



MANUAL TRANSMITTAL

Department of the Treasury
Internal Revenue Service

4.11.11

APRIL 17, 2023

EFFECTIVE DATE

(04-17-2023)

PURPOSE

- (1) This transmits a revised IRM 4.11.11, Examining Officer's Guide (EOG), Net Operating Loss Cases

MATERIAL CHANGES

- (1) Minor editorial changes have been made throughout this IRM. Website addresses, legal references, and IRM references were reviewed and updated as necessary. Significant changes to this IRM are reflected in the table below:

Reference	Description
IRM 4.11.11.1	Title renamed; added Background, Authority, Roles and Responsibilities, Acronyms, and Related Resources; updated and expanded net operating loss (NOL) references; these were included in Related Resources. Removed obsolete references; replaced with those more recent.
IRM 4.11.11.2	Title renamed Overview for Net Operating Loss (NOL) and Net Operating Loss Deduction (NOLD). Material changes made due to recent changes in the law- TCJA and CARES Act.
IRM 4.11.11.2.1	Added new subsection named IRC section 172 Net Operating Loss Deduction, incorporating new and old law.
IRM 4.11.11.2.2	Added new subsection named Calculating the NOL separating the NOL computation from the NOLD computation.
IRM 4.11.11.2.3	Added subsection on Calculating the Excess Business Loss.
IRM 4.11.11.2.4	Added subsection on determining the NOLD.
IRM 4.11.11.2.5	Added subsection on resources including Knowledge Management and Lead Sheets for SBSE Examiners.
IRM 4.11.11.3	Removed reference to obsolete Form 3621-A; replaced with information on Knowledge Management.

Reference	Description
IRM 4.11.11.4	Added subsection on Examining Tax Returns Reporting Net Operating Losses, incorporating the guidance in Interim Guidance, SBSE-04-0222-002, emphasizing the need to consider the impact on carryback years.
IRM 4.11.11.5 and IRM 4.11.11.6	Renumbered subsections.
IRM 4.11.11.7	Renumbered subsection; Added references to the difference between Alpha Statute “AA” and “BB”. Updated reference to IRM on Statutes. Updated examples to more current years.
IRM 4.11.11.8 and IRM 4.11.11.9	Renumbered subsections; Referred to verifying the entries on Form 5344 as these are now commonly generated by RGS software. Updated IRM references.
IRM 4.11.11.10	Renumbered subsections.; removed obsolete information, revoked provisions, updated IRM references.
IRM 4.11.11.11	Renumbered subsection, updated samples and references; added some clarification.
IRM 4.11.11.12	Renumbered subsection, added information about the impact the CARES Act has on elections.
IRM 4.11.11.13 through IRM 4.11.11.18	Renumbered subsections, updated example, updated references.

EFFECT ON OTHER DOCUMENTS

This IRM supersedes IRM 4.11.11, dated February 14, 2014. It incorporates the guidance in Interim Guidance, SBSE-04-0222-002.

AUDIENCE

Examination personnel in Small Business and Self-Employed (SB/SE) Examination and Large Business and International (LB&I) employees.

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Small Business/Self-Employed

4.11.11

Net Operating Loss Cases

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4.11.11.1
(04-17-2023)
Program Scope and Objectives

- (1) **Purpose:** Provide guidance for examiners working cases involving net operating losses, net operating loss deductions, and excess business losses
- (2) **Audience:** LB&I and SB/SE personnel.
- (3) **Policy Owner:** SBSE HQ Director, Exam Quality and Technical Support
- (4) **Program Owner:** SBSE EQTS
- (5) **Primary Stakeholders:** LB&I and SB/SE personnel
- (6) **Program Goals:** To assist examiners working cases involving net operating losses (NOLs), net operating loss deductions (NOLDs), and/or excess business losses (EBLs) with relevant information

4.11.11.1.1
(04-17-2023)
Background

- (1) A taxpayer that reports little or no taxable income will generally report little or no tax for that year. However, absent the net operating loss provisions, there is generally no tax benefit to having a material loss beyond reducing tax for the current year. Some taxpayers, such as farmers, may have years of losses and years of gains. Due to fluctuations in income and expenses, a taxpayer can have substantial profits in one year and losses in another. With this in mind, the relief provisions of IRC 172 were enacted for business income and loss. This section provides that an NOL may be carried to other years as a deduction, thereby preserving the economic impact of the loss.

4.11.11.1.2
(04-17-2023)
Authority

- (1) The following are some of the Internal Revenue Code sections and Treasury Regulations that govern NOLs, NOLDs, and EBLs.
 - IRC 172, Net Operating Loss Deduction
 - IRC 461(l), Limitation on Excess Business Loss of Noncorporate Taxpayers
 - IRC 170(d), Carryovers of Excess Contributions
 - Treas. Reg. 1.172-1 through 1.172-10, 26 CFR 1.172-1 et seq, Net Operating Loss Deduction
 - Treas. Reg. 1.46-2, 26 CFR 1.46-2, Carryback and Carryover of Unused Credit
 - Treas. Reg. 301.6501(m)-1, 26 CFR 301.6501(m)-1, Tentative Carryback Adjustment Assessment period
 - Treas. Reg. 301.6511(d)-2, 26 CFR 301.6511(d)-2, Overpayment of Income Tax on Account of Net Operating Loss or Capital Loss Carrybacks
 - Treas. Reg. 301.9100-2(b), 26 CFR 301.9100-2(b), Automatic Six Month Extension For Filing an Election
 - Treas. Reg. 301.9100-12T, 26 CFR 301.9100-12T, Various Elections Under the Tax Reform Act of 1976

Note: Additional IRC sections are cited in the IRM where they are applicable to the issue covered.

4.11.11.1.3
(04-17-2023)
Roles and Responsibilities

- (1) The Director, Headquarters Examination, is the executive responsible for providing policy and guidance for compliance activities in Field, Specialty and Campus Exam operations and ensuring consistent application of policy, procedures and tax law to effect tax administration while protecting taxpayers' rights. See IRM 1.1.16.5.5.

4.11.11.1.4
(04-17-2023)
**Acronyms and
Abbreviations**

- (1) The following table includes acronyms and abbreviations commonly associated with net operating losses:

Acronym /Abbreviation	Definition
AGI	Adjusted Gross Income
AMT	Alternative Minimum Tax
C/B	Carryback
CARES Act	Coronavirus Aid, Relief and Economic Substance Act
CFWD or C/F	Carryforward
C/O	Carryover
EBL	Excess Business Loss
EIN	Employer Identification Number
FTC	Foreign Tax Credit
IDRS	Integrated Data Retrieval System
MTC	Minimum Tax Credit
MTI	Modified Taxable Income
NII	Net Investment Income
NOL	Net Operating Loss
NOLD	Net Operating Loss Deduction
RINT	Restricted Interest Carryback Claim
SSN	Social Security Number
TENT	Tentative Refund Application
TCJA	Tax Cuts and Jobs Act of 2017
TXI	Taxable Income

4.11.11.1.5
(04-17-2023)
Related Resources

- (1) Webpage: Information on this subject can be found on Knowledge Management Knowledge Bases for 1040 and Corporate:
- *Losses in 1040 Knowledge Base*
 - *NOL and AMT in Corporate Knowledge Base*
- (2) Below is a list of some related code sections that may apply:
- IRC 39, Carryback and Carryforward of Unused Credits
 - IRC 56, Adjustments in Computing Alternative Minimum Taxable
 - IRC 58, Denial of Certain Losses—[AMT]
 - IRC 59, Other Definitions and Special Rules—[AMT]
 - IRC 165, Losses
 - IRC 172, Net Operating Loss Deduction

