

7. Net Operating Losses (NOLs)

- a. With respect to net operating losses (NOLs), the legislation provides for:
 - i. a prior NOL conversion subtraction, and
 - ii. a deduction for NOLs generated in taxable years beginning after 2014.

The new law changes the way that NOLs are computed. Under current law, NOLs are limited to the federal, pre-apportioned NOL. Under the new law, NOLs are computed on a post-apportionment basis. A taxpayer's degree of presence in New York in the year the NOL is generated will directly affect the amount of NOL available to be carried forward and deducted from future business income. This is a significant departure from current law, under which NOLs are computed subject to the ceiling of the federal NOL, on a pre-apportionment basis.

The new law provides for a 20-year carryforward period for NOLs, with NOLs to be deducted on a first-in, first-out basis. The new law also allows a taxpayer to carryback the NOL for up to three tax years, but not to any years starting before January 1, 2015. This means that the 3-year carryback will not be fully implemented until years starting on or after January 1, 2018.

In addition to a new NOL that would arise in a year beginning with 2015, a taxpayer would have the benefit of its pre-2015 NOL, calculated based upon complicated transition rules providing for a "prior NOL conversion" (PNOLC) subtraction pool that is calculated with reference to the "base year" of 2014. These rules enable taxpayers to carry forward existing NOLs and reflect an interplay between the NOL changes and the changes in the combination rules. An "unabsorbed NOL" is determined as of the end of the base year (for calendar year taxpayers, 2014). This amount is divided by the Business Allocation Percentage for the base year, and multiplied by the tax rate applicable in the base year (i.e., 7.1%). The resulting amount is divided by 6.5%, the tax rate under the new law.

The amount of combined NOLs for a combined group is calculated using the separate PNOLCs of each of the taxpayer members of the combined report. If a taxpayer was included in a combined report for the base year but begins to file separately, its PNOLC will be computed based on the portion the taxpayer contributed to the group's Conversion Subtraction pool. If a combined group included members in the base year that are no longer included, the group's Conversion Subtraction pool will be computed based on the portion the balance the group members contributed to the group's Conversion Subtraction pool. If a taxpayer was included in a combined report for 2014 and is included in a combined group consisting of additional members in 2015, then the Conversion Subtraction pool will be computed based on the sum of the Conversion Subtraction pools computed separately for the group and for the additional members.

The amount of a taxpayer's Conversion Subtraction will be allowable over a ten-year period (1/10th per year) on a carryforward basis (i.e., in a given year, in addition to the unused Conversion Subtraction from prior years). A one-time election, which must be made on a timely filed return for the tax year beginning on or after January 1, 2015, but before January 1, 2016 (the 2015 year for calendar year filers), is allowable to deduct up to half of the Conversion Subtraction pool over a two-year period. A taxpayer making this election cannot carryforward any unused amount of the Conversion Subtraction beyond that two-year period.

Under NOL ordering rules, the NOL deduction for the year is applied after the PNOLC subtraction. Any unused PNOLC may be carried forward until tax year 2035 for calendar year filers.

EisnerAmper LLP comment: The new provisions can considerably complicate the computation of a taxpayer's deferred tax asset. A taxpayer is required to quantify not only the current year's NOL, but also the "unabsorbed NOL," quantify the Conversion Subtraction pool given appropriate inclusion in or out of the combined group of any given member, apply the new law to make a judgment as to the proper members of the combined group, and reach a conclusion as to the advantage or disadvantage of the one-time election.