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RECENT CHANGES TO FEDERAL NET OPERATING LOSS CARRYBACK PROVISIONS CREATE POTENTIAL YEAR-END PLANNING OPPORTUNITIES FOR TAXPAYERS

On November 6, 2009, President Obama signed the Worker, Homeownership, and Business Assistance Act of 2009 (the "Act"). Among other things, the Act extends the period over which a net operating loss ("NOL") may be carried back for tax years beginning in or ending in either 2008 or 2009.

An NOL generally represents the amount by which a taxpayer's business deductions exceed its gross income. Under current law, an NOL may generally be carried back only two years and then carried forward for up to twenty years to offset taxable income in such years. Earlier this year, the American Recovery and Reinvestment Act of 2009 (the "ARRA") extended the NOL carryback period from two years to up to five years for tax years beginning or ending in 2008. However, the ARRA provision only applied to small businesses with gross receipts of \$15 million or less.

Now, under the Act, **any** business regardless of its size (excluding only participants in the TARP program), may elect to carry back an NOL that arose in either the 2008 or 2009 tax year for a period of up to five years. To the extent a taxpayer elects to carry back an NOL for five years, the NOL can only be used to offset 50 percent of the taxable income that arose in the fifth preceding tax year (generally the 2003 tax year for a 2008 NOL and the 2004 tax year for a 2009 NOL). Any remaining NOLs can be used against 100 percent of the taxable income that arose in the other four prior tax years.

In general, the five-year carryback period is intended to provide businesses that continue to suffer operating losses during the current economic downturn with a much needed cash infusion. In addition, a potential one-time tax planning opportunity exists for certain taxpayers that currently hold "underwater" trade or business assets (such as, for example, items of inventory, accounts receivable, or real estate or depreciable property used in a taxpayer's trade or business) and which are still operating at a relatively profitable or close to breakeven level. However, calendar-year taxpayers must act very quickly because the Act does not apply to NOLs that arise within tax years that begin after December 31, 2009 (fiscal-year taxpayers may have more time to act, depending upon when their most recent tax year began).

For example, if a calendar-year taxpayer otherwise operating at a breakeven level originally purchased a trade or business asset for \$10 million and then sells that asset on or before December 31, 2009 for \$5 million, the resulting \$5 million loss (assuming it otherwise meets the requirements for qualifying as an NOL subject to the carryback rules and is not, for example, a capital loss) may be carried back for a period of up to five years. Furthermore, assuming the taxpayer did not have any taxable income during the two years immediately preceding the NOL but had at least \$5 million in taxable income in the third through fifth preceding years, the taxpayer may claim a federal tax refund of up to \$1.75 million (assuming a 35 percent federal tax rate), which effectively reduces the amount of the taxpayer's actual economic loss by 35 percent. On the other hand, if the asset was sold on January 1, 2010, a calendar-year taxpayer would receive no tax benefit under the current rules because the five-year period only applies to NOLs arising in tax years that begin in either 2008 or 2009. Accordingly, as noted above, certain calendar-year taxpayers holding built-in-loss assets must act quickly to take advantage of the Act's five-year carryback rule.

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Readers of this Alert should be aware that there are a wide variety of special rules to consider under the Act and under other applicable provisions under the Internal Revenue Code. These special rules include, but are not limited to, rules regarding NOLs sustained by certain taxpayers such as REITs, insurance companies, small businesses, corporate taxpayers subject to the alternative minimum tax, and partnerships and their partners.

Please feel free to contact any of the HRO attorneys listed in the margin of this Alert to discuss the new provisions of the Act and how they might potentially apply to your particular facts and circumstances.

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