

810-3-15.2-.01 Net Operating Loss Carryback or Carryover.

(1) Computation of a Net Operating Loss (NOL).

(a) A net operating loss is the amount by which deductions (after modifications) exceed gross income. A net operating loss may result from losses incurred in a trade or business, from the sale of assets used in a trade or business, or from personal casualties or thefts.

1. For the purpose of computing the amount of an allowable net operating loss, certain items of income, expense or deduction will be classified as "business" or "nonbusiness." The following is a partial list of items regularly classified as business or nonbusiness:

(i) Business. Business income, expense and deductions include, but are not limited to: salary and wages; income or loss from a trade or business; gain or loss from sale of assets used in a trade or business; losses on Internal Revenue Code § 1244 stock (up to the amount of ordinary loss allowed for federal income tax purposes); rental income or loss; income or loss from a partnership; income or loss from an Alabama S corporation; income or loss from farming; employee moving expenses; employee business expenses; and casualty and theft losses.

(ii) Nonbusiness. Nonbusiness income, expense and deductions include, but are not limited to: medical expenses; taxes; interest expense; charitable contributions; miscellaneous deductions other than employee business expenses; gain from the sale of a personal residence to the extent recognized in accordance with § 40-18-14, Code of Alabama 1975; gain or loss from the sale of assets not used in a trade or business (including distributive shares of gains or losses from such assets held by a partnership or an Alabama S corporation); interest and dividend income (including distributive shares of interest and dividend income received by a partnership or an Alabama S corporation); losses on Internal Revenue Code §1244 stock (in excess of the amount of ordinary loss allowed for federal income tax purposes) federal income tax refunds or tax paid; alimony received; taxable pension and annuities; income or loss from a trust or estate; deductible contributions to IRA retirement plans; Keogh retirement plans; employee benefit contributions paid by an employer; penalties for early withdrawal of savings; alimony paid and disability income exclusions.

2. In computing the amount of a net operating loss allowable for a particular taxable year, the following modifications must be made:

(i) no deduction may be taken for any net operating loss carried over from another year,

(ii) no deduction is allowed for the personal exemption or exemption for dependents allowed by § 40-18-19, Code of Alabama 1975,

(iii) nonbusiness deductions, including the federal income tax deduction, may not exceed nonbusiness income, and

(iv) the optional standard deduction, if claimed, is considered a nonbusiness deduction and may not exceed nonbusiness income.

(b) Definitions. As used in this regulation, the following terms have the meanings ascribed to them, unless the context clearly indicates otherwise:

1. "NOL" means "net operating loss."

2. "Carryback" means an NOL applied to a year prior to the year in which the NOL occurred.

3. "Carryover" means the excess NOL after a portion of the NOL has been applied to a carryback or carryforward year.

4. "Carryforward" means an NOL applied to a year subsequent to the year in which the NOL occurred.

5. "Intervening Year" means a year between the earliest year to which an NOL can be carried back and the year in which the NOL occurred.

6. "Loss Year" means the year in which an NOL occurred.

(2) Application of an NOL Carryback.

(a) For loss years beginning after December 31, 1997, an NOL may be carried back and deducted from taxable income in each of the preceding two years or until exhausted.

(b) NOL Carrybacks.

1. When an NOL is carried back to a prior year, taxable income will be recomputed in such prior year as specified in subparagraphs (i), (ii), and (iii) below.

(i) If the NOL being carried back is equal to or greater than taxable income as previously reported or last adjusted (including any deductions for NOLs carried over or carried back to such year from any loss year prior to the current loss year), taxable income will be reduced to zero. See paragraph (5) below for the computation of any remaining NOL for carryover to a subsequent year. See subparagraph 3 for refund procedures.

(ii) If the NOL being carried back is less than taxable income as previously reported or last adjusted (including any deductions for NOLs carried over or carried back to such year from any loss year prior to the current loss year), taxable income for the carryback year is reduced by the amount of the NOL.

(iii) The NOL carryback reduces adjusted gross income, and therefore, will affect those deductions which are based on or limited by a percentage of adjusted gross income.

(I) The limitation on contributions will be reduced.

(II) The amount of medical expenses exceeding 4% of adjusted gross income may increase.

(III) If the optional standard deduction is elected, the amount will be computed by applying the appropriate percentage to adjusted gross income after subtracting the NOL carryback.

2. Recomputation of Tax in a Carryback Year. The appropriate rates for the carryback year will be applied to the amount of taxable income after subtraction of the NOL deduction.

3. Refund Procedures.

(i) To apply an NOL carryback and to request any refund due, complete Form NOL-85A and attach it to Form 40X (Amended Alabama Individual Income Tax Return) for each year to which the carryback is being applied.

(ii) Limitations on Refund Claims. A claim for refund of tax based on an NOL carryback must be filed within three (3) years, including extensions, from the due date of the loss year return.

(I) If the taxpayer has an NOL and fails to claim the NOL carryback within three years, including extensions, from the due date of the loss year return, no refund will be made based on the NOL carryback. The taxpayer will be allowed to carry any available loss forward.

(II) After computing the carryback and reducing the loss available by the taxable income and required modifications for all of the carryback years, a loss may still be available to be carried forward. If so, the remaining available loss may be claimed in the first year following the loss year, providing the loss is claimed when the return is filed for the carryforward year as described in paragraph (4).

4. No deduction will be allowed in any carryback year which has been closed by expiration of the statute of limitations or by final assessment prior to the application of the carryback.

(3) Election to Relinquish the Entire Carryback Period.

(a) A taxpayer may elect to forego the carryback period of an NOL.

(b) If such an election is made, the NOL will then be carried forward to the first available year following the loss year. The carryforward period limitation of fifteen (15) years is not extended if an election is made to forego the carryback period.

