



Excess Business Loss and Net Operating Loss (NOL)

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Excess Business Loss Limitation

Your overall business losses may be limited as you cannot deduct an excess business loss in the current year. An excess business loss is the amount by which your total deductions from all of your trades or businesses are more than your gross income or gains from all of your trades or businesses, plus a threshold amount. For 2025, the threshold amount is \$313,000 (\$626,000 if Married Filing Jointly). Any disallowed excess business loss is treated as a net operating loss (NOL) carryforward, subject to the NOL rules. See *How to Use an NOL*, next column.

Example: George has \$500,000 of gross income and \$850,000 of deductions from his retail furniture business. His excess business loss is \$37,000 [$\$850,000 - (\$500,000 + \$313,000)$]. George must treat his excess business loss of \$37,000 as an NOL carryforward to 2026.

Pass-Through Entities

For pass-through entities (partnerships and S corporations), the excess loss limit applies at the partner and shareholder level. Each partner's or shareholder's share of the 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 limitation.

Passive Activity Loss Rules

The excess business loss limit is applied after the passive loss rules. Under the passive activity rules, losses and expenses attributable to passive activities may only be deducted from passive activities. Generally, passive activities are those in which you may own an interest in the business, but do not materially participate. Some activities are considered passive by default, such as rental activities.

Net Operating Loss (NOL)

A net operating loss (NOL) generally means the amount by which your business deductions exceed gross income.

An individual, estate, or trust may have an NOL if deductions for the year exceed income. NOLs are caused by losses from the following:

- Trade or businesses (Schedules C and F losses, or Schedule K-1 losses from partnerships or S corporations),
- Casualty and theft losses (whether personal or business), and
- Rental property (Schedule E).

Individual NOL

An individual may have an NOL if adjusted gross income (AGI) minus the standard deduction or itemized deductions is a negative amount, and the negative amount is due to business deductions exceeding business income.

Estate or Trust NOL

An estate or trust may have an NOL if the taxable income line on Form 1041, *U.S. Income Tax Return for Estates and Trusts*, is a negative amount, and the negative amount is due to business deductions exceeding business income.

How to Use an NOL

Once the NOL has been calculated for the tax year, the NOL deduction is limited to 80% of taxable income and may not be carried back to any previous year. The remaining NOL is carried forward to the following year. If not used up in that year, it continues to be carried forward until it is used up. For farming loss NOLs, the default rule is to carry the NOL back two years, but an election may be made to waive the carryback period.



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NOL Carryback and Carryforward

Default rule. The NOL deduction is limited to 80% of taxable income (taxable income for the year in which it is carried forward to, determined without regard to the NOL deduction), which means an NOL cannot completely zero out taxable income. This 80% limitation does not apply to a property and casualty insurance company.

Note: When computing your NOL, the 20% qualified business income deduction (QBID) is not taken into account.

Carryback. Generally, the option to carry back an NOL is disallowed. Exceptions apply to certain farming losses and NOLs of nonlife insurance companies.

Exception: Farming loss. A farming loss is the smaller of the NOL for the tax year or the NOL computed considering only farming income and deductions, and has a 2-year carryback. An election may be made to waive the carryback period.

Note: Farming NOLs arising in tax year 2025 are limited by the excess business loss limitation rule, so the NOL carryback will not exceed \$313,000 (\$626,000 for joint returns).

Exception: Property and casualty insurance companies. Applies to insurance companies other than a life insurance company, and an NOL has a 2-year carryback period. An election may be made to waive the carryback period.

Carryforward. In general, an NOL carryforward is adjusted to take into account the 80% of taxable income limitation and may be carried forward indefinitely (until used up).

Exception: Property and casualty insurance companies. An NOL carryforward is limited to 20 years and the 80% limitation does not apply.

Where to report the NOL in a carryback or carryforward year. The NOL deduction is listed as a negative number as Other Income on Form 1040, with a statement attached that shows how the NOL deduction was computed. If more than one NOL is deducted in the same year, the statement must cover each NOL.

How to Calculate an NOL Carryforward

The NOL that is more than 80% of taxable income for the year is an NOL carryforward. Certain modifications must be made to taxable income to determine how much NOL will be used up in that year and how much may be carried

over to the next tax year. The carryforward is the excess of the NOL deduction over modified taxable income for the carryback or carryforward year. If the NOL deduction includes more than one NOL, apply the NOLs against modified taxable income in the same order they were incurred, starting with the earliest.

Additionally, if an NOL consists of both a farming loss and a non-farming loss, the losses should be treated separately and the farming loss is treated as a separate NOL and taken into account only after the non-farming NOL is applied.

Example: Glenn, single, has a retail music business and has the following income and deductions on his 2025 Form 1040.

Income	
Wages from part-time job	\$1,225
Interest on savings	425
Net long-term capital gain on sale of real estate used in business	2,000
Glenn's total income	\$3,650

Deductions	
Net loss from business	\$5,000
Net short-term capital loss on sale of stock	1,000
Standard deduction	15,000
Glenn's total deductions	\$21,000

Glenn's deductions exceed his income by \$17,350 (\$21,000 – \$3,650). To determine if he has an NOL, the following deductions are not allowed.

Nonbusiness net short-term capital loss	\$1,000
Nonbusiness deductions (\$15,000 standard deduction) minus nonbusiness income (\$425 interest income)	14,575
Total adjustments to net loss	\$15,575

Glenn's NOL for 2025 is computed as follows:

Glenn's total 2025 income	\$3,650
Less:	
Glenn's original 2025 total deductions	21,000
Reduced by the disallowed items	(15,575)
Glenn's NOL for 2025	(\$1,775)

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 73.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of \$5,000.

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