- IRC 461(l), Excess Business Loss
- IRC 469, Passive Activity Losses and Credits Limited
- IRC 1202, Partial Exclusion for Gain From Certain Small Business Stock
- IRC 1212, Capital Loss Carrybacks and Carryovers
- IRC 1341, Computation of Tax Where Taxpayer Restores Substantial Amount Held Under Claim of Right
- IRC 1402, Definitions, (Self—Employment Income)
- IRC 6411, Tentative Carryback and Refund Adjustment
- IRC 6201, Assessment Authority
- IRC 6501, Limitations on Assessment and Collection
- IRC 6511, Limitations on Credit or Refund
- IRC 6601, Interest On Underpayment, Nonpayment, Or Extensions Of Time For Payment, Of Tax
- IRC 6676, Erroneous Claim for Refund or Credit
- IRC 7602, Examination of Books and Witnesses
- IRC 7701, Definitions

(3) Below are relevant IRMs:

- IRM Exhibit 4.4.12-1, Item 44 and 45, NOL Information Examples
- IRM 4.10.5, Examination of Returns, Required Filing Checks
- IRM 4.10.11, Examination of Returns, Claims for Refund and Requests for Abatement
- IRM 4.10.8.14.3, Adjustments to Net Operating Loss (NOL)
- IRM Exhibit 4.10.4-6, Auditing Net Operating Loss Deductions (NOLD)
- IRM 4.27.1, Bankruptcy, Examiner Responsibilities and Procedures
- IRM 4.36, Joint Committee Procedures
- IRM 20.1.5.3.4, Penalty Handbook, Return Related Penalties - Carrybacks and Carryovers
- IRM 20.2.4, Interest, Overpayment Interest
- IRM 20.2.5, Interest, Interest on Underpayments
- IRM 20.2.9, Interest, Interest on Carryback of Net Operating Loss
- IRM 21.5.9, Account Resolution, Carrybacks

(4) Below are relevant Revenue Notices, Revenue Procedures and Revenue Rulings

- Rev. Proc. 2021-14, Special Election for Taxpayers with Farming Loss NOLs
- *Notice 2020-26*, Extension of Time to File Application for Tentative Carryback Adjustment
- Rev. Proc. 2020-24, Examination of Returns and Claims for Refund, credit, or Abatement; Determination of Corrected Tax Liability
- Rev. Rul. 2009-9, Theft Losses
- Rev. Rul. 87-44, Effect of Election to Forgo the Carryback Period on AMT
- Rev. Rul. 86-57, Claims; Joint Returns; Credit Against Separate Tax Liability; Net operating loss
- Rev. Rul. 81-88, Section 6511 Limitations on Credit or Refund
- Rev. Rul. 80-6, Joint Return; Net Operating Loss for Separate Return Year
- Rev. Rul. 77-225, Charitable Contribution; Carryover of Improper Deduction; Limitation Period

4.11.11.2
(04-17-2023)

**Overview for Net
Operating Loss (NOL)
and Net Operating Loss
Deduction (NOLD)**

- (1) Due to numerous changes in tax law, it is important to know applicable law for the years that the NOL arose, the intervening years and the years to which the loss can be carried. For example, an NOL from a taxable year beginning in 2017 can generally be carried back 2 years, but can only be carried forward 20 years. An NOL from a taxable year beginning in 2021 can generally only be carried forward, but it can be carried forward indefinitely. An NOL from a taxable year beginning in 2018, 2019, and 2020 can generally be carried back 5 years, and carried forward indefinitely; but NOL deductions for years beginning after 2020 are subject to the 80% of taxable income limitation as discussed in IRM 4.11.11.2.1 if the NOL deduction is attributable to an NOL from a tax year beginning after 2017.
- (2) It is important to know the applicable law regarding the amount of the NOL that is absorbed in the intervening years. This is particularly important with individual returns that have varying modifications to the taxable income used to arrive at the amount absorbed.
- (3) It is important to note the exceptions to the general rules. For example, for tax year 2021, business losses that are attributable to farming or insurance other than life insurance are permitted to be carried back 2 years. For losses attributed to a farming business, the 80% taxable income limitation still applies. For insurance companies other than life insurance companies, the 80% taxable income limitation does not apply, but the carryforward period is limited to 20 years.
- (4) A taxpayer who has an overpayment of tax as a result of an NOL carryback can file a tentative refund application (also referred to as a TENT) or a restricted interest (RINT) claim for adjustment or refund with respect to the carryback year. IRM 21.5.9, Account Resolution, Carrybacks, provides details on carryback rules including the difference between a carryback claim filed using an amended return form and tentative carryback application using a Form 1045, Application for Tentative Refund for Individuals, Estates and Trusts, or Form 1139 Corporation Application for Tentative Refund, for corporations (other than S Corporations).
- (5) As noted in IRM 4.11.11.2.3, an Excess Business Loss is treated as an NOL carryover for subsequent years.
- (6) As noted in IRM 4.11.11.4, Examining Tax Returns Reporting Net Operating Losses, examiners adjusting returns that report a net operating loss are responsible for addressing the impact on other years.
- (7) Special ordering rules apply to carrybacks of NOLs, capital losses (corporations only), and certain nonrefundable credits.
- (8) Special rules apply to REITs, life insurance companies and carrybacks to years to which IRC 965 applies (IRC172(b)(1)(D)).
- (9) After a reorganization or other change in corporate ownership, the use of certain carryforwards may be limited or prohibited under IRC 382, Limitation on net operating loss carryforwards and certain built-in losses following ownership change or 26 CFR 1.1502-21(c) Limitations on net operating loss carryovers and carrybacks from separate return limitation years. See also IRM 4.11.11.10, Effects on Other Areas Including Ordering Rules. It includes other code sections that may have an impact on the amount of the NOLD.

4.11.11.2.1
(04-17-2023)
**IRC Section 172 Net
Operating Loss
Deduction**

- (1) IRC 172 provides the method to compute an NOL and addresses when an NOLD can be claimed.
 - a. A net operating loss is generally the excess of deductions (as they relate to a business or casualty) allowed over the gross income. Business deductions include those deducted for expenditures incurred as an employee. However, no such itemized deductions are allowed for most individual taxpayers for 2018 through 2025 for employee business expenses or personal casualty losses. (This is a result of the Tax Cuts and Jobs Act, provisions 11044 and 11045.)
 - b. An NOL is determined on individual, trust, estate, and corporate returns. It is not determined at the pass-through entity level.
 - c. A deduction of the NOL carried to the year (carried forward or back from another year) is referred to as a net operating loss deduction (NOLD). The NOL is computed in order to determine the NOLD in the carryback or carryover year. It does not change the negative taxable income in the year of the NOL. An NOLD is the sum of the NOL carryovers and carrybacks to a year, subject to limitations beginning in 2021. Certain NOL adjustments are required in order to determine the NOLD in the year to which the loss is carried.
 - d. The computation of the NOL and NOLD is subject to certain modifications to taxable income or loss as listed in IRC 172(d).
- (2) Over the years, there have been numerous changes in the number of years an NOL could be carried back or forward. There have generally been exceptions to the rules for taxpayers in certain activities, such as farmers. This section provides information regarding the calculation of the NOL or NOLD as well as applicable steps that can be taken in verifying the deduction.
 - a. For years beginning prior to 1/1/2018, the NOL could generally be carried back 2 years and carried forward 20 years (assuming the taxpayer did not elect to forgo the carryback). The loss is carried back to the earliest available year. If there are NOLs arising from multiple years, they are applied in the order that they are incurred.
 - b. The passage of the Tax Cuts and Jobs Act of 2017 (TCJA) and subsequently the Coronavirus Aid, Relief and Economic Security Act (CARES) Act in 2020 introduced significant changes to the carryback and carryover rules:
 - As a result of the CARES Act, NOLs arising in taxable years beginning after 12/31/2017 and before 1/1/2021 may be carried back 5 years and forward indefinitely.
 - As a result of TCJA, in general, for years beginning after 12/31/2020, NOLs may not be carried back, but may be carried forward indefinitely. This tax law change under TCJA was postponed by the CARES Act. (Prior to the CARES Act, the restrictions on carrybacks were to be effective for 2018 and subsequent years.)
 - As a result of TCJA, in general, an NOLD from NOLs arising from taxable years beginning after 12/31/2017 is subject to an 80% taxable income limitation. The CARES Act modified this TCJA change by delaying the limitations, so it only applies to NOLDs in taxable years beginning after 12/31/2020.

