¶520 Limit on Excess Business Losses for Noncorporate Taxpayers

NEW LAW EXPLAINED

Excess business losses of noncorporate taxpayers disallowed.—Excess business losses of noncorporate taxpayers are not allowed for tax years beginning after December 31, 2017, and before January 1, 2026 (Code Sec. 461(l)(1)(B), as added by the Tax Cuts and Jobs Act). Any excess business loss that is disallowed is treated as a net operating loss (NOL) carryover to the following tax year (Code Sec. 461(l)(2), as added by the 2017 Tax Cuts Act). Noncorporate taxpayers must apply this rule for excess business losses after applying the passive activity loss rules (Code Sec. 461(l)(6), as added by the 2017 Tax Cuts Act; Code Sec. 469).

COMMENT

For losses arising in tax years beginning after December 31, 2017, an NOL may only reduce 80 percent of taxable income in a carryback or carryforward tax year. See ¶515 for further details on the modified NOL rules.

An "excess business loss" is the excess, if any, of:

1) the taxpayer's aggregate deductions for the tax year from the taxpayer's trades or businesses, determined without regard to whether or not such deductions are disallowed for such tax year under the excess business loss limitation (Code Sec. 461(l)(1), as added by the 2017 Tax Cuts Act); over
2) the sum of:
    a) the taxpayer's aggregate gross income or gain for the tax year from such trades or businesses, plus
    b) $250,000, adjusted for inflation (200 percent of the $250,000 amount in the case of a joint return) (Code Sec. 461(l)(3), as added by the 2017 Tax Cuts Act).

The $250,000 amount in (b), above, is adjusted for inflation for tax years beginning after December 31, 2018. The $250,000 amount will be increased by $250,000 multiplied by the cost-of-living-adjustment determined under Code Sec. 1(f)(3) (as amended by the 2017 Tax Cuts Act) for the calendar year in which the tax year begins. If the increase is not a multiple of $1,000, then the increase is rounded to the nearest multiple of $1,000 (Code Sec. 461(l)(3)(B), as added by the 2017 Tax Cuts Act).

EXAMPLE

For 2018, Ned Brown has $1,000,000 of gross income and $1,400,000 of deductions from a retail business that is not a passive activity. His excess business loss is $150,000 ($1,400,000 − ($1,000,000 + $250,000)). Brown must treat his excess business loss of $150,000 as an NOL carryover to 2019.

COMMENT

During the period that excess business losses are disallowed (tax years beginning after December 31, 2017, and before January 1, 2026), the similar limit on excess farm losses of noncorporate taxpayers will not apply (Code Sec. 461(l)(1)(A), as added by the 2017 Tax Cuts Act).

Partnerships and S corporations. For partnerships and S corporations, the limit on excess business losses is applied at the partner or shareholder level. Each partner's distributive share or each S corporation shareholder's pro rata share of 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 rules to the partner's or shareholder's tax year with or within which the partnership's or S corporation's tax year ends (Code Sec. 461(l)(4), as added by the 2017 Tax Cuts Act; Conference Report on H.R. 1, Tax Cuts and Jobs Act (H. Rept. 115-466)).

Reporting requirements. The IRS is authorized to issue additional reporting requirements that it determines are necessary to carry out the purposes of the excess business loss rules (Code Sec. 461(l)(5), as added by the 2017 Tax Cuts Act)).

Effective date. The amendments made by this provision apply to tax years beginning after December 31, 2017 (Act Sec. 11012(b) of the Tax Cuts and Jobs Act).