

## How Small Businesses Can Use the New Longer NOL Carryback to Achieve Maximum Tax Savings

Dear Client/Friend:

The American Recovery and Reinvestment Act of 2009 (commonly referred to as the Recovery Act), which was signed into law on Feb. 17, 2009, makes a number of beneficial changes for businesses. A key provision in the new law which is designed to help struggling eligible small businesses cope with the economic downturn is a temporary elective extension of the carryback period for certain net operating losses (NOLs) from 2 years to up to 5 years. The longer NOL carryback period gives small businesses that experienced losses the ability to get immediate refunds of income taxes paid in earlier years. The refunds can be used to fund capital investment or other expenses.

Important decisions must be made for an eligible small business to achieve maximum tax savings from this provision. The IRS has issued favorable guidance on this provision and says that it will act quickly to get refunds to businesses carrying back losses under the new rule. But, in addition to making correct choices, a business must follow certain filing procedures to qualify for this important tax break and, in some cases, must do so before Apr. 18, 2009.

***Details of the new longer NOL carryback period.*** In general, NOLs may be carried back 2 years and forward 20 years (different rules apply for certain specialized types of losses and the carryback period may be waived). For NOLs arising in a tax year beginning or ending in 2008, the Recovery Act permits eligible small businesses (ESBs) to elect to increase the NOL carryback period from 2 years to 3, 4, or 5 years. For calendar year businesses, the election is available only for 2008. A fiscal-year taxpayer whose year ends in 2008 can make the election either for its fiscal year ending in 2008 or its fiscal year beginning in 2008 and ending in 2009, but not both.

An ESB is a trade or business (including one conducted in or through a corporation, partnership, or sole proprietorship) whose average annual gross receipts are \$15 million or less for the three-tax-year period (or shorter period of existence) ending with (as clarified in the IRS guidance) the tax year in which the loss arose (as opposed to the tax year before the year of the loss, as some had read the statutory language). The IRS interpretation generally is more favorable to taxpayers because, for example, more calendar year taxpayers would qualify using 2008 receipts rather than 2005 receipts, when economic conditions were much better. In determining whether a partnership or S corporation qualifies as an ESB, the gross receipts test applies at the entity level but the election is made by the partner or S shareholder, as the case may be.

***Deadlines for making the election.*** A taxpayer that already filed a 2008 return may still make the election to use a 3-, 4- or 5-year carryback by the later of: (A) six months after the due date of the return (determined without extensions), or (B) Apr. 17, 2009. A taxpayer that previously elected to waive the normal 2-year carryback period may undo it and make a new 3-, 4- or 5-year election no later than Apr. 17, 2009. A taxpayer that has not filed a return for the year of the loss, has until the later of: (A) the due date (with extensions) of the return for the year of the loss, or (B) Apr. 17, 2009 to make the election.

***Deciding which choice or choices to make.*** ESBs with a qualifying NOL must decide whether to waive the carryback period or to use a 2-, 3-, 4- or 5-year carryback period. Fiscal year filers have the added choice of which year to use. These choices are quite complex and require a detailed examination of your tax picture. The key factor in deciding whether to elect to carry an NOL back 3, 4, or 5 years should be which election will result in the largest tax savings. For example, if the NOL is more than or at least equal to your combined income for the third, fourth, and fifth years before the year in which it arose, then the loss should be carried back to the fifth year so that it can be used in all three years. We can help you make the choice or choices that will achieve maximum tax savings for you. It is especially important to make the right choice because once made, the choice is irrevocable.

**Getting a quick refund.** Corporations making the election can get a quick refund by filing Form 1139. Individuals use Form 1045 to get a quick refund. The IRS has supplied detailed instructions as to what information must accompany these forms. We can handle all of that.

**Ponzi scheme losses.** In separate guidance, the IRS says losses from Ponzi schemes, like the Madoff situation, may be deducted as theft losses and because theft losses are treated as business losses for NOL purposes, the individual suffering such losses is considered a sole proprietor. This means that the individual may be able to use the 3-, 4- or 5-year carryback period for his or her 2008 Ponzi scheme losses.

Sincerely,

Neal A. Price & Company, LLP

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