4.11.11.2.2
(04-17-2023)

Calculating the NOL

- (1) A non-corporate taxpayer filing a return that shows negative taxable income potentially has an NOL - the basis for computing an NOLD in another year. Starting with the negative taxable income, several modifications (add backs) must be made to determine if the taxpayer has an NOL.
- (2) An NOL must result from a loss on the operation of a trade or business or from a casualty or theft loss. Therefore, modifications must be made to taxable income to eliminate losses that are not related to these types of deductions.
- (3) The modifications are listed in IRC 172(d).
- (4) For individuals, the NOL can be calculated using Schedule A of the Form 1045.
- (5) For individuals, SB/SE examiners can use the RGS Special Application on Knowledge Management to verify the calculation of the NOL. See IRM 4.11.11.3, Proper Use of the NOLD.

4.11.11.2.3
(04-17-2023)

Calculating the Excess Business Loss

- (1) The Tax Cuts and Jobs Act (TCJA) (as modified by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), the American Rescue Plan Act (ARPA) and the Inflation Reduction Act (IRA)) provided for limitations on business losses for noncorporate taxpayers pursuant to IRC 461(l) effective for years beginning after 12/31/2020 and before 1/1/2029.
- (2) The limitation is computed using Form 461, Limitation on Business Losses.
- (3) The limitation is the excess of:
 - Total deductions attributable to the taxpayer's trade(s) or business(es) over
 - Total gross income and gains attributable to the taxpayer's trade(s) or business(es) PLUS the applicable threshold amount.
- (4) The threshold amount is adjusted for inflation. For 2021, the threshold amounts were \$262,000 or \$524,000 if married filing jointly.
- (5) The excess amount is treated as an offsetting amount - shown as a positive number as other income. For 2021, the amount should be identified as "ELA"
- (6) Ordering rules: At risk rules (IRC 465) and passive activity losses (IRC 469) are applied prior to the computation of the Excess Business Loss.
- (7) The excess amount is treated as an NOL carryover in subsequent year(s).

4.11.11.2.4
(04-17-2023)

Determining the NOLD

- (1) For taxable years beginning before 1/1/2021, the NOLD is the aggregate of net operating loss carryovers, plus net operating loss carrybacks.
- (2) For taxable years beginning after 12/31/2020:
 - a. Determine the total amount of NOLs arising from taxable years beginning before 1/1/2018, carried to such taxable year.
 - b. If the amount in (a) is equal to or exceeds the taxable income for such taxable year (computed without deductions listed in (3)), then the NOLD is the amount in (a).
 - c. If the amount in (a) is less than the taxable income (as computed in (b)), then the NOLD is the total amount in (a) **plus** the lesser of:

- The total amount of NOLs arising from taxable years beginning after December 31, 2017 that are carried to such year, and
- 80% of the excess of taxable income (as computed in (b)) over the amount in (a).

(3) For the purposes of this subsection, 80% of taxable income is computed without regard to the deductions under IRC sections 172, 199A and 250.

4.11.11.2.5 (04-17-2023) Resources

- (1) RGS Special applications are available on the Virtual Library of Knowledge Management. These provide computations for NOL, NOLD, and amounts absorbed. See IRM 4.11.11.3. Different spreadsheets are required for Joint Committee Cases. See IRM 4.11.11.15.
- (2) IRM 21.5.9 has sections detailing aspects of NOLs.
- (3) For SBSE Examinations, Lead sheets are available for issues involving NOLs, NOLs, and EBLs in the Lead Sheet Issues Reference Guide (LSIRG). See IRM 4.10.15.7.9.3.
- (4) Corporate/Business Issues & Credits Knowledge Base - NOL & AMT provides audit tools, training and other materials related to corporate NOLs and AMT. See also IRM 4.11.11.1.5, Related Resources

4.11.11.3 (04-17-2023) Proper Use of the Net Operating Loss Deduction (NOLD)

- (1) It is important to ensure the NOLD receives the proper tax treatment because of the potential impact that the NOLDs may have on multiple year returns. A key element of the process is the correct determination of the loss year's NOL and computation of the NOLD, both of which should be verified for accuracy as part of the examination process. For individuals, SB/SE examiners can use the RGS Special Application on the Virtual Library located Losses Book in the 1040 Knowledge Base. The chapter named *Net Operating Losses* contains the spreadsheets used to compute the NOL, the NOLD and the amount of the NOL carryover that is absorbed in the intervening years. These spreadsheets can be used as supporting schedules on the examination report.
- (2) In general, the NOL will be carried to the earliest possible year. Earlier NOLs are absorbed first. See special elections in IRM 4.11.11.12 below for exception. In general, NOLs are generated from the following sources:
 - a. Deductions from trade or business
 - b. Deductions for business-related expenses as an employee
 - c. Deductions for casualty and theft losses
 - d. Deduction for losses from a partnership or S corporation. Individuals can use apportioned shares of partnership/corporate business income and loss to calculate their individual NOL.
- (3) NOL deductions may have an effect on the following areas depending on the year of the tax return. The list below is not all inclusive.
 - a. Income averaging for farmers and fishermen—When an NOL occurs in a year after a taxpayer has income averaged and the NOL is carried back to a base period year or years, base period income is decreased which decreases averaged income.
 - b. Retirement income credit (credit for qualified retirement savings contributions) —Schedule R for the elderly and the permanently and totally disabled.

- c. Foreign tax credit—Form 1116, Foreign Tax Credit.
- d. Alternative minimum tax—Form 6251, Alternative Minimum Tax—Individuals.
- e. Items computed based on AGI.

(4) See IRM 21.5.9.5.10, Carryback Net Operating Loss for more details.

4.11.11.4
(02-07-2022)

Examining Tax Returns Reporting Net Operating Losses

- (1) Examination of tax returns reporting net operating losses often involve a carryback for the amount of the NOLD. It is important to know if the carryback has been paid. If you are examining an unpaid claim (RINT), follow the procedures in IRM 4.10.11, Examination of Returns, Claims for Refund and Requests for Abatement. If you are examining a carryback year with a paid tentative refund (TENT), see IRM 4.10.8.14.3.3, Reports After a Tentative Refund or Credit.
- (2) Examiners adjusting returns that report a net operating loss are responsible for addressing the impact of the adjustment on any carryback(s) filed. To help ensure all actions taken by the taxpayer are considered during the examination, examiners should ask the taxpayer if the loss was carried back, and review IDRS at the beginning of the examination and again during the preparation of the proposed adjustments report for all eligible carryback years in search of category and/or transaction codes indicating the loss was carried back.
- (3) The SUMRY record of the taxpayer may show case controls on the carryback year(s):
 - CTRL-ASGMT to indicate there is an open case control in place,
 - CLOSED to indicate the case has closed a control(s), or
 - MULTIPLE to indicate multiple open case controls
- (4) The control base and history information section of the TXMODA record of the loss year may show:
 - Category code TENT to indicate a tentative refund has been paid or is currently being considered or
 - Category code RINT to indicate a restricted interest refund claim on an amended tax return.

