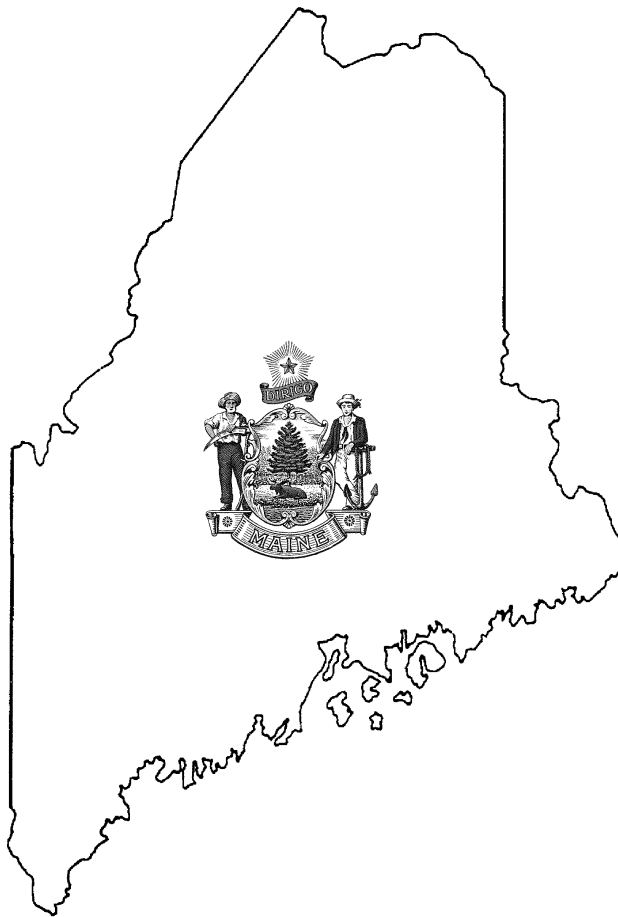


MODIFICATIONS RELATED TO NET OPERATING LOSSES – EXAMPLES FOR INDIVIDUALS



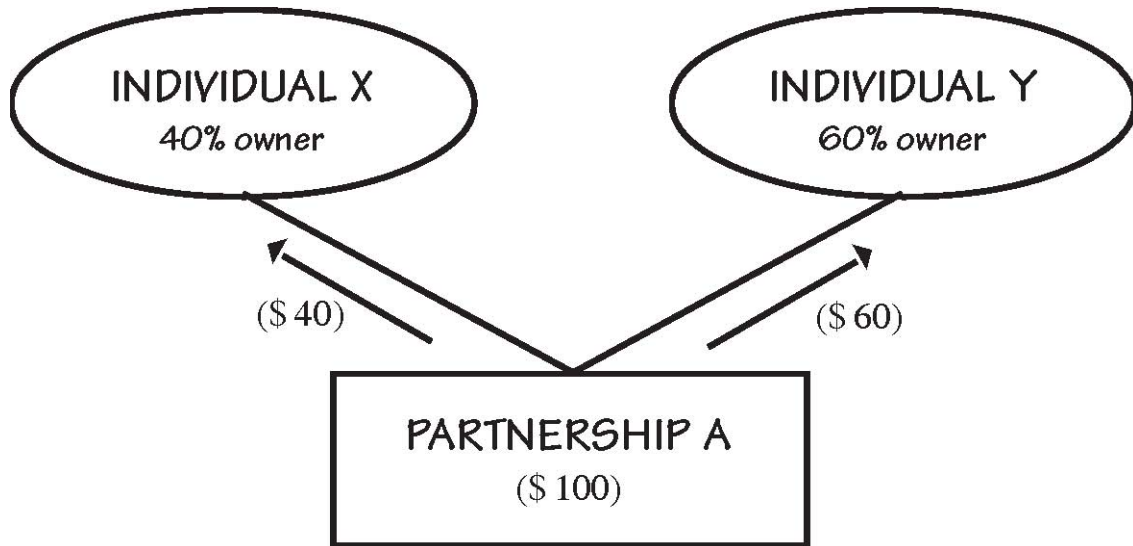
GUIDANCE DOCUMENT

Maine Revenue Services, Income/Estate Tax Division

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**THE PROCESS OF CLAIMING A CURRENT YEAR FEDERAL
NET OPERATING LOSS BY AN INDIVIDUAL MEMBER
OF A PASS-THROUGH ENTITY**



Income and losses are generated by the entity (Partnership A) and pass through to the members (Individual X and Individual Y). For a current year net operating loss, the entity calculates the amount of the total federal loss and the portion that is applicable to each member. In the diagram above, if Partnership A incurred a loss of \$100, a \$40 loss passes through to Individual X and a \$60 loss passes through to Individual Y. Each member then includes their available pass-through loss, along with any other income and losses on federal Form 1040, subject to certain federal limitations.

