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California Suspends Net Operating Loss Deduction, Increases Carryover Period, and Allows Carryback Deductions

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By enactment of Assembly Bill 1452, California has temporarily suspended the net operating loss carryover deduction for two years, increased the net operating loss carryover period to twenty years, and will phase in a deduction for net operating loss carrybacks.

Historically, California has limited the carryover amount of net operating losses ("NOLs").[1] For NOLs sustained in tax years beginning after 1986, but before 2000, the carryover was limited to 50 percent.[2] For tax years 2000 and 2001 the carryover was limited to 55 percent. For tax years 2002 and 2003, the carryover was limited to 60 percent. For NOLs sustained in 2004 and thereafter, 100 percent of the NOL sustained could be carried over.[3]

Suspension of NOL Deduction

Assembly Bill ("AB") 1452 suspends the deduction for NOL carryovers for both corporate and individual taxpayers for tax years beginning in 2008 and 2009.[4] The carryover period for any NOL deduction suspended as a result of this legislation is extended for the number of years the NOL deduction is suspended.[5]

Corporate taxpayers with less than $500,000 of taxable income subject to California corporation franchise or income tax for the tax year, and individual taxpayers subject to the Personal Income Tax Law ("PITL")

[1] In California, NOLs are entity specific. Thus, a unitary business filing a combined report that sustains an overall NOL must intrastate apportion the NOL among each taxpayer member of the combined report.
[2] NOLs attributable to tax years beginning before 1987 may not be carried forward.
[3] NOL deductions were suspended for tax years beginning in 2002 and 2003, but the carryover period was extended for the number of years the deductions were suspended.
[4] Sections 17276.9(a) and 24416.9(a). All statutory references are to the California Revenue and Taxation Code.
[5] Sections 17276.9(b) and 24416.9(b).

with net business income of less than $500,000 for the tax year are exempt from the suspension of the NOL carryover deduction for that year.[6]

The $500,000 income limit for corporate taxpayers is based on the taxpayer's California source income.[7] For taxpayers subject to the PITL, "business income" means income from a trade or business, whether conducted directly by the taxpayer, or by a pass-through entity owned directly or indirectly by the taxpayer, income from rental activity, and income attributable to a farming business.[8] A pass-through entity is defined as a partnership or S-corporation for these purposes.[9]

NOL Carryover Period Increased

AB 1452 extends the carryover period for NOLs attributable to a tax year beginning on or after January 1, 2008 to 20 years.[10] The NOL carryover period for earlier tax years remains unchanged, as follows:[11]

- NOLs sustained before the beginning of the 2008 tax year but after the 1999 tax year are carried over for 10 years;
- NOLs sustained prior to the 2000 tax year but after the 1986 tax year are carried over for 5 years;
- NOLs sustained prior to the 1987 tax year may not be carried over.[12]

NOL Carryback Phase-In

California has never allowed NOL carrybacks. Now, with the passage of AB 1452, NOLs sustained during or after tax years beginning in 2011 may be carried back two years.[13] The NOL carryback deduction will be phased in gradually, allowing carryback of 50 percent of the NOL sustained in 2011, 75 percent of the NOL sustained in 2012, and all of the NOL sustained on or after January 1, 2013.[14] An NOL may be carried back to tax years beginning in 2009, notwithstanding the 2009 suspension of the deduction for NOL carryovers.[15]

Concluding Thoughts

As the foregoing indicates, California has a myriad of special rules regarding NOLs. Taxpayers should carefully review these rules and note that they substantially deviate from the rules governing federal NOLs.

[6] Sections 17276.9(d) and 24416.9(d).
[7] See *FTB Tax News*, January 2009, and FTB Form 100 Instructions, *What's New/Tax Law Changes*. The author has confirmed in an informal discussion with FTB legal counsel that the $500,000 threshold is considered on a post-apportioned basis, and that the amount reported on line 19 of Form 100 must be less than $500,000 for the exemption from the suspension of the NOL carryover deduction to apply.
[8] Section 17276.9(d)(1) through (3).
[9] Section 17276.9(d)(1).
[10] Sections 17276.10 and 24416.10.
[11] Sections 17276(d)(1) and 24416(e)(1).
[12] Sections 17276(a)(2) and 24416(a)(2).
[13] Sections 17276(c)(2) and 24416(d)(2).
[14] Sections 17276(c)(2)(A)-(C) and 24416(d)(2)(A)-(C).
[15] Sections 17276.9(c) and 24416.9(c).

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