See IRM 21.5.9, Carrybacks, for additional information.

- (5) When a tentative refund request has been filed, the IMFOL/BMFOL record of the **carryback year** may show:
 - Transaction Code (TC) 295 to indicate the refund has been paid.
- (6) When a restricted interest refund claim has been filed, the IMFOL/BMFOL record of the **carryback year** may show:
 - TC 976/977 or TC 971 with an Action Code 091 for a filed amended return and/or
 - TC 291 for the abated tax if the amended return was processed.
- (7) If the existence of a carryback is indicated as a result of the IDRS review, examiners should secure the relevant information from the taxpayer or the Correspondence Imaging System (CIS) and address the impact of the proposed loss-year adjustment(s) on any carryback refund(s) claimed or processed. CIS

information may be secured through an AIMS/ERCS Coordinator. If the tentative refund/claim has not been processed but there are open case controls, see IRM 4.10.2.2.5, Other IRS Business Units Working with Taxpayer

4.11.11.5
(04-17-2023)
NOL Workpapers

- (1) In addition to the above forms, examiners should include in their workpapers a spreadsheet analysis covering the loss year and any carryover/carryback year(s) to which the loss is carried. The spreadsheet should begin with taxable income per return or as previously adjusted and conclude with the proposed deficiency or overassessment.
- (2) A workpaper or schedule should be prepared for charitable contribution carryovers and the alternative minimum tax net operating loss deduction.
- (3) Every case should have a complete summary of all carryback and carryover items. The following is a listing of items requiring a summary when they are applicable:
 - a. Net operating losses
 - b. Foreign tax credit
 - c. General business credit
 - d. Contributions
 - e. Alternative tax net operating losses
 - f. Prior year minimum tax credit
 - g. Capital losses

4.11.11.6
(04-17-2023)
Penalties—NOL Carrybacks and Carryovers

- (1) IRC 6676 calls for a civil penalty on erroneous claims for refund or credit unless it is shown that the claim has a reasonable cause.
- (2) See IRM 20.1.5.3.4, Carrybacks and Carryovers, for additional guidance on penalty applicability.
- (3) See IRM 20.1.5.18, IRC 6676, Erroneous Claim for Refund or Credit Penalty, for possible application of this penalty in NOL carryback or carryover adjustment situations.

4.11.11.7
(04-17-2023)
Statute of Limitations for Assessment

- (1) The period of limitations on assessment in carryback years can be different from the general period of limitations on assessment. See IRC 6501, Assessment Statute of Limitations Controls, IRM 25.6.1.10.2.8.1, Net Operating Loss (NOL) Carryback or Capital Loss Carryback and IRM 4.10.11.5.1.2, Assessment Statute Expiration Date (ASED) - NOL Carrybacks.
- (2) IRC 6501(a) provides that a tax generally must be assessed within three years after the filing of the return. If a deficiency exists on a tax module that is not attributable to a carryback allowance (net operating loss carryback, capital loss carryback, credit carryback) on the same tax module, the statutory period of time to make the assessment is generally the later of the following:
 - a. 3 years from the return due date,
 - b. 3 years from the date the return was filed, or
 - c. Exceptions found under IRC 6501(c).
- (3) IRC 6501(h) and IRC 6501(k) provide exceptions to this general rule with respect to NOL carrybacks. If a deficiency exists on a tax module that is attrib-

utable to a carryback allowance (net operating loss carryback, capital loss carryback, credit carryback), the statute for assessment of the deficiency generally is the later of the following:

- a. 3 years from the due date of the loss year return in which the carryback allowance originated,
 - b. 3 years from the date the loss year return—in which the carryback allowance originated—was filed, or
 - c. Exceptions found under IRC 6501(c).
- (4) Under IRC 6501(h), a deficiency in the gain year resulting from an NOL carryback may be assessed at any time before the assessment statute expiration date (ASED) of the loss year. However, IRC 6501(h) only extends the ASED for deficiencies attributable to the NOL carryback deduction and provides exceptions to this general rule with respect to NOL carrybacks. See IRM 25.6.23, Examination Process—Assessment Statute of Limitations Controls.

Example: M Corporation claims an NOL of \$50,000 for tax year 2017 and files a Form 1120X to carry back the loss to its 2015 tax year. In 2018, M receives a refund of \$10,000 for 2015 attributable to the carryback. In 2020, it is determined that the amount of the NOL for 2017 is \$30,000, rather than \$50,000, and that the correct refund for 2015 attributable to the carryback should have been \$6,000, rather than \$10,000. Assuming that M filed its 2017 return timely, the Service has until April 17, 2021 (4-15-18 landed on a weekend) to assess the excessive amount refunded attributable to the NOL carryback, i.e., \$4,000 (\$10,000, the original amount refunded due to the NOL, minus \$6,000, the amount the Service should have refunded after accounting for the NOL).

- (5) Under IRC 6501(k) if an NOL carryback results in a tentative carryback allowance per IRC 6411, the ASED for assessing the deficiency in the gain year is extended to include the applicable period in IRC 6501(h). If the ASED under IRC 6501(h) is still open to assess deficiencies in the gain year attributable to the carryback, the assessment period also is still open to assess a deficiency in the gain year that is unrelated to the carryback. The amount that may be assessed, however, is limited to the amount applied, credited, or refunded under IRC 6411, less any amount the Service may assess under IRC 6501(h).

Exception: The assessable amount may not exceed the amount of the carryback minus any amount already assessed under IRC 6501(h).

Example: M Corporation claims an NOL of \$50,000 for tax year 2017 and files an application per IRC 6411 for a carryback adjustment of its tax for 2015. In 2018, M receives a refund of \$10,000 attributable to the carryback. In 2020, the Service determines that the correct amount of the NOL for 2017 is \$30,000, rather than \$50,000, and that the correct refund for 2015 attributable to the carryback should have been \$6,000, rather than \$10,000. In addition, the Service determines that M had an additional deficiency of \$8,000 for 2015 due to its failure to report certain income on its 2015 return. Assuming that M filed its 2017 return timely under IRC 6501(h), the Service has until April 17, 2021 to assess the excessive carryback amount refunded, i.e., \$4,000 (\$10,000 the original amount refunded, minus \$6,000, the amount the Service should have

refunded after accounting for the NOL). Under IRC 6501(k), the Service may also assess on or before April 17, 2021, \$6,000 of the \$8,000 deficiency due to M's failure to include certain income on its 2008 return (\$10,000, the amount refunded under IRC 6411, minus \$4,000, the amount that may be assessed under IRC 6501(h), solely by reason of the excess carryback).