FREQUENTLY ASKED QUESTIONS

Q1. I have a current year net operating loss reported to me from a pass-through entity. Can I use this loss against all of my Maine income?

A1. A current year net operating loss can be used to offset an individual's entire Maine income to the extent that the loss is deductible by that individual for federal tax purposes. For example, noncorporate taxpayers are limited to a maximum of \$250,000 for single filers (\$500,000 for married filers) of losses from trades and businesses that can be used to offset income from other sources. Net operating loss carrybacks and carryforwards are limited as described in this document.

Q2. If my federal carryover is limited in a particular year, can I use the excess amount to reduce my Maine income?

A2. The amount of federal NOL carryover is the total amount that Maine will accept, except for tax years beginning in 2009, 2010, and 2011 as noted in this document. Note however, that for tax years after 2017, Maine also allows a subtraction modification up to the amount of federal NOL deduction disallowed as a result of the limitation under IRC § 172(a)(2). You can also reduce income at the state level by recapturing a prior year's Maine addition modification due to federal carryback of a net operating loss. In addition, for tax years beginning after 2011, you may recapture Maine addition modifications from tax years beginning in 2009, 2010, and 2011 resulting from the disallowance under Maine law of federal carryforward amounts in those years.

Q3. If a C corporation elects S corporation status, may the individual shareholders recapture the net operating loss addition modifications that were imposed on the business prior to the S corporation election?

A3. Under Maine law, except with respect to certain NOLs realized in 2008, no NOL deductions are allowed for tax years beginning in 2009, 2010, and 2011. For tax years beginning on or after January 1, 2005, but before 2009, and for tax years beginning after 2011, recapture modifications related to net operating loss add-backs imposed on C corporations may be claimed by individual shareholders of an electing S corporation. Prior to tax year 2005, those subtraction modifications could not be utilized by the individual shareholders.

INTRODUCTION

If a business sustains a net operating loss (“NOL”) in a taxable year under the Internal Revenue Code (“IRC”), that loss may be applied against federal taxable income in years surrounding the loss. Generally, federal losses incurred in tax years ending prior to 2018 may be carried back two years and carried forward up to twenty years. Federal losses incurred in tax years ending after 2017 generally may not be carried back but may be carried forward indefinitely. However, there are exceptions that allow some NOLs incurred after 2017 to also be carried back. Deductions for the carryback and carryforward of NOLs incurred in tax years beginning prior to 2018 may offset taxable income up to the amount of the loss. Deductions for NOLs incurred in tax years beginning after 2017 are limited to 80% of taxable income.

Over the years, Maine has been in various stages of conformity with the federal loss carryback and carryforward rules. Currently, Maine law does not allow any federal loss carryback, but does permit income in future years (other than 2009, 2010 and 2011) to be offset by the amount of federal carryback not allowed on the Maine income tax return. For tax years beginning after 2017, Maine law also allows a deduction for the amount of federal NOL carryforward disallowed as a result of the limitation under IRC § 172(a)(2).

Nonconformity with federal law requires adjustments to federal taxable income through addition and subtraction modifications. This guidance document provides information about Maine income modifications related to federal NOLs in more detail than is available in the filing instructions for the individual income tax returns. The applicable statutory references are listed below.

