factor is 0.9524 and the present value of the \$4,944 tax savings is \$4,754. Consequently, Scott and Erin should not carry the NOL back and claim a refund for taxes paid because the \$4,754 present value of the future tax savings is greater than the \$4,598 refund from carryback. However, this can change if the money is needed now. As the interest rate approaches 8% using the same table, the values are about the same.

Control Timing of NOL

If you have some choice in determining the tax year that an NOL is realized, it should be placed in the year that results in a deduction that will generate the greatest tax benefit. The years in which the NOL deduction generates the greatest benefit are those that have the highest taxable income (and are therefore in the highest marginal bracket).

For example, if a farmer's marginal tax rate is higher in 2022 than in 2023, accelerating an NOL into 2024 instead of delaying it to 2025 will cause the loss to offset the higher bracket 2022 income instead of the lower bracket 2023 income.

Farm Corporations and NOLs

A farm corporation generally figures and deducts a NOL the same way an individual, estate, or trust does. The same 2-year carryback and indefinite carryforward periods apply, and the same sequence applies when the corporation carries two or more NOLs to the same year.

A corporation's NOL generally differs from individual, estate, and trust NOLs in the following ways.

1. A corporation can take different deductions when figuring an NOL.
2. A corporation must make different modifications to its taxable income in the carryback or carryforward year when figuring how much of the NOL is used and how much is carried over to the next year.
3. A corporation uses different forms when claiming an NOL deduction.
4. A corporation is not subject to section 46, which limits the amount of losses from the trades or businesses of noncorporate taxpayers.

Figuring the NOL

A corporation figures an NOL in the same way it figures taxable income. It starts with its gross income and subtracts its deductions. If its deductions are more than its gross income, the corporation has an NOL. However, the following rules for figuring the NOL apply.

1. The NOL deduction for an NOL carryback or carryover from another year is not allowed.
2. The dividends-received deductions for dividends received from domestic and foreign corporations and for dividends received on certain preferred

stock of a public utility are computed without regard to the limitation on the aggregate amount of deductions under section 246(b).

3. The dividends-paid deduction for dividends paid on certain preferred stock of a public utility is computed without regard to the limitation under section 247(a)(1)(B).
4. No deduction under section 199A is allowed.
5. The section 250 deduction for foreign based intangible income is not allowed.

Claiming the NOL Deduction

If a corporation carries the NOL back, it has the same options for filing as an individual but it uses Form 1139, Corporation Application for Tentative Refund, instead of Form 1045, Application for Tentative Refund, and Form 1120X, Amended U.S. Corporation Income Tax Return, instead of Form 1040X, Amended U.S. Individual Income Tax Return. Generally, the corporation must file form 1139 within 12 months of the end of the tax year in which an NOL arose.

If a corporation expects to have an NOL in its current year, it can automatically extend the time for paying all or part of its income tax for the immediately preceding year. It does this by filing Form 1138, Extension of Time for Payment of Taxes by a Corporation Expecting a Net Operating Loss Carryback. File this form by the last day of the month that includes the due date (including extensions) for filing the return for the tax year from which the NOL carryback arose.

Figuring the NOL Carryover

If the NOL available for a carryback or carryforward year is greater than the taxable income for that year, the corporation must modify its taxable income to figure how much of the NOL it will use up in that year and how much it can carry over to the next tax year. Its carryover is the excess of the available NOL over its modified taxable income for the carryback or carryforward year.

Modified Taxable Income

A corporation figures its modified taxable income the same way it figures its taxable income, with the following exceptions.

- It can deduct NOLs only from years before the NOL year whose carryover is being figured.
- The corporation must figure its deduction for charitable contributions without considering any NOL carrybacks.

The modified taxable income for any year cannot be less than zero. Modified taxable income is used only to figure how much of an NOL the corporation uses up in the carryback or carryforward year and how much it carries to the next year. It is not used to fill out the corporation's tax return or figure its tax.

Ownership Change

A loss corporation (one with cumulative losses) that has an ownership change may be limited on the taxable income it can offset by NOL carryforwards arising before the date of the ownership change. This limit applies to any year ending after the change of ownership.

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

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IRS Publication 536: Net Operating Losses (NOLs) for Individuals, Estates and Trusts. This provides 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.

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