

ST13-17 – Handling Net Operating Loss (NOL)

Preamble: Have you ever had a carry forward return include a Net Operating Loss (NOL) and not know how / whether to remove it? This document explains how to handle these situations and how to prevent them from happening in the future.

Reference: IRS Pub 536, Net Operating Losses (NOLs) for Individuals, Estates, and Trusts

Definition: “If your deductions for the year are more than your income for the year, you may have a net operating loss (NOL). An NOL year is the year in which an NOL occurs. You can use an NOL by deducting it from your income in another year or years.”

Discussion: Scenarios which would generate a valid NOL (Schedule C loss, Casualty losses, Moving Expenses, etc.) are generally out-of-scope for (non-Military) volunteer preparers. However, there are common in-scope scenarios, which unless handled properly, will cause TaxWise to generate a spurious NOL. This can be difficult to detect when reviewing the current year return because it does not affect current year calculations, but will (by default) be carried forward and cause problems which need to be resolved on subsequent year returns.

Situations:

- NOL from prior year carried forward to current year
- NOL for current year

Situation: NOL from prior year carried forward to current year

You will notice this when a new created return (with automatic carry forward data from prior year) has 1040 Wkt7 red in the tree. (There may also be a red Form 1045 Page 2 in the tree – ignore that for now.) When you open 1040 Wkt7, you will see a negative amount filled in on Line 15 plus the NOL statement box will be red [See Example 1]. (If there is no offsetting miscellaneous income, 1040, Line 21 will also be negative.)

Before going further, you must determine what caused the original NOL carry forward, because the current year return may be out-of-scope. Looking at Form 1045 Page 2 (NOL calculation) from the prior year is a good place to start. (Note: it is possible that the original NOL was from a return even further back than the prior year.)

The most likely situation (if there were no out-of-scope items on the original return which generated the NOL) is that the TP had a carried forward Capital Loss and insufficient taxable income to offset the loss – resulting in a negative AGI on the original return. If the carried forward NOL from the original return is equal to the amount of the Capital Loss on the original return and the original Form 1045 Page 2 had zero on lines 2 and 3, then it is safe to assume that this is what’s going on – The original Form 1045 was filled out incorrectly and the NOL is spurious and should be ignored. To remove the spurious NOL, go to the bottom of 1040 Wkt3 (for the current year return) and zero out the amount on line 2 of the Carryovers from 20xx to 20xx section – This should automatically remove the amount from 1040 Wkt7 line 15 and 1040 Wkt7 should no longer be red in the tree. [See Example 2] Note: You may still have a spurious NOL for the current year – see the next section.

There are situations which will generate a valid NOL on the original return – These include: Schedule C loss, Casualty and theft losses, moving expenses, rental property, etc. ***If the carry forward NOL amount is from a valid NOL on the original return, then the current year return is out-of-scope.***

ST13-17 – Handling Net Operating Loss (NOL)

Situation: NOL for current year

Note: Handle “NOL from prior year carried forward to current year” (previous section) before worrying about NOL for current year.

If TaxWise thinks there is possible NOL for the current year, then it will automatically add Form 1045 Page 2 to the tree and it will be red. This may happen at any point during data entry, but may go away later – DO NOT try to handle this form unless it is still red after all data entry is complete and any diagnostic issues resolved.

If Form 1045 Page 2¹ is still red after all other data entry is complete [See Example 3], then line 2 (and, if necessary, line 3) should be filled in based on values from Schedule D, Lines 7 and 15. If filling these in removes the red from all other lines on the form AND line 25 is zero, then you are done [See Example 4]. (The return is in-scope and no spurious NOL will be carried forward to the next year.)

If Form 1040 Page, line 25 is still non-zero after filling in lines 2 and 3, then there is a valid NOL for the current year AND the return is out-of-scope².

Note: Quality Reviewers should look for Form 1045 in the tree and make sure that it is filled out properly and the return is not out-of-scope, especially if the AGI is less than zero.

¹ Form 1045 Page 2 will say “Schedule A: Net Operating Loss (NOL)” at the top – This has nothing to do with Form 1040 Schedule A.

² Just to give an example of why NOL is out of scope, consider that an NOL can be carried back as well as carried forward!