| <u>Section</u> | <u>Applicable Years</u> |
|----------------------------------|---|
| Addition Modifications | |
| 36 M.R.S. § 5122(1)(D) | 1982 through 2001 |
| 36 M.R.S. § 5122(1)(E) | 1982 and later |
| 36 M.R.S. § 5122(1)(H) | Losses in 1989 – 1992 and after 2001 carried back |
| 36 M.R.S. § 5122(1)(M) | Loss in 2001 carried back |
| 36 M.R.S. § 5122(1)(DD) | Carryforwards to 2009 – 2011 |
| 36 M.R.S. § 5122(1)(LL) | After 2017 (addback of sub-§ 2(TT)) |
| Subtraction Modifications | |
| 36 M.R.S. § 5122(2)(H) | After 1989 (recapture of sub-§ 1(H)) |
| 36 M.R.S. § 5122(2)(P) | After 2001 (recapture of sub-§ 1(M)) |
| 36 M.R.S. § 5122(2)(V) | After 2004 (recapture of § 5200-A(1)(H)) |
| 36 M.R.S. § 5122(2)(W) | After 2004 (recapture of § 5200-A(1)(M)) |
| 36 M.R.S. § 5122(2)(CC) | After 2011 (recapture of sub-§ 1(DD)) |
| 36 M.R.S. § 5122(2)(TT) | After 2017 (NOL carryforward limited under IRC § 172(a)(2)) |

Link to the statute: mainelegislature.org/legis/statutes/36/title36sec5122.html

Except for a four-year period from 1989 through 1992, Maine was in full conformity with federal law regarding NOLs until 2001. For tax years beginning in 2001, Maine decoupled from the special federal allowance for carrybacks of more than two years. Beginning with 2002 tax years, Maine law has decoupled from all federal carrybacks. Except for years 2009 through 2011,

Maine does allow an income offset in years after the loss for the federal carrybacks that were disallowed.

For tax years 2009 through 2011, all federal carryforwards and all Maine NOL subtractions were deferred. Starting with tax year 2012, these adjustments again become available. Amounts disallowed during the three-year period may be recaptured through subtraction modifications beginning in 2012 during the remaining federal carryforward period, plus the number of years the NOL carryforwards or Maine modifications were denied.

Federal NOLs, including carrybacks and carryforwards, are reflected in the federal adjusted gross income reported on the Maine individual income tax return, Form 1040ME. If a Maine amended return is being filed due to a federal NOL carryback, you must attach a copy of federal Form 1045 or Form 1040X and a schedule that reflects, from year to year, the use of the federal NOL carryback or carryforward and related income modifications described in this document.

The following modifications related to net operating losses are reported on the Maine individual income tax return:

- 1) For loss years from 1982 through 2001, an addition equal to the amount of any federal loss which is carried back in accordance with IRC § 172 (36 M.R.S. § 5122(1)(D));
- 2) For tax years 1982 and later, the amount of any federal NOL deduction which was used to offset Maine income in the loss year (36 M.R.S. § 5122(1)(E));
- 3) For tax years beginning in 2009, 2010, and 2011, the amount of any federal NOL carryforward (36 M.R.S. § 5122(1)(DD)). This addition modification is recaptured through a subtraction modification in years 2012 and later (36 M.R.S. § 5122(2)(CC));
- 4) In the year to which an NOL is carried back, the amount of a federal loss originating in tax years 1989, 1990, 1991, or 1992 that is applied to that carryback year (36 M.R.S. § 5122(1)(H)). Except for tax years beginning in 2009, 2010 and 2011, this addition modification is recaptured through a subtraction modification in years subsequent to the loss year (36 M.R.S. § 5122(2)(H));
- 5) In the year to which an NOL is carried back, the amount of a federal loss originating in tax years 2002 or later that is applied to that carryback year (36 M.R.S. § 5122(1)(H)). Except for tax years beginning in 2009, 2010, and 2011, this addition modification is recaptured through a subtraction modification in years subsequent to the loss year (36 M.R.S. § 5122(2)(H));
- 6) In the year to which an NOL is carried back, the amount of a federal loss originating in a tax year ending or beginning in 2001 that is carried back more than two years (36 M.R.S. § 5122(1)(M)). This addition modification does not apply to 2001 losses carried back to 1999 or 2000 and does not apply to certain small businesses and farmers. Except for tax years beginning in 2009, 2010, and 2011, this addition modification is recaptured through a subtraction modification in years 2002 and later (36 M.R.S. § 5122(2)(P));
- 7) For tax years beginning on or after January 1, 2005, addition modifications (under 36 M.R.S. § 5200-A(1)(H) and 36 M.R.S. § 5200-A(1)(M)) claimed by a C corporation that subsequently elects S corporation status, may be recaptured by individual shareholders to the extent not already recaptured (36 M.R.S. § 5122(2)(V) and 36 M.R.S. § 5122(2)(W)),

except that the recapture allowed pursuant to section 36 M.R.S. § 5122(2)(V) may not be claimed in tax years beginning in 2009, 2010, and 2011;