- (6) **Regular statute open in carryback year**—If the regular statute of limitations under IRC 6501(a) has not yet expired for the carryback year, a decision should be made on Form 9984, Examiner's Activity Record, (and/or supporting workpapers) documenting as to whether the normal statute will be protected or the carryback statute will be controlling.
- (7) A deciding factor in determining whether to use an alpha statute or the original statute is if there are 180 days left on the statute. If there are more than 179 days left on the statute, in general, the examiner will use the original statute date. If there are fewer than 180 days left on the statute, the examiner will use the alpha statute described in IRM 25.6.23. If the normal statute will not be protected, the statute should be updated to AA if the carryback claim has not been paid, and BB if it has been paid, and the decision not to protect the normal statute documented on Form 895. See IRM Exhibit 25.6.23-3, Instructions for Updating the Statute on AIMS for additional requirements when updating the statute to an alpha code..
- (8) Adjustments can be made for the purpose of determining how much of a net operating loss may be carried over and deducted in a subsequent year. The authority for doing so is IRC 7602(a) which states, "For the purpose of ascertaining the correctness of any return, the Secretary is authorized to examine any books, papers, records, or other data which may be relevant or material to such inquiry."
- (9) Substantiation of the net operating loss deduction must satisfy IRC 6001. IRS can look at records as far back as is necessary in order to determine the correct amount of the NOLD being utilized in the current year and subsequent years. Copies of tax returns are not proof nor are accountants' workpapers. In *Owens v. Commissioner*, T.C. Memo 2001-143, the Court concluded that "Although each of the returns for 1990, 1991, and 1992 shows a loss attributable to petitioners' Schedule C business, petitioners failed to introduce any evidence establishing the loss claimed in each of those returns. The returns for 1990 through 1992 constitute nothing more than the position of petitioners that they had the respective losses claimed in those returns."
- (10) A carryover from a carryback year with barred items provides for the carryover of the **correct** taxable income. In essence, errors in a closed year are **corrected** for purposes of determining the taxable income of an open year.
 - a. For the application of this rule to the year that an NOL should have arisen except a now barred deduction was not claimed by the taxpayer, see Situation 2 of Rev. Rul. 81-88, 1981-1 CB 585 (amplified by Rev. Rul.85-64) where a taxpayer who failed to take a deduction of \$220x in a closed year in which it had \$100x of taxable income could use the \$220x to generate an NOL carryforward of \$120x.
 - b. For the application of this rule to the year that an NOL arose, but a now barred deduction was overstated, see Rev. Rul. 56-285, 1956-1 CB 134

(an NOL carryover to an open year was reduced by the amount of erroneous excess depreciation a taxpayer had claimed in the closed loss year).

Exceptions to the rule above are as follows:

- a. Do not use the correct taxable income when the IRC or Treas. Regs. specifically requires a timely act as a condition to allowing a particular tax treatment in a closed year.
- b. **Carryback to an otherwise closed year in which the taxpayer failed to claim a deduction.** A barred deduction is not taken into account in determining the amount of the carryback used in the closed year; therefore, more of the NOL must be applied than would be the case if the correct taxable income was taken into account. This result is based on Treas. Reg. 301.6511(d)-2(a)(3). Consequently, the barred deduction does not reduce the amount carried over to the year after that closed year (i.e., the correct taxable income is not applied for this purpose either). See Rev. Rul. 81-88, 1981-1 CB 585, Situation 1 and the following example.

Example: XYZ Corporation filed its 2015 return timely, reporting taxable income of \$100,000 and tax of \$40,000. No extensions were filed and the IRC 6501(a) statute for 2015 expired on March 15, 2019. (The due date for C corporations prior to the enactment of P.L. 114-41 was 2 1/2 months after the taxable year end.) XYZ Corporation filed its 2016 return timely, in which a net operating loss of \$165,000 was reported. On June 1, 2019, an 1120X was filed by XYZ to carry back the 2017 loss to 2015. On September 8, 2019, an audit of XYZ for taxable years 2015 through 2017 revealed that XYZ had failed to claim \$20,000 in deductions on its 2015 return. No other adjustments were discovered during the audit. XYZ will receive a refund of the \$40,000 in tax for 2015. The net operating loss carryover to 2016 will be \$65,000 (\$165,000 - \$100,000). The \$20,000 unclaimed deduction cannot increase the amount of the refund in 2015 nor will it impact the amount of the NOL carryover to taxable year 2016.

4.11.11.8
(04-17-2023)
**Form 5344, Examination
Closing Record,
Procedures**

- (1) The examiner should verify that the proper amounts and transaction codes are entered on Form 5344.
- (2) Item 12, Tax, Penalty, and Interest Adjustments—If a portion of the adjustment is due to a carryback multiple entries may be required in Block 12.

Example: The transcript shows a TC 295 for \$20,000 (abatement resulting from a tentative allowance). The Examination Report shows \$15,000 of the tentative is disallowed. The Examination Report also shows an adjustment of \$5,000 that is not attributable to the carryback. Item 12 should reflect a TC 308 (deficiency assessment generating an assessment of interest from the computation included with the entry) of \$15,000 and a TC 300 (deficiency assessment) of \$5,000 and a restricted interest Examination Report should tie to the \$5,000 for a total of \$20,000.

- (3) Item 44, NOL Carryforward Disallowed Amount—This item is used if all or part of an NOL carryforward is disallowed and the carryforward year return is **not**

picked up for examination (return not due). See IRM 4.4.12, Examined Closings, Surveyed Claims, and Partial Assessments, specifically IRM 4.4.12.5.53, Item 44: NOL C/F Disallowed Amount, and IRM Exhibit 4.4.12-1, Item 44 and 45, NOL Information Examples.

- (4) Item 45, NOL Indicator—This item is entered whenever an NOL return (taxable income line is less than zero) was audited. See IRM 4.4.12.5.54.3, Item 45: NOL Indicator for Non-NOL Years Offset by Carryover, and IRM Exhibit 4.4.12-1.

4.11.11.9
(04-17-2023)
**Form 5346, Examination
Information Report,
Procedures**

- (1) Form 5346, Examination Information Report, is used by examiners when it is determined that a related tax return should be considered for examination. When examination adjustments are made that reduce or eliminate the amount of NOL being carried over to subsequent years not yet filed, Form 5346 should be completed by the examiner and submitted to planning and special programs (PSP). This is important since it safeguards against the possibility of taxpayers claiming unallowable losses in future unfiled years.

4.11.11.10
(04-17-2023)
**Effects on Other Areas
Including Ordering
Rules**

- (1) There is a requirement to offset all taxable income in a carryback year before applying the carryback to other years including years subsequent to the loss year. IRC 172(b)(2) states that the entire amount of the NOL for any taxable year (referred to in this section as the 'loss year') shall be carried to the earliest of the taxable years to which (by reason of IRC 172(b)(1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be any excess of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried.
- (2) An NOL carryback may necessitate a recomputation of tax liability for the carryback year. Typical deductions that may require recomputation include itemized deductions based on adjusted gross income (AGI). Any credits that are based on or limited by the amount of tax must also be refigured.
- (3) The credit ordering rules can be complicated. The examiner must establish the correct taxable income before applying any credits or capital loss carrybacks, etc. There would have to be regular tax before application of any credits. For example, if the current year return has no regular tax (before credits), there would be a carryback of the credit to the taxable year preceding the unused credit year and a carryover of the credit with a 20 year carryover period for general business credits. See IRC 39(a)(1) and IRM 21.5.9.5.12.1, Carryback Credits Ordering Rule.
- (4) Never recompute charitable contributions when there is an NOL **carryback**. The amount of charitable contribution deduction is impacted by an NOL **carryover** only. Regarding the interaction between NOLs and charitable contributions, refer to IRC 172(d), IRC 170(d), Treas. Reg. 1.170A-10 (for individuals), and Treas. Reg. 1.170A-11 (for corporations).
- (5) See Notice 89-3, 1989-1 CB 623, IRC 170(d)(1)(B), and Treas. Reg. 1.170A-10 regarding the following:
 - a. Ordering rules for the allocation of net operating losses, overall foreign losses, and separate limitation losses.
 - b. The recapture of overall foreign losses and separate limitation losses.
 - c. The allocation of U.S. source losses.