ST13-17 – Handling Net Operating Loss (NOL)

Example 1: NOL carried forward from prior year on 1040 Wkt7

US Form 1040 and 1040NR, Line 21: Other Income Worksheet 2013

Name: Issue NOL SSN: 014-02-0752

TSJ (taxpayer, spouse, joint) boxes are provided for entries that are not calculated from other forms.

	TSJ	Amount
1 Gambling winnings from Form W-2G		0
2 Form 1099-MISC, lines 3, 7, and 8		0
3 Taxable distributions from education savings accounts (ESAs) and QTPs		0
4 Recovery of itemized deductions		0
5 Foreign income exclusion from Form 2555, line 45		0
6 Foreign income exclusion from Form 2555-EZ, line 18		0
7 Income addition from Form 6478, line 2		0
8 Income addition from Form 8814, line 12		0
9 Taxable Archer MSA distributions from Form 8853, line 8		0
10 Taxable Medicare Advantage MSA distributions from Form 8853, line 12		0
11 Taxable long-term care insurance contract payments from Form 8853, line 26		0
12 Taxable HSA distributions from Form 8889, line 16		0
13 Income for failure to maintain HDHP coverage from Form 8889, line 20		0
14 Jury duty pay		0
15 NOL carried forward - enter as a negative amount A statement is required for e-file. F9 here for the NOL statement		-3000
16 Describe		0
17 Describe		0
18 Describe		0
19 Describe		0
20 Describe		0
21 Describe		0
22 Describe		0
23 Describe		0
24 Describe		0
25 Describe		0
26 Describe		0
27 Describe		0
28 Describe		0
29 Describe		0
30 Describe		0
31 Total other income		-3000

This happens when there is a NOL carried forward from the prior year

ST13-17 – Handling Net Operating Loss (NOL)

Example 2: Fixing spurious NOL from previous year on 1040 Wkt3

US Child Tax Credit, Federal Extension Payment, and Carryovers Worksheet 2013

Name: Issue NOL SSN: 014-02-0752

Child Tax Credit (CTC)

1 \$1,000 X 0 qualifying children	0
2 Modified AGI is AGI plus excluded income from Forms 2555 (EZ) and 4563, and excluded income from Puerto Rico	0
3 Modified AGI limitation \$110,000, married filing jointly; \$55,000, married	

10 Subtract line 9 from line 8 0

11 Child tax credit 0

Amount paid with Federal extension (Forms 4868 or 2350) 0

Carryovers from 2013 to 2014

1 Section 179 expense disallowed, Form 4562, accumulative total	0
2 Net operating loss from 2013 only, Form 1045 Amount carried forward from 2012. Listed on Form 1040, line 21, or Form 1040NR, line 21. Enter as a positive amount	3000
3 2013 charitable contributions. Organization limit.	
4 Investment interest expense, Form 4952, accumulative total	0
5 Foreign tax credit from 2013 only, Form 1116	

Enter Zero on this line to get rid of spurious NOL from prior year

ST13-17 – Handling Net Operating Loss (NOL)

Example 3: Form 1045 Pg 2 automatically added to tree when TW thinks there is possible NOL for current year