8) For tax years beginning after 2017, a deduction equal to the amount of federal NOL carry-forward deduction disallowed as a result of the limitation under IRC § 172(a)(2) to the extent the amount does not exceed Maine taxable income and that has not been previously used as a modification to reduce Maine taxable income. (36 M.R.S. § 5122(2)(TT)). Amounts deducted under this subtraction modification must be added back to Maine taxable income through an addition modification in the year the loss is claimed as a federal deduction pursuant to IRC 172. (36 M.R.S. § 5122(1)(LL)).

PART 1 –TAX YEARS AFTER 2011

For all tax years after 2001, Maine has decoupled from federal NOL carryback provisions. Any federal carryback must be offset by an addition modification of the same amount in the year of the carryback. 36 M.R.S. § 5122(1)(H). Similarly, Maine disallowed carryforwards in 2009, 2010, and 2011 and any federal carryforward in those years must have been offset by a corresponding Maine addition modification.

The addition modifications for a federal carryback or carryforward can be recaptured in years subsequent to the year of the loss, excluding tax years 2009, 2010, and 2011, through subtraction modifications. 36 M.R.S. §§ 5122(2)(H), 5122(2)(P) and 5122(2)(CC). The recapture modifications must be reduced by any Maine income that is offset in the year of the loss. NOL recapture subtraction modifications denied for tax years beginning in 2009, 2010, and 2011 can be claimed beginning with the 2012 tax year. The allowable carryover period for suspended losses and suspended recapture subtraction modifications is extended by the number of years the subtraction modification was suspended.

To maximize the benefit of an NOL recapture carryforward, a taxpayer may elect to utilize only the recapture deduction amount needed to reduce taxable income so that there is no income tax liability after the application of other deductions and tax credits. Any remaining NOL recapture can be carried forward to additional future years within the allowable carryover period.

For tax years beginning after 2017, Maine has decoupled from the federal NOL deduction limit equal to 80% of taxable income. NOL deductions disallowed due to this federal limitation may be deducted for Maine tax purposes by claiming a subtraction modification. Amounts subtracted must be added back for Maine purposes in the year that the NOL deduction is claimed as a federal deduction. Below are the statutory paragraphs related to NOL modifications in effect for tax years after 2011.

§5122. Modifications

1. Additions. Federal adjusted gross income shall be increased by:

E. The amount of any deduction claimed for the taxable year under the United States Internal Revenue Code, Section 172 which has previously been used to offset the modifications provided by this subsection;

H. The absolute value of the amount of any net operating loss arising from tax years beginning on or after January 1, 1989, but before January 1, 1993, that arises from an S corporation with total assets for the year of at least \$1,000,000 and the absolute value of the amount of any net operating loss arising from tax years beginning on or after January 1, 2002 that, pursuant to the United States Internal Revenue Code, Section 172, are being carried back for federal income tax purposes to the taxable year by the taxpayer;

M. The absolute value of the amount of any net operating loss arising from a tax year beginning or ending in 2001 that the taxpayer, pursuant to Section 102 of the federal

Job Creation and Worker Assistance Act of 2002, Public Law 107-147, carries back more than 2 years to the taxable year for federal income tax purposes;

DD. For any taxable year beginning in 2009, 2010 or 2011, an amount equal to the absolute value of any net operating loss carry-forward claimed for purposes of the federal income tax;

LL. An amount equal to the net operating loss carry-forward claimed as a deduction under the Code, Section 172 in determining federal taxable income for the taxable year that was previously allowed as a deduction pursuant to subsection 2, paragraph TT.