4.11.11.10.1
(04-17-2023)

Business Credits

- (1) For taxable years beginning after 12/31/97, the general business credit is carried back one year per IRC 39(a)(1). The statute of limitations will be governed by the year in which the NOL arose. See IRC 6511(d)(4).
- (2) Where there is an NOL carryback that reduces regular tax liability in the carryback year to the point where there are unused credits, certain credits (such as general business credits or foreign tax credits) must be carried back before any carryforward of the credits.

4.11.11.10.2
(04-17-2023)

Corporate Capital Loss Carrybacks

- (1) A corporation may carry back a capital loss to each of the three years preceding the loss year. Any excess may be carried forward for five years following the loss year. However, the amount which can be carried back is limited to an amount that does not cause or increase an NOL in the carryback year. The entire amount of any net capital loss must be carried to the earliest of the taxable years to which such net capital loss may be carried. Special limitations exist for losses attributable to a foreign expropriation capital loss..
- (2) See IRC 1212(a)(1), Treas. Reg. 1.1212-1(a)(3)(ii), and IRM 21.5.9.5.11.2, Net Capital Loss (NCL)—Corporations—Carryback/Carryforward Limitations.

4.11.11.10.3
(04-17-2023)

Alternative Tax Net Operating Loss Deduction (ATNOLD)

- (1) When computing alternative minimum tax (AMT) for non corporate taxpayers (or for corporations in taxable years beginning prior to 1/1/2018), the regular NOLD must be substituted with ATNOLD. ATNOLD is equal to the regular NOLD with modifications. Note: Corporate AMT was repealed for taxable years beginning after 12/31/2017.
- (2) First, adjustments must be made to the NOL as provided in the following:
 - IRC 56
 - IRC 57 (items of tax preference)
 - IRC 58
- (3) Second, ATNOLD is limited to 90% of alternative minimum taxable income in the carryover or carryback years in general.
- (4) Various legislative acts over the last several years have allowed for certain NOLs to offset 100 percent (instead of 90 percent) of the taxpayer's alternative minimum taxable income (AMTI). Some of these legislative acts:
 - a. The Job Creation and Workers Assistance Act of 2002
 - b. Gulf Opportunity Zone Act of 2005 (GO Zone)
 - c. Kansas Disaster Net Operating Losses (2008)
 - d. Midwest Disaster Net Operating Losses (2008)
 - e. National Disaster Relief Act of 2008
 - f. The American Recovery and Reinvestment Act of 2009
 - g. The Worker, Home ownership, and Business Assistance Act of 2009

Note: Information on these legislative acts can be found in specific subsections of this IRM. Also see IRM 21.5.9.5.10.5, Carryback Net Operating Loss (NOL) Affecting Alternative Minimum Tax (AMT).

4.11.11.10.3.1
(04-17-2023)
**Computation of
Alternative Tax NOL
Deduction (ATNOLD)**

- (1) **ATNOLD:** To figure the amount of the recomputed AMT NOL that can be carried to another year, the recomputed loss is subtracted from the alternative minimum taxable income (as modified under the NOL rules) for the carryover year. This rule is applied even if the taxpayer is not subject to alternative minimum tax in that year.
- (2) The ATNOLD is computed as follows:
 - a. Make the adjustments to the NOL computed for regular tax purposes with the adjustments provided in IRC 56 and IRC 58 and reduced by the items of tax preference determined under IRC 57 (but only to the extent that the item increased the NOL for the year for regular tax purposes). See IRC 56(d)(2).
 - b. After making the above calculations, the amount of the NOLD that may be deducted in a carryback or carryover year may not exceed 90% of the alternative minimum taxable income for that year, as figured before the NOL deduction.
- (3) In years that the taxpayer does not have an alternative minimum tax liability, the taxpayer must still reduce his ATNOL by 90% of the taxpayer's alternative minimum taxable income for that year. For this purpose, alternative minimum taxable income is the amount arrived at on line 6, Form 6251. See IRC 56(d)(1)(a). The amount of ATNOL carryforward for tax years beginning before 1987 that may be deducted in tax years beginning after 1986 may not exceed 90% of his alternative minimum taxable income for that year.
- (4) For more detailed information on these adjustments, refer to Pub 536, Net Operating Losses for Individuals, Estates and Trust and instructions for Form 6251, Alternative Minimum Tax—Individuals.

4.11.11.10.4
(04-17-2023)
Restricted Interest

- (1) In general, interest on a refund is allowed and paid under IRC 6611(a) from the date of the overpayment to a date (to be determined by the Secretary) preceding the date of the refund check by not more than 30 days. IRC 6611(f) provides special rules for computing interest on refunds attributable to NOL carrybacks. If any overpayment results from an NOL carryback, the overpayment is deemed not to have been made prior to the filing date for the taxable year in which such NOL arises. For this purpose, the term "filing date" means the last date prescribed for filing the return of tax imposed by subtitle A for the taxable year (determined without regard to extensions). Because these special rules modify the normal overpayment interest rules, the interest is commonly referred to as "restricted interest".
- (2) Cases involving NOL carrybacks must be identified on Form 3198, Special Handling Notice, as restricted interest cases.
- (3) Form 2285, Concurrent Determinations of Deficiencies, is prepared where there is a combination of restricted adjustments and general adjustments in a given tax year. An example of this would be where there is an NOL carryback from 2011 to 2009—this is purely a restricted adjustment. However, if changes are made to the taxable income of the carryback year that have nothing to do with the NOL carryback, these are general adjustments. General adjustments generate interest calculations based upon IRC 6601. Restricted adjustments involving refunds are calculated using IRC 6611 while any deficiency impacting restricted adjustments are calculated using IRC 6601(d).

- (4) See IRM 20.2.1.4, Normal and Restricted Interest, and IRM 20.2.9, Interest on Carryback of Net Operating Loss and IRM Exhibit 4.10.8-12, Restricted Interest Decision Chart (Non-Joint Committee Cases Only).

4.11.11.10.5
(04-17-2023)
Self-Employment Tax Cases

- (1) NOL carryovers and or carrybacks have no affect on the self-employment tax liability of the year to which they are carried. See IRC 1402(a)(4).

4.11.11.11
(04-17-2023)
Requesting a Refund

- (1) As noted in IRM 4.11.11.2 a refund can be requested using a Form 1045, Application for Tentative Refund for Individuals, Estates and Trusts, or Form 1139, Corporation Application for Tentative Refund, for corporations (other than S Corporations).
- (2) A Form 1045 or Form 1139 should not be filed with the examiner. The form should be sent directly to the service center per the instructions to avoid delays. As noted in (4) below, action must be taken on a timely basis from the date of receipt. The examiner can request a copy.
- (3) If a taxpayer's tax liability is reduced due to an NOL carryback, the taxpayer may request a refund or credit or a tentative refund. Upon receipt of any claim or tentative carryback, the examiner should verify and update the statute of limitations with consideration of the source year return statute and the potential for use of alpha statutes under IRM 25.6.23. Also, the examiners should request a transcript of account before preparing the examination report to verify the correct statute and determine if the refund has already been made.
- (4) A request for refund or credit for an NOL carryback can be accomplished by a taxpayer filing Form 1040X (individuals) or Form 1120X (C Corporation). See IRC 6511(a) and IRM 4.10.11, Examination of Returns, Claims for Refund and Requests for Abatement.
- (5) Below are some important things to keep in mind :
- A claim for refund generally must be filed within 3 years from the time the return was filed (including extensions). However, if a refund is attributable to an NOL carryback, a claim for refund can be filed within 3 years of the due date (including extensions) of the NOL source year return. Carryback allowances are generally processed with a transaction that contains an INT-CMPTN-DT (e.g., TC 295, 299, 305, 309).
 - IRC 6511(d)(2), Special Period of Limitation With Respect to Net Operating Loss or Capital Loss Carrybacks, is an additional provision. The taxpayer may file a claim if either the statute under IRC 6511(a) or IRC 6511(d)(2) is open.
 - Form 1045 (individuals) or Form 1139 (corporations) are application forms used to file for a **tentative** refund.
 - An application for tentative refund must be filed within 12 months following the end of the loss year. Action must be taken by the Service on the application within 90 days of the filing of the Form 1045 or Form 1139. See Treas. Reg. 1.6411-3(a).
 - Tentative carryback refunds are considered "tentative refunds" and subject to regular report writing procedures. The deficiency procedure does not apply to assessments arising from tentative carryback allowances. See IRC 6213(b)(3).