US 1045 (2013) Page 2																									
Name: <u>Issue NOL</u>	SSN: <u>014-02-0752</u>																								
Schedule A: Net Operating Loss (NOL)																									
<p>1 Amount from Form 1040, line 41, or Form 1040NR, line 39 Use Shift F1 for help with line entries needed below. Highlighted amounts below are a reminder to you. F3, if not applicable.</p> <p>2 Nonbusiness capital losses BEFORE limitation. Enter as a positive number</p> <p>3 Nonbusiness capital gains without regard to section 1202 exclusion</p> <p>4 Line 2 minus line 3, but not less than -0-</p> <p>5 Line 3 minus line 2, but not less than -0-</p> <p>6 Nonbusiness deductions</p> <p>7 Nonbusiness income other than capital gains</p> <p>8 Add lines 5 and 7</p> <p>9 Line 6 minus line 8, but not less than -0-</p> <p>10 Line 8 minus line 6, but not less than -0- or more than line 5</p> <p>11 Business capital losses BEFORE limitation. Enter as a positive number</p> <p>12 Business capital gains without regard to any section 1202 exclusion</p> <p>13 Add lines 10 and 12</p> <p>14 Subtract line 13 from line 11, but not less than -0-</p> <p>15 Add lines 4 and 14</p> <p>16 Loss from Schedule D, line 16</p> <p>17 Section 1202 exclusion. Enter as a positive number</p> <p>18 Subtract line 17 from line 16, but not less than -0-</p> <p>19 Loss from Schedule D, line 21</p> <p>20 Line 18 minus line 19, but not less than -0-</p> <p>21 Line 19 minus line 18, but not less than -0-</p> <p>22 Subtract line 20 from line 15, but not less than -0-</p> <p>23 Domestic production activities deduction</p> <p>24 NOL deduction for losses from other years. Enter as a positive number. F3 if highlighted and the correct amount is -0-</p> <p>25 NOL. If the result is -0- or more, you do not have an NOL. If you want to waive the carryback period, select the "Election" explanation listed on the "Find a form" menu and state that you are electing under section 172(b)(3) to relinquish the entire carryback period for any 2013 NOL</p>	<table border="1"> <tr><td>-14486</td></tr> <tr><td>0</td></tr> <tr><td>0</td></tr> <tr><td>0</td></tr> <tr><td>0</td></tr> <tr><td>12633</td></tr> <tr><td>1147</td></tr> <tr><td>1147</td></tr> <tr><td>11486</td></tr> <tr><td>0</td></tr> <tr><td>0</td></tr> <tr><td>0</td></tr> <tr><td>0</td></tr> <tr><td>3723</td></tr> <tr><td>0</td></tr> <tr><td>3723</td></tr> <tr><td>3000</td></tr> <tr><td>723</td></tr> <tr><td>0</td></tr> <tr><td>0</td></tr> <tr><td>0</td></tr> <tr><td>0</td></tr> <tr><td>0</td></tr> <tr><td>-3000</td></tr> </table>	-14486	0	0	0	0	12633	1147	1147	11486	0	0	0	0	3723	0	3723	3000	723	0	0	0	0	0	-3000
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ST13-17 – Handling Net Operating Loss (NOL)

Example 4: Form 1045 Pg 2 filled in – eliminating spurious NOL that would have been carried forward to following year

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US 1045 (2013) Page 2

Name: Issue NOL SSN: 014-02-0752

Schedule A: Net Operating Loss (NOL)

1	Amount from Form 1040, line 41, or Form 1040NR, line 39		-14486
Use Shift F1 for help with line entries needed below. Highlighted amounts below are a reminder to you. F3, if not applicable.			
2	Nonbusiness capital losses BEFORE limitation. Enter as a positive number	4000	
3	Nonbusiness capital gains without regard to section 1202 exclusion	277	
4	Line 2 minus line 3, but not less than -0-	3723	
5	Line 3 minus line 2, but not less than -0-	0	
6	Nonbusiness deduction	12633	
7	Nonbusiness income	1147	
8	Add lines 5 and 7	1147	
9	Line 6 minus line 8, but not less than -0-		11486
10	Line 8 minus line 6, but not less than -0- or more than line 5	0	
11	Business capital losses BEFORE limitation. Enter as a positive number	0	
12	Business capital gains without regard to any section 1202 exclusion	0	
13	Add lines 10 and 12	0	
14	Subtract line 13 from line 11, but not less than -0-	0	
15	Add lines 4 and 14	3723	
16	Loss from Schedule D, line 16	3723	
17	Section 1202 exclusion. Enter as a positive number		0
18	Subtract line 17 from line 16, but not less than -0-	3723	
19	Loss from Schedule D, line 21	3000	
20	Line 18 minus line 19, but not less than -0-	723	
21	Line 19 minus line 18, but not less than -0-		0
22	Subtract line 20 from line 15, but not less than -0-		3000
23	Domestic production activities deduction		0
24	NOL deduction for losses from other sources. Enter as a positive number. F3 if highlighted and the correct amount		0
25	NOL. If the result is -0- or more, you may elect to carry back the loss to the year(s) immediately preceding the current year. If you want to waive the carryback period, select the "Election" explanation listed on the "Find a form" menu and state that you are electing under section 172(b)(3) to relinquish the entire carryback period for any 2013 NOL		0

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