2. Subtractions. Federal adjusted gross income shall be reduced by:

H. For each taxable year subsequent to the year of the loss, an amount equal to the absolute value of the net operating loss arising from tax years beginning on or after January 1, 1989, but before January 1, 1993, for which federal adjusted gross income was increased in accordance with subsection 1, paragraph H, and the absolute value of the amount of any net operating loss arising from tax years beginning on or after January 1, 2002, for which federal adjusted gross income was increased in accordance with subsection 1, paragraph H and that pursuant to the Code, Section 172 was carried back for federal income tax purposes, less the absolute value of loss used in the taxable year of loss to offset any addition modification required by subsection 1, but only to the extent that:

(1) Maine taxable income is not reduced below zero;

(2) The taxable year is within the allowable federal period for carry-over;

(3) The amount has not been previously used as a modification pursuant to this subsection; and

(4) The modification under this paragraph is not claimed for any tax year beginning in 2009, 2010 or 2011. The amount not deducted as the result of the restriction with respect to tax years beginning in 2009, 2010 or 2011 may be deducted in any tax year beginning after December 31, 2011, but only to the extent that the requirements of subparagraphs (1) and (3) are met and the taxable year is within the allowable federal period for carry-over plus the number of years that the net operating loss carry-over adjustment was not deducted as a result of the restriction with respect to tax years beginning in 2009, 2010 or 2011;

P. An amount equal to the absolute value of any net operating loss arising in a tax year beginning or ending in 2001 for which federal adjusted gross income was increased in accordance with subsection 1, paragraph M and that, pursuant to Section 102 of the federal Job Creation and Worker Assistance Act of 2002, Public Law 107-147, was carried back more than 2 years to the taxable year for federal income tax purposes, but only to the extent that:

(1) Maine taxable income is not reduced below zero;

(2) The taxable year is either within 2 years prior to the year in which the loss arose or within the allowable federal period for carry-over of net operating losses;

(3) The amount has not been previously used as a modification pursuant to this subsection; and

(4) The modification under this paragraph is not claimed for any tax year beginning in 2009, 2010 or 2011. The amount not deducted as the result of the restriction with respect to tax years beginning in 2009, 2010 or 2011 may be deducted in any tax year beginning after December 31, 2011, but only to the extent that the requirements of subparagraphs (1) and (3) are met and the taxable year is within the allowable federal period for carry-over plus the number of years that the net operating loss carry-over adjustment was not deducted as a result of the restriction with respect to tax years beginning in 2009, 2010 or 2011;

V. The taxpayer's pro rata share of an amount that was previously added back to federal taxable income pursuant to section 5200-A, subsection 1, paragraph H by an S corporation of which the taxpayer is a shareholder and by which, absent the S corporation election, the corporation could have reduced its federal taxable income for the taxable year pursuant to section 5200-A, subsection 2, paragraph H, except that the modification under this paragraph may not be claimed for any tax year beginning in 2009, 2010 or 2011. The amount not deducted as the result of the restriction with respect to tax years beginning in 2009, 2010 or 2011 may be deducted in any tax year beginning after December 31, 2011, but only to the extent that the requirements of section 5200-A, subsection 2, paragraph H, subparagraphs (1) and (3) are met and the taxable year is within the allowable federal period for carry-over plus the number of years that the net operating loss carry-over adjustment was not deducted as a result of the restriction with respect to tax years beginning in 2009, 2010 or 2011;

W. The taxpayer's pro rata share of an amount that was previously added back to federal taxable income pursuant to section 5200-A, subsection 1, paragraph M by an S corporation of which the taxpayer is a shareholder and by which, absent the S corporation election, the corporation could have reduced its federal taxable income for the taxable year pursuant to section 5200-A, subsection 2, paragraph L;

CC. An amount equal to the value of any prior year addition modification under subsection 1, paragraph DD, but only to the extent that:

(1) Maine taxable income is not reduced below zero;

(2) The taxable year is within the allowable federal period for carry-over plus the number of years that the net operating loss carry-over adjustment was not deducted as a result of the restriction with respect to tax years beginning in 2009, 2010 or 2011;

(3) The amount has not been previously used as a modification pursuant to this subsection; and

(4) The modification under this paragraph is not claimed for any tax year beginning in 2009, 2010 or 2011;

TT. For taxable years beginning on or after January 1, 2018, to the extent otherwise deductible, an amount equal to the net operating loss carry-forward deduction disallowed as a result of the limitation under the Code, Section 172(a)(2), but only to the extent that:

(1) Maine taxable income is not reduced below zero; and

(2) The amount has not been previously used as a modification pursuant to this paragraph.

