

Excess Business Loss and Net Operating Loss (NOL)



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Excess Business Loss Limitation

Your overall business losses may be limited as you cannot deduct an excess business loss in the current year. An excess business loss is the amount by which your total deductions from all of your trades or businesses are more than your gross income or gains from all of your trades or businesses, plus a threshold amount. For 2023, the threshold amount is \$289,000 (\$578,000 if Married Filing Jointly). Any disallowed excess business loss is treated as a net operating loss (NOL) carryforward, subject to the NOL rules. See *How to Use an NOL*, next column.

Example: George has \$500,000 of gross income and \$800,000 of deductions from his retail furniture business. His excess business loss is \$11,000 [$\$800,000 - (\$500,000 + \$289,000)$]. George must treat his excess business loss of \$11,000 as an NOL carryforward to 2024.

Pass-Through Entities

For pass-through entities (partnerships and S corporations), the excess loss limit applies at the partner and shareholder level. Each partner's or shareholder's share of the items of income, gain, deduction, or loss of the partnership or S corporation is taken into account by the partner or shareholder in applying the excess business loss limitation.

Passive Activity Loss Rules

The excess business loss limit is applied after the passive loss rules. Under the passive activity rules, losses and expenses attributable to passive activities may only be deducted from passive activities. Generally, passive activities are those in which you may own an interest in the business, but do not materially participate. Some activities are considered passive by default, such as rental activities.

Net Operating Loss (NOL)

A net operating loss (NOL) generally means the amount by which your business deductions exceed gross income.

An individual, estate, or trust may have an NOL if deductions for the year exceed income. NOLs are caused by losses from the following:

- Trade or businesses (Schedules C and F losses, or Schedule K-1 losses from partnerships or S corporations),
- Casualty and theft losses (whether personal or business), and
- Rental property (Schedule E).

Individual NOL

An individual may have an NOL if adjusted gross income (AGI) minus the standard deduction or itemized deductions is a negative amount, and the negative amount is due to business deductions exceeding business income.

Estate or Trust NOL

An estate or trust may have an NOL if the taxable income line on Form 1041, *U.S. Income Tax Return for Estates and Trusts*, is a negative amount, and the negative amount is due to business deductions exceeding business income.

How to Use an NOL

Once the NOL has been calculated for the tax year, the NOL deduction is limited to 80% of taxable income and may not be carried back to any previous year. The remaining NOL is carried forward to the following year. If not used up in that year, it continues to be carried forward until it is used up. For farming loss NOLs, the default rule is to carry the NOL back two years, but an election may be made to waive the carryback period.