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DOES YOUR SMALL BUSINESS HAVE AN NOL?

BRENTWOOD, Tenn. – In the current economy, it's safe to say that many small businesses might have chalked up a net operating loss (NOL) during the last year or two. If that's the case, the Tennessee Society of CPAs advises that there is one potential tax deduction that you should not miss. But it may be necessary to call in an expert to determine if you are eligible.

CALCULATING A LOSS

Determining whether you have a loss is easy enough: You simply add up the income your company earned and the expenses it paid. Subtract the expenses from your income, and you'll be left with your taxable income for the year. But what happens if the money you spent in running your business is greater than your business income?

ENTER THE NOL

In this situation, the business is considered to have a NOL. Generally, individuals who are sole proprietors of a business can use NOLs. S corporations and partnerships cannot, but their shareholders or partners may be able to apply the NOL to their own individual NOLs.

WHAT CONSTITUTES A NOL?

First let's consider what kinds of losses generally are eligible to calculate a NOL. They must be a result of excess expenses related to a trade or business. The NOL may also include the following losses or deductions: casualty or theft losses, expenses for moving to a new job location, your share of partnership or S corporation operating losses or rental property losses. Personal expenses or tax exemptions, then, are one example of what you cannot deduct to calculate your NOL, and capital losses are another.

A SIMPLE EXAMPLE

Let's explain the idea with an example. Your business earned \$100,000 last year. However, that was a drop from your past earnings due to the rough economy. Your expenses for running your business during the year were \$150,000, because that's what you spent in the past when the economy was in better shape and your sales were higher. So, on the tax returns that you're preparing now for 2009, you would be able to deduct your losses. However, since you lost \$50,000 more than you made, you may be able to use those additional losses in other tax years, deducting them against your past or future earnings as a NOL.

PUTTING IT TO WORK

We've simplified NOLs here, but there are complicated rules on how to apply them, including a list of expenses and deductions that don't count toward the NOL. As a general rule, it's useful to remember that they are called net *operating* losses for a reason. Any expenses not related to the *operation* of a business probably will not apply.

CARRY BACK? CARRY FORWARD?

What happens if you do have a NOL? Once again, there are complicated rules involved in answering that question. The rules help determine, among other things in which years the NOL can be applied. Generally, you would begin by applying your losses to your previous two years' tax returns, although this rule can be waived under certain circumstances. If losses remain after you've applied your NOL to your two previous years' income, you can then carry forward the losses for up to 20 years after the original NOL occurred. For NOLs arising in 2009, you can elect to carry the loss back for three, four or five years (instead of the normal two years). However, there are complicated rules to be followed to do this.

About Money Management

Money Management is a weekly column on personal finance prepared and distributed by the Tennessee Society of Certified Public Accountants (TSCPA) as a part of its financial literacy initiative.

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