Examples

Example #1.1 – NOL in 2018, all of the loss is carried forward

The taxpayer has a federal net operating loss of \$65,000 in tax year 2018. The entire amount of the loss is carried forward; \$20,000 is applied to 2019 and \$45,000 to 2020. Because the federal loss did not offset any Maine addition modifications in 2018, no Maine adjustment is required in 2019 or 2020. A subtraction modification is allowed in the column for 2019 of \$5,000 related to the portion of the federal NOL carryforward that was not allowed under IRC § 172(a)(2) (limited to the lower of taxable income or the unused portion of the federal NOL). However, that amount must be added back when the federal NOL carryover is used in 2020.

| | <u>2016</u> | <u>2017</u> | <u>2018</u> | <u>2019</u> | <u>2020</u> |
|------------------------------|-------------|-------------|-------------|-------------|-------------|
| Federal income prior to NOL | \$40,000 | \$50,000 | (\$65,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | | | | (\$20,000) | (\$45,000) |
| Federal taxable income | \$40,000 | \$50,000 | (\$65,000) | \$5,000 | \$25,000 |
| Modifications: § 5122(2)(TT) | | | | (\$5,000) | |
| § 5122(1)(LL) | | | | | \$5,000 |
| Maine taxable income | \$40,000 | \$50,000 | (\$65,000) | \$0 | \$30,000 |

Example #1.2 – NOL in 2018, all of the loss is carried back

The taxpayer has a federal net operating loss of \$75,000 in tax year 2018. The entire loss is carried back; \$40,000 is applied to 2016 and \$35,000 to 2017. To reverse the federal carrybacks, a \$40,000 Maine addition modification is entered in the column for tax year 2016 and a \$35,000 addition modification is entered in the column for tax year 2017. The addition modifications in 2016 and 2017 are recaptured as subtraction modifications in tax years 2019 and 2020. Because the federal loss did not offset any unrelated Maine addition modifications in 2018, no addition modifications are required in 2019 or 2020.

| | <u>2016</u> | <u>2017</u> | <u>2018</u> | <u>2019</u> | <u>2020</u> |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|
| Federal Income prior to NOL | \$50,000 | \$50,000 | (\$75,000) | \$35,000 | \$80,000 |
| NOL carryback/carryforward | (\$40,000) | (\$35,000) | _____ | _____ | _____ |
| Federal taxable Income | \$10,000 | \$15,000 | (\$75,000) | \$35,000 | \$80,000 |
| NOL Modifications: § 5122(1)(H) | \$40,000 | \$35,000 | | | |
| § 5122(2)(H) | | | | (\$35,000) | (\$40,000) |
| _____ | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | \$50,000 | \$50,000 | (\$75,000) | \$0 | \$40,000 |

Example #1.3 – NOL in 2018, some of the loss is carried back, some is carried forward

The taxpayer has a federal net operating loss of \$80,000 in tax year 2018. Part of the loss (\$56,000) is carried back; \$16,000 is applied to 2016 and \$40,000 to 2017. The remaining loss (\$24,000) is carried forward; \$20,000 is applied to 2019 and \$4,000 to 2020. To reverse the federal carrybacks, a \$16,000 Maine addition modification is entered in the column for tax year 2016 and a \$40,000 addition modification is entered in the column for tax year 2017. The addition modifications in 2016 and 2017 are recaptured as subtraction modifications of \$1,000 in the column for tax year 2019, \$40,000 for 2020 and \$15,000 for 2021. A subtraction modification is allowed in the column for 2019 of \$4,000 for the portion of the remaining federal NOL carryforward that was not allowed under IRC § 172(a)(2) (limited to the lower of taxable income or the unused portion of the federal NOL). However, that amount must be added back when the federal NOL carryover is used in 2020.

| | <u>2016</u> | <u>2017</u> | <u>2018</u> | <u>2019</u> | <u>2020</u> | <u>2021</u> |
|-----------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Federal income prior to NOL | \$20,000 | \$50,000 | (\$80,000) | \$25,000 | \$40,000 | \$30,000 |
| NOL carryback/carryforward | (\$16,000) | (\$40,000) | _____ | (\$20,000) | (\$4,000) | _____ |
| Federal taxable income | \$4,000 | \$10,000 | (\$80,000) | \$5,000 | \$36,000 | \$30,000 |
| NOL Modifications: § 5200-A(1)(H) | \$16,000 | \$40,000 | | | | |
| § 5122(2)(H) | | | | (\$1,000) | (\$40,000) | (\$15,000) |
| § 5122(2)(TT) | | | | (\$4,000) | | |
| § 5122(1)(LL) | | | | | \$4,000 | |
| _____ | _____ | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | \$20,000 | \$50,000 | (\$80,000) | \$0 | \$0 | \$15,000 |