(c) For loss years beginning after December 31, 1997, the election to forego the carryback period can be made in one of two ways. The election can be made on or before the due date (with extensions) for filing the income tax return for the loss year. If no election is made by the due date of the loss year return, then the filing of the next year's return by the due date, including extensions, and claiming the loss on the return shall be considered the taxpayer's election to forego the carryback period. The election, once made, is irrevocable.

(d) If a proper election to forego the carryback period is not made, or not timely made, the NOL must be carried back to the earliest year preceding the loss year in which the NOL may be utilized (e.g., a 1998 NOL must be carried back to 1996). Any unused NOL may be carried to the next earliest preceding year, in order.

(4) Application of an NOL Carryforward to a Year After the Loss Year.

(a) Eligible Carryforward Years. An NOL may be carried forward to years subsequent to the loss year in order of time or until exhausted, whichever occurs first; subject to the following limitations:

1. To each of the fifteen tax years following the loss year.

2. No deduction will be allowed in any carryforward year which has been closed by expiration of the statute of limitations or by final assessment prior to the application of the carryforward.

(b) Computation of Taxable Income.

1. If the NOL being carried forward is equal to or greater than taxable income, taxable income will be reduced to zero. Taxable income is computed without considering the current NOL carryover to be applied, but will reflect any prior carryovers which have been applied. See paragraph (5) below for the computation of any remaining NOL for carryover to a subsequent year.

2. If the NOL being carried forward is less than taxable income (computed without considering the NOL deduction to be applied), adjusted gross income will be reduced (but not below zero) by the amount of the NOL carryforward.

(i) The NOL carryforward reduces adjusted gross income, and therefore, will affect those deductions which are based on or limited by a percentage of adjusted gross income.

(I) The limitation on contributions will be reduced.

(II) The amount of medical expenses exceeding 4% of adjusted gross income may increase.

(III) If the optional standard deduction is elected, the amount will be computed by applying the appropriate percentage to adjusted gross income after subtracting the NOL carryforward.

(5) Computation of any Remaining NOL Carryover After Application of an NOL.

(a) In order to determine the amount of an NOL available for carryover, certain adjustments must be made to the taxable income for the year in which the deduction was taken. The amount by which the NOL will be reduced is called "modified taxable income."

(b) The modifications required by law provide that no deduction is allowed for:

1. the personal exemption provided in § 40-18-19(a)(6), and
2. the deduction for dependents provided in § 40-18- 19(a)(7).

(c) These modifications are applied after all prior adjustments or modifications have been made to adjusted gross income and/or taxable income in the year to which the NOL is being applied.

1. If a prior NOL carryback or carryover was fully absorbed in the year, and a subsequent NOL is carried to the year and cannot be fully absorbed, the modifications required in subparagraph (a) above would be computed after taxable income has been recomputed for the year.

2. If the subsequent NOL can be fully absorbed, after taxable income has been recomputed for the prior NOL, taxable income for the year must be recomputed, with adjusted gross income reduced again for the subsequent NOL.

(6) Special Rules.

(a) Joint Returns.

1. In general, in the case of a husband and wife who file a joint income tax return for any taxable year in which an NOL occurs, the loss is to be computed on the basis of the combined income and deductions of both spouses, and the modifications required are to be computed as if the combined income were the income of one individual. However, if separate returns were filed for any of the carryback years, the NOL must be computed as if separate returns were being filed in the joint loss year.

2. Special rules are necessary when there is a change in the status of the spouses due to marriage, divorce or death.

(i) An NOL sustained after or prior to a marriage cannot be used to reduce the taxable income of a former or future spouse, even though a joint return was filed for the carryback and/or carryforward year. The NOL can only be applied to the separate income of the spouse which incurred the loss.

(ii) If there is a change in marital status due to the death of a spouse:

(I) and in a succeeding year the survivor sustains an NOL, the loss may be carried back only to that portion of the income reported on a joint return previously filed with the decedent which is allocated to the survivor.

(II) and a joint return is filed for the year of death of the spouse and an NOL was sustained -

I. the loss may be carried back to a year in which the decedent filed a joint return with the surviving spouse, and/or

II. the loss allocated to the deceased spouse may be carried back to a year in which the decedent filed a separate return.

A. Any NOL allocated to a deceased spouse not utilized in subsentence II, above, may not be carried forward.

(b) Reduction for Allowable NOL, Whether or Not Claimed.

1. An NOL carryback or carryover will be reduced by the amount available for use, whether used or not. For instance, if a taxpayer neglects to claim an NOL carryback within the prescribed time limit, the amount of loss available for carryover to other years will be reduced by the amount that could have been carried back but was not claimed.

2. If the loss was available for use prior to the final assessment, the remaining NOL must be reduced by the amount that was available for use before the final assessment.

(c) NOLs of Nonresidents.

1. In general, nonresidents are allowed the same deduction for NOLs as the deduction allowed to residents, except that the loss must be attributable to sources in Alabama, and is applied to income attributed to Alabama. The computation of the loss, as applied to Alabama source income, is made as provided in paragraph (1) above. The deduction for a carryback is computed as provided in paragraph (2) above. The deduction for a carryover is computed as provided in paragraph (4) above. The computation of any remaining carryover of an NOL that cannot be fully absorbed is computed as provided in paragraph (5) above.

2. A number of deductions allowed nonresidents, including the personal exemption and exemption for dependents, are limited based on the ratio of income from Alabama sources to income from all sources. When an NOL is fully absorbed, these deductions must be recomputed based on the changes to Alabama income and total income after the NOL is applied.

Authors: Ann F. Winborne, CPA

Authority: Sections 40-2A-7(a)(5) and 40-18-15.2, Code of Alabama 1975.

History: New rule: Filed February 5, 2009, effective March 12, 2009.