- f. The filing of Form 1045 or Form 1139 does not constitute a claim for credit or refund upon which the taxpayer may file suit in court, if it is rejected by the Commissioner. A tentative allowance can generally be identified on a transcript by the posting of a TC 295.

4.11.11.12
(04-17-2023)
**Election to Forgo
Carryback**

- (1) Due to the TCJA and the CARES Act, effective for tax years beginning 2021, most taxpayers do not have the option to carry a loss back. Exceptions to this rule are losses related to farming businesses and insurance companies other than life insurance. Such taxpayers are eligible to carry the NOL incurred relating to such losses back two years. Prior to the changes for most taxpayers, and currently for taxpayers that meet the exception, a taxpayer can elect to forgo the carryback period. See IRC 172(b)(3). The election must be made by the due date (including extensions) for filing the return for the loss year, unless an exception applies. Taxpayers usually attach a statement to the filed tax return notifying the Service that the taxpayer has elected to forgo the carryback period.
- (2) When a taxpayer claims an NOL during audit that was not previously claimed, the taxpayer's option to forgo carrying the NOL back will most likely be unavailable. The IRC 172(b)(3) election to waive carryback must be made by the due date, including extensions, for filing the taxpayer's return for the taxable year in which the NOL arises.
- (3) Due to the CARES Act, special rules apply to elections for taxable years beginning in 2018 and 2019:
 - In general, an election would need to be made with 2020 return (the first taxable year ending after 3/27/2020). See Rev. Proc. 2020-24 Examination of returns and claims for refund, credit, or abatement determination of the correct liability.
 - Special rules apply to taxpayers with farming losses. See Rev. Proc. 2021-14.
- (4) The timing for elections for prior years as well as the number of years that the NOL could be carried back depend on the provisions effective during those years. For example, former IRC 172(b)(1)(H) discussed the rules for carryback of 2008 or 2009 NOLs.
- (5) With respect to taxpayers eligible to carryback, if the IRC 172(b)(3) election is not timely made, the NOL must generally be carried back 2 years per IRC 172(b)(1)(A)(i). However, for tax years beginning after December 31, 2020, most taxpayers can only carry their NOLs forward.
- (6) Once the election is made to forgo the carryback, it is generally irrevocable. An exception to this is when new legislation specifically allows taxpayers to revoke the election, such as the provision in the American Recovery and Reinvestment Act (ARRA) 2009, section 1211, which allowed taxpayers until April 17, 2009, to revoke a prior election to waive the carryback period or as discussed in (4) above regarding the CARES Act. See IRM 21.5.9.5.10.9.2, Revocation of an Election to Waive the Carryback Period for Farming Losses - CTRA of 2020.
- (7) If a taxpayer did not make the election to forgo the carryback period and just carried the NOL forward, the examiner should disallow such carryover.

However, if the NOL year statute is still open, the loss can still be carried back by the taxpayer via Form 1120X or Form 1040X or by the IRS if the examination includes the carryback year(s).

- (8) If the statute of limitations on refunds has expired for the NOL year, a taxpayer cannot get a refund for carrying back the NOL. However, the taxpayer must still offset the NOL by the prior years' modified taxable income in compliance with IRC 172(b)(2). Only the excess of the NOL over the modified taxable income in those carryback years can be carried forward and utilized.
- (9) Any corporation can ask for Treas. Reg. 1.6164-1 Extension of Time for Payment of Taxes by Corporations Expecting Carrybacks relief. Prior to TCJA and CARES, under 172, a loss must generally be carried back. Only if an election is made under IRC 172(b)(3) is a taxpayer permitted to carry forward without first carrying back. See *Farmer v. Commissioner*, TC Memo 1998-327 in which the Tax Court disallowed a claimed NOL carryover where the taxpayer did not first carryback the NOL and did not file an election to forego the carryback period under IRC 172(b)(3). The Tax Court's analysis relied entirely upon the statute, IRC 172.
- (10) An election to forego the carryback period applies to both the regular tax NOL and the AMT NOL. See Rev. Rul. 87-44, 1987-1 CB. 3, and *Plumb v. Commissioner*, 97 T.C. 632, 638, 1991.

4.11.11.13
(04-17-2023)
Filing Status Changes

- (1) NOLs incurred in years when the taxpayers were not married to each other can only be applied against the separate income of the spouse who generated the loss. In other words, an NOL sustained by one spouse before marriage cannot be carried over to offset the **other** spouse's income on a joint return; it can only be applied against the income of the spouse who incurred the loss. See *Calvin v. United States*, 354 F.2d 202 (10th Cir. 1965).
- (2) Losses incurred and carried back by a spouse after a divorce or the death of a spouse can only be applied against the separate income of the spouse who incurred the loss even if the taxpayers filed joint returns in the year to which the loss is carried. See *Zeeman v. United States*, 395 F.2d 861 (2nd Cir. 1968).
- (3) A spouse who did not incur the loss may claim a refund if his or her share of the joint tax was reduced by the other spouse's NOL.

4.11.11.14
(04-17-2023)
Carryforwards

- (1) When the amount of an NOLD is material, it constitutes a large, unusual, or questionable (LUQ) item under the auditing standards. This is especially true if the NOLD was generated from the same business that gave rise to an adjustment for unreported taxable income in the current year under examination.
- (2) It is important to determine the correct taxable income in the source year as well as all of the earlier years that gave rise to the NOL carryforward (NOLD). The Service may redetermine correct taxable income in a closed year in order to ascertain either the amount of an NOL, or the amount of an NOL that is absorbed in the closed year for purposes of determining the correct net operating loss deduction for an open year. The authority for doing so is IRC 7602(a), which states, "For the purpose of ascertaining the correctness of any return, ...the Secretary is authorized to examine any books, papers, records, or other data which may be relevant or material to such inquiry."

- (3) The examiner will determine the amount of NOLD allowed upon examination of the facts and records provided. The taxpayer is required to maintain such records as will allow the examiner to verify the accuracy of the deduction. If the taxpayer declines to produce the records or the records are unavailable, the examiner may disallow the entire NOLD for lack of substantiation.
- (4) Copies of tax returns are not proof, nor are accountant's workpapers or testimony that is general, vague and unsupported. There are numerous court cases that address the requirement to provide adequate substantiation of the loss claimed in the NOL year when the year of the NOLD is under examination. See, for example, *Owens v. Commissioner*, T.C. Memo 2001-143 (2001).

(5) **Example 1**

The 201712 year is under examination. The return reflects a \$320,000 NOL carry-forward from 201212. The 201212 statute is closed, but in reviewing the taxpayer's financials and the 201212 return, it was determined the taxpayer took a large deduction for an ordinary loss. The loss appeared nondeductible based on facts uncovered in the 201712 examination and prior year financials. The NOL originated from a related party loan. The examiner requested evidence to support the following:

- a. Existence of a true debtor creditor relationship between the related parties
- b. Substantiation of an actual economic outlay
- c. Substantiation that the alleged loan was uncollectible
- d. Substantiation that the alleged loan was not a capital investment

Since sufficient information was not submitted to support the NOL carryforward created from the business bad debt, the carryforward into the current year was reduced.