Example #1.4 – NOL in 2018, some of the loss is carried back, some is carried forward

The taxpayer has a federal net operating loss of \$80,000 in tax year 2018. Part of the loss (\$56,000) is carried back; \$16,000 is applied to 2016 and \$40,000 to 2017. The remaining loss (\$24,000) is carried forward; \$20,000 to 2019 and \$4,000 to 2020. To reverse the federal carrybacks, a \$16,000 Maine addition modification is entered in the column for tax year 2016 and a \$40,000 addition modification is entered in the column for tax year 2017. The 2018 loss is available to offset Maine addition modifications. In this example, \$5,000 of Maine income in

2018 is offset by the federal loss. In order to prevent that portion of the federal loss used to offset Maine income from also reducing income in a carryforward year, Maine requires an adjustment. The recapture subtraction modification related to the carryback offsets in 2016 and 2017 must be reduced by the amount of addition modification offset in the loss year. In this example, the \$56,000 recapture modification must be reduced by \$5,000, resulting in subtraction modifications of \$1,000 in 2019, \$40,000 in 2020, and \$10,000 in 2021. In this example, the recapture reduction under section 5122(2)(H) prevents the taxpayer from avoiding tax on the \$5,000 unrelated modification in 2018 and also reducing income in the carryforward years by the full carryback recapture. A subtraction modification is allowed in the column for 2019 of \$4,000 for the portion of the federal NOL carryforward that was not allowed under IRC § 172(a)(2). However, that amount must be added back when the federal NOL carryover is used in 2020.

| | <u>2016</u> | <u>2017</u> | <u>2018</u> | <u>2019</u> | <u>2020</u> | <u>2021</u> |
|---------------------------------|-----------------|-----------------|-------------------|-------------|-------------|-----------------|
| Federal income prior to NOL | \$20,000 | \$50,000 | (\$80,000) | \$25,000 | \$40,000 | \$30,000 |
| NOL carryback/carryforward | (\$16,000) | (\$40,000) | _____ | (\$20,000) | (\$4,000) | _____ |
| Federal taxable income | \$4,000 | \$10,000 | (\$80,000) | \$5,000 | \$36,000 | \$30,000 |
| Maine unrelated modification | | | \$5,000 | | | |
| NOL Modifications: § 5122(1)(H) | \$16,000 | \$40,000 | | | | |
| § 5122(2)(H) | | | | (\$1,000) | (\$40,000) | (\$10,000) |
| § 5122(2)(TT) | | | | (\$4,000) | | |
| § 5122(1)(LL) | | | | | \$4,000 | |
| Maine taxable income | <u>\$20,000</u> | <u>\$50,000</u> | <u>(\$75,000)</u> | <u>\$0</u> | <u>\$0</u> | <u>\$20,000</u> |

PART 2 – TAX YEARS 2009, 2010, AND 2011

For all tax years after 2001, Maine has decoupled from federal carryback provisions. Any federal carryback must be offset by an addition modification of the same amount in the year of the carryback. 36 M.R.S. § 5122(1)(H). Similarly, Maine disallows carryforwards in 2009, 2010, and 2011 and any federal carryforward in those years must also be offset by a corresponding addition modification. The addition modifications for a federal carryback or carryforward can be recaptured in years subsequent to the year of the loss, beginning with tax year 2012, through subtraction modifications. 36 M.R.S. §§ 5122(2)(H), 5122(2)(P) and 5122(2)(CC). The recapture modifications must be reduced by any Maine income that is offset in the year of the loss. In addition, for tax years beginning in 2009, 2010, and 2011, NOL recapture subtraction modifications are suspended until 2012. The allowable carryover period for suspended losses and suspended recapture subtraction modifications is extended by the number of years the subtraction modification is suspended. Below are the statutory paragraphs related to NOL modifications in effect for tax years beginning in 2009, 2010, and 2011.

