New Excess Business Loss Limitation

As part of the huge advantage given to the largest corporations that populate the Fortune 500 with a corporate tax cut of 13% in the tax act passed last December, the Tax Cuts and Jobs Act (TCJA), Congress has instituted a new loss limitation for all other non-corporate businesses so as to pay for those tax benefits for companies such as Google, General Motors.

The TCJA instituted a loss limitation entitled Excess Business Losses which limit deductible losses incurred by non-corporate taxpayers, in other words, individuals to $250,000.00 for single taxpayers, and $500,000.00 for those who file married, filing jointly.

While the amounts seem large to many, this new limitation is a huge impediment to small business, especially start-up companies which are unincorporated.

The following gets somewhat complicated, but here we go.

In determining taxable income for any given tax year starting in 2018 shareholders of S corporations, partners of a partnership, or any type of pass-through entity now have a limitation as to losses each year.

Generally there are a number of hoops one must get through to be able to deduct losses to begin with before looking at this new rule.

As a threshold matter the aggregate amount of losses taken into account by a shareholder or partner for a taxable year cannot exceed in the case of an S corporation the sum of the shareholder’s “adjusted basis” for his stock plus his adjusted basis of any corporate indebtedness owed to the shareholder.

In the case of a partnership the adjusted basis of such partner’s interest in the partnership is similarly calculated.

Any losses in excess of “basis” is not allowed in a taxable year is carried forward to such time that the basis is replenished either through debt, profits attributable to the partner/shareholder, or new additions in capital contributed to the enterprise.

Another hoop to pass is that any pass-through loss that is allowed under the above “basis-limitation rule” must also be tested under the “at-risk” and, then again, the “passive activity” loss rules before it may be utilized by a shareholder or partner in determining his taxable income.
Any loss that is disallowed under either of these rules is “suspended” and is carried forward indefinitely to succeeding taxable years until the taxpayer has more amounts at risk, or realizes more passive income, or disposes of his interest in the pass-through entity.

If the loss is not limited by the foregoing rules it may be applied against the shareholder’s or the partner’s other income.

The New Act under TCJA

The Act imposes another limitation on a non-corporate taxpayer’s ability to utilize a pass-through loss against other income, whether it is realized through a sole proprietorship, S corporation or partnership which is applied after the basis-limitation, at-risk, and passive loss rules.

Specifically for taxable years beginning after December 31, 2017 and before January 1, 2026 the excess business losses of a non-corporate taxpayer are not allowed for the taxable year.

A taxpayer’s “excess business loss” for a taxable year is the excess of:

(a) the taxpayer’s aggregate deductions attributable to his trades or businesses for the year, over

(b) the sum of:

(i) the taxpayer’s aggregate gross income or gain for the year attributable to such trades or businesses, plus

(ii) $250,000 (or $500,000 in the case of a joint return)

What this means is that if one can pass through all the hoops, and regulations above, there is a limitation of any losses incurred on an annual basis of $250,000.00 for single taxpayers, and $500,000.00 for those who file Married Filing Jointly.

In the case of a partnership or S corporation this provision (as in the case of the at-risk and passive activity rules) is applied at the partner or shareholder level.

Each partner’s and each S corporation shareholder’s share of the pass-through entity’s items of income, gain, deduction, or loss are taken into account in applying the limitation for the taxable year of the partner or S corporation shareholder.

The non-corporate taxpayer’s excess business loss for a taxable year is carried forward and treated as part of the taxpayer’s net operating loss (“NOL”) carryforward in subsequent taxable years.

If any of the above applies to you, I suggest you give us a call.
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