The consideration of the 201212 issue is not an audit of 201212 and a 201212 Examination Report is not required. In this example, the examiner simply requested verification of the NOL carryforward deduction reflected on the 201712 return and examined the components of the NOL deduction. The examiner's analysis of this deduction is similar to any other line items an examiner selects for verification on a return.

(6) **Example 2**

The 201712 Form 1120 is under examination. The 201112 through 201712 years have NOLs plus a large NOL carryforward is reflected on the 201712 year. All returns were timely filed. The examiner finds the taxpayer is claiming significant amounts of personal expenses in various corporate expense accounts. The disallowance of these expenses results in the 201712 NOL turning into positive taxable income. However, the NOL carryforward eliminates the 201712 current taxable income resulting in no tax due. The examiner picks up 201512 and 20612 and discovers the same problem with the same expense accounts. Inspection of the 201212 through 201412 returns reveal the same types of expense accounts; however, the statutes are closed for 201212, 201312, and 201412.

The examiner requests supporting documentation (i.e., books and records for the source years) via Form 4564 Information Document Request (IDR) for the NOL carryforward from 201212, 201312, and 201412. The IDR submitted to the taxpayer stated, "The expenses were adjusted by \$XXXX in 201712, 201612 and 201512. Those adjustments exceeded the NOLs shown on the returns as filed. The 201212, 201312, and 201412 returns show the same expense categories in similar amounts with similar NOLs in each year. In order to substantiate that the carryover deduction from those years are allowable, please provide the appropriate 201212, 201312, and 201412 general ledger pages for those expenses along with the supporting documentation for any allowable expenses."

Since no documentation was provided to support the NOL carryforwards from 201212, 201312, and 201412, they were disallowed.

- (7) When an NOL is carried forward, modified taxable income may need to be computed in order to determine the amount of the NOL absorbed in the intervening year and the amount that can be carried forward to the following year.
 - a. The amount that will be carried over to the next year will be the excess of the NOLD over the modified taxable income
 - b. The modified income in the intervening year is computed using the modifications described in IRC 172(b)(2)
 - c. The modifications include capital gains and losses of taxpayers other than corporations, deduction for personal exemptions, modifications related to real estate investment trusts, qualified business income deduction, and deduction for foreign-derived intangible income.
 - d. The modified taxable income will not be less than zero
 - e. For taxable years beginning after 12/31/2020, modified taxable income will be reduced by 20% of the excess (if any) described in IRC 172(a)(2)(B)(ii)
 - f. In the Virtual Library in Knowledge Management, there is a *Worksheet for NOL Carryover* to assist in the computation.

4.11.11.15
(04-17-2023)
Joint Committee

- (1) See IRM 4.36.1 through IRM 4.36.5 for Joint Committee procedures for IRC 6405 refunds of taxes in excess of the current statutory threshold of \$2 million (\$5 million for corporations, other than S Corporations).

4.11.11.16
(04-17-2023)
**NOL and Carryover
Losses Passive Activity
Loss (PAL) Issue**

- (1) Rentals or businesses in which the taxpayer does not materially participate are examples of passive activities.
- (2) IRC 469(b) provides that a PAL generally cannot be carried back. It can only be carried forward. A PAL is not an NOL subject to carryback. A PAL does not become an NOL until it is no longer subject to the IRC 469 limitations. For example, a loss will become an NOL in the following instances:
 - a. IRC 469(g): Allowable loss triggered via an entire disposition to an unrelated party in a fully taxable transaction.
 - b. IRC 469(i): Allowable loss offset for rental real estate (to the extent of the allowable \$25,000 offset).

Note: Whether held individually, in a corporation, or in a trust, a passive loss generally cannot be carried back.

- (3) On disposition of a passive activity, the Service can make adjustments to prior year suspended PALs from this activity that were incorrectly computed in closed tax years. Similarly, if there is an NOL, credit, or capital loss carryover, the Service can adjust suspended passive losses that were incorrectly computed in barred years.
- (4) IRC 6501 provides the general rule regarding the period of limitations for assessing tax. Rev. Rul. 81-88 refers to 26 CFR 301.6511(d)-2(a)(3) that states that if a claim is for an overpayment based both on an NOL carryback and on other items, some of which are barred by a statute of limitations, the computation of any overpayment for the carryback year begins first by calculating the tax attributable to allowable items not barred by a statute of limitations. However, if the claim relates to barred items that decrease taxable income, the first adjustment is the net operating loss carryback.
- (5) Thus, PAL carryovers that were incorrectly computed in prior years but impact the current year tax can be adjusted. On a fully taxable disposition of a passive activity to an unrelated party, IRC 469(g) allows PAL suspended losses to be triggered. The triggering of these losses can create an NOL that can be carried back. On any NOL carryback, IRC 6501(h) indicates that the statute on the carryback years is governed by the loss year. Furthermore, in the carryback years, the Service can disallow unrelated deductions up to the refund amount generated by the loss carryback. Thus, unrelated passive losses could also be adjusted.

4.11.11.17
(04-17-2023)
**NOL Carrybacks or
Other Deductions
Involving Court Ordered
Restitution**

- (1) NOL carrybacks or carryovers and other deductions in a tax period for which an amount of restitution was ordered and assessed pursuant to IRC 6201(a)(4)(A) reduce a taxpayer's civil tax liability for that tax period.
- (2) Such deductions, however, do not in any way affect the Service's assessment or collection of the amount of restitution itself. The Service must collect the entire amount ordered as restitution under IRC 6201(a)(4)(A) regardless of whether the civil tax liability for the same period is less than the amount ordered as restitution under IRC 6201(a)(4)(A).

4.11.11.18
(04-17-2023)
**NOL Carrybacks From
Investment Theft Losses**

- (1) Taxpayers who experienced losses in certain investment arrangements discovered to be criminally fraudulent (commonly referred to as "Ponzi" schemes) may be entitled to claim an investment theft loss, which is an ordinary loss. Rev. Rul. 2009-9 describes the proper income tax treatment for losses resulting from these Ponzi schemes. Additionally, Rev. Proc. 2009-20 provides an optional "safe harbor" under which qualified investors may treat a loss as a theft deduction if the investor entered into a specified fraudulent arrangement discussed below, and the other requirements of Rev. Proc. 2009-20, as modified by Rev. Proc. 2011-58, are satisfied. Refer to IRM 21.6.4.4.1.7, Casualty and Theft Losses. An investment theft loss may result in an NOL. Special rules have applied to NOLs relating to an investment theft loss. Refer to IRM 21.6.4.4.1.7, Casualty and Theft, and American Recovery and Reinvestment Act of 2009—Net Operating Losses, to determine if Rev. Proc. 2009-19, Rev. Proc. 2009-26 or Rev. Proc. 2009-52 applies for extended carryback period.
- (2) A **specified fraudulent arrangement** is an arrangement in which a party (the lead figure):
 - a. Receives cash or property from investors;

- b. Purports to earn income for the investors;
- c. Reports income amounts to the investors that are partially or wholly fictitious;
- d. Makes payments, if any, of purported income or principal to some investors from amounts that other investors invested in the fraudulent arrangement; and
- e. Appropriates some or all of the investors' cash or property.

Example: The fraudulent investment arrangement described in Rev. Rul. 2009-9 is a specified fraudulent arrangement.

- (3) For more information about the requirements for claiming investment theft losses, refer to the *Ponzi and Investment Loss* page in the Losses book of the Virtual Library.