

Tax Changes for Businesses in the "Worker, Homeownership, and Business Assistance Act of 2009"

Dear Client/Friend:

The Worker, Homeownership, and Business Assistance Act of 2009 (the Act), which was signed into law on Nov. 6, 2009, makes it easier for most businesses to get immediate tax savings from net operating losses (NOLs). It does so by allowing certain NOLs to be carried back to earlier, more profitable years. In these tough economic times, that's good news for businesses who have suffered losses recently after better years when high taxes were paid. On the negative side, the Act defers a scheduled drop in the FUTA (Federal Unemployment Tax Act (FUTA) tax rate, increases penalties for certain businesses that fail to meet return filing requirements, and boosts estimated taxes for large corporations in 2014.

Background on NOLs. A net operating loss (NOL) is the excess of business deductions (computed with certain modifications) over gross income in a particular tax year. The loss can be deducted, through an NOL carryback or carryover, in another tax year in which gross income exceeds business deductions. In general, NOLs may be carried back two years and forward 20 years. The NOL is first carried to the earliest tax year for which it's allowable as a carryback or a carryover, and is then carried to the next earliest tax year. A business may forego the entire carryback period and instead carry the NOL forward.

For NOLs arising in a tax year beginning or ending in 2008, eligible small businesses (ESBs) could elect to increase the NOL carryback period from 2 years to 3, 4, or 5 years. A calendar year business could only make the election for 2008. A fiscal-year taxpayer whose year ended in 2008 could make the election either for (a) its fiscal year ending in 2008 or (b) 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 the tax year in which the loss arose.

New law allows longer carryback period for most businesses. The Act generally permits any business (not just an ESB) to increase the carryback period for an applicable NOL to 3, 4, or 5 years from 2 years (however, businesses getting certain federal bailout funds are not eligible). An applicable NOL is a business's NOL for any tax year ending after Dec. 31, 2007, and beginning before Jan. 1, 2010. Generally, an election may be made for only one tax year. However, an ESB that made or makes an election under the rules in effect before Nov. 6, 2009 (the Act's enactment date) may make an election for 2 tax years instead of just 1.

The amount of the NOL that can be carried back to the 5th tax year before the loss year can't be more than 50% of a business's taxable income for that 5th preceding tax year determined without taking into account any NOL for the loss year or for any tax year after the loss year. The amount of the NOL otherwise carried to tax years after the 5th preceding tax year is adjusted to take into account that the NOL could offset only 50% of the taxable income for that 5th preceding tax year.

For example, assume Ace Corp (not an ESB) has an NOL of \$5 million for its tax year ending Aug. 31, 2009. In its tax year ending Aug. 31, 2004, it had taxable income of \$6 million. If Ace elects to carry back its NOL to the 2004 tax year, then it may apply only \$3 million of that loss against its taxable income for 2004. In determining the amount of the NOL that ACE can carry over to years ending after Aug. 31, 2004, the NOL is reduced by only the \$3 million that was offset for the 2004 tax year.

However, note that the 50% limitation does not apply to the applicable 2008 NOL of an ESB that makes an election under pre-Act law, even if the election is made after Nov. 6, 2009.

Note that the Act carries a separate, similar set of NOL carryback rules for life insurance companies.

NOL transition rules to watch out for. The Act's transition rules allow a business to revoke any election to waive the carryback period for an applicable NOL or an applicable loss from operations for a tax year ending before Nov. 6, 2009. The election can be revoked by the extended due date for filing the tax return for the business's last tax year beginning in 2009. Similarly, any application for a tentative carryback adjustment to gain an immediate refund for such a loss is treated as timely filed if filed by the extended due date for filing the tax return for the business's last tax year beginning in 2009. Normally, an election to waive the carryback period cannot be revoked. The transition rules afford an opportunity to undo a waiver for an applicable NOL, or an applicable loss from operations for a tax year ending before Nov. 6, 2009.

Scheduled drop in FUTA tax rate is deferred. Before the Act, the FUTA rate was scheduled to drop from 6.2% to 6% after 2009. Under the Act, the 6.2% FUTA tax rate continues to apply through June of 2011, and afterwards a 6.0% rate will apply.

Estimated tax change. For large corporations (those with \$1 billion or more in assets), the required payment of estimated tax otherwise due in July, August, or September of 2014 under pre-Act law will be increased by 33%. The amount of the next required installment will be appropriately reduced to reflect the amount of the increase in the earlier installment.

Passthrough penalties increased. The base amount on which a penalty is computed for a failure to file either a partnership or S corporation return for a tax year beginning after Dec. 31, 2009, is increased to \$195 per partner or shareholder.

Please give us a call and we'll set up a meeting to discuss how your business is affected by the Act's changes, particularly its more-generous, but complex, NOL changes.

Sincerely,

Neal A. Price & Company, LLP

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