

On March 4, 2010, the Kentucky House passed House Bill 530, which contains several tax provisions that would impact Kentucky businesses. The Kentucky Association of REALTORS has been closely monitoring this and other proposed legislation that may impact its members.

One of the major revenue-generating provisions in House Bill 530 deals with the suspension of Kentucky net operating loss deductions (NOLs) for businesses and individuals.

C corporations, which are taxpaying entities, unlike S corporations and partnerships whose income flows through to the owners, and individuals sometimes generate net operating losses ("NOLs"). NOLs traditionally have been allowed to be carried back and forward to offset income earned in other years. Current Federal law allows for these losses to be carried back 2 years and forward for a maximum of 20 years, although in certain circumstances, the carryback period can be extended to as many as 5 years. Note that in 2005 Kentucky eliminated the ability to carry a NOL back to offset income earned in prior years, but currently allows a 20 year carryforward.

The current proposed change would prevent C corporations and individuals from utilizing NOLs to offset income generated in years beginning after December 31, 2009 but before January 1, 2013 (generally, the 2010, 2011 and 2012 tax returns).

A simple example will demonstrate how an individual NOL can be generated in a particular year, say 2009:

Total sources of taxable income / (loss) during the year (including \$80,000 Schedule C net loss from real estate sales activities) ¹	<u>\$30,000</u>
Adjusted gross income / (loss)	(30,000)
Itemized deductions ²	<u>(20,000)</u>
NOL available for carryback (Federal only) or carryforward	(50,000)

Under current law, this \$50,000 NOL would be able to be utilized to offset Kentucky taxable income in future years (up to 20 years), as shown in the following example for 2010:

Total sources of taxable income / (loss) during the year (including \$20,000 Schedule C net income from real estate sales activities) ¹	<u>\$70,000</u>
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Adjusted gross income / (loss)	70,000
Itemized deductions	<u>(20,000)</u>
Individual taxable income generated in current year	50,000
Less: Net operating loss carryforward	<u>(50,000)</u>
Taxable income	0

In this simple example, an individual would owe no Kentucky income tax over this 2 year period under current law. If House Bill 530 passes in its current form, this individual would still not owe tax in year 1 but would owe Kentucky income tax on \$50,000 of income in year 2 (approximately \$2,700) due to the suspension of the Kentucky NOL.

Under the proposal, the 2009 NOL in the example could not be used until 2013, at the earliest. The suspension years not count toward the 20-year window for using NOLs.

The concern of many around the state is that this suspension of NOL utilization will hurt business people as they try to recover from the economic downturn by creating a higher tax burden for the next 3 years.

House Bill 530 will now go to the Kentucky Senate where there appears to be significant opposition to this NOL suspension provision; however, because this provision is projected to raise about \$180 million during the biennium, if this provision is defeated, \$180 million will need to be raised somewhere else or cut from spending projections.

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¹ Includes W-2 income, investment income, retirement income and any business income, including net Schedule C income or loss (including commissions from Form 1099) and net Schedule E income or loss from rental real estate activities.

² Amount of deductible itemized deductions may be limited in this calculation.