§5122. Modifications

1. Additions. Federal adjusted gross income shall be increased by:

E. The amount of any deduction claimed for the taxable year under the United States Internal Revenue Code, Section 172 which has previously been used to offset the modifications provided by this subsection;

H. The absolute value of the amount of any net operating loss arising from tax years beginning on or after January 1, 1989, but before January 1, 1993, that arises from an S corporation with total assets for the year of at least \$1,000,000 and the absolute value of the amount of any net operating loss arising from tax years beginning on or after January 1, 2002 that, pursuant to the United States Internal Revenue Code, Section 172, are being carried back for federal income tax purposes to the taxable year by the taxpayer;

M. The absolute value of the amount of any net operating loss arising from a tax year beginning or ending in 2001 that the taxpayer, pursuant to Section 102 of the federal Job Creation and Worker Assistance Act of 2002, Public Law 107-147, carries back more than 2 years to the taxable year for federal income tax purposes;

DD. For any taxable year beginning in 2009, 2010 or 2011, an amount equal to the absolute value of any net operating loss carry-forward claimed for purposes of the federal income tax;

2. Subtractions. Federal adjusted gross income shall be reduced by:

H. For each taxable year subsequent to the year of the loss, an amount equal to the absolute value of the net operating loss arising from tax years beginning on or after January 1, 1989, but before January 1, 1993, for which federal adjusted gross income was increased in accordance with subsection 1, paragraph H, and the absolute value of the amount of any net operating loss arising from tax years beginning on or after January 1, 2002, for which federal adjusted gross income was increased in accordance with subsection 1, paragraph H and that pursuant to the Code, Section 172 was carried

back for federal income tax purposes, less the absolute value of loss used in the taxable year of loss to offset any addition modification required by subsection 1, but only to the extent that:

(1) Maine taxable income is not reduced below zero;

(2) The taxable year is within the allowable federal period for carry-over;

(3) The amount has not been previously used as a modification pursuant to this subsection; and

(4) The modification under this paragraph is not claimed for any tax year beginning in 2009, 2010 or 2011. The amount not deducted as the result of the restriction with respect to tax years beginning in 2009, 2010 or 2011 may be deducted in any tax year beginning after December 31, 2011, but only to the extent that the requirements of subparagraphs (1) and (3) are met and the taxable year is within the allowable federal period for carry-over plus the number of years that the net operating loss carry-over adjustment was not deducted as a result of the restriction with respect to tax years beginning in 2009, 2010 or 2011;

P. An amount equal to the absolute value of any net operating loss arising in a tax year beginning or ending in 2001 for which federal adjusted gross income was increased in accordance with subsection 1, paragraph M and that, pursuant to Section 102 of the federal Job Creation and Worker Assistance Act of 2002, Public Law 107-147, was carried back more than 2 years to the taxable year for federal income tax purposes, but only to the extent that:

(1) Maine taxable income is not reduced below zero;

(2) The taxable year is either within 2 years prior to the year in which the loss arose or within the allowable federal period for carry-over of net operating losses;

(3) The amount has not been previously used as a modification pursuant to this subsection; and

(4) The modification under this paragraph is not claimed for any tax year beginning in 2009, 2010 or 2011. The amount not deducted as the result of the restriction with respect to tax years beginning in 2009, 2010 or 2011 may be deducted in any tax year beginning after December 31, 2011, but only to the extent that the requirements of subparagraphs (1) and (3) are met and the taxable year is within the allowable federal period for carry-over plus the number of years that the net operating loss carry-over adjustment was not deducted as a result of the restriction with respect to tax years beginning in 2009, 2010 or 2011;

V. The taxpayer's pro rata share of an amount that was previously added back to federal taxable income pursuant to section 5200-A, subsection 1, paragraph H by an S corporation of which the taxpayer is a shareholder and by which, absent the S corporation election, the corporation could have reduced its federal taxable income for

the taxable year pursuant to section 5200-A, subsection 2, paragraph H, except that the modification under this paragraph may not be claimed for any tax year beginning in 2009, 2010 or 2011. The amount not deducted as the result of the restriction with respect to tax years beginning in 2009, 2010 or 2011 may be deducted in any tax year beginning after December 31, 2011, but only to the extent that the requirements of section 5200-A, subsection 2, paragraph H, subparagraphs (1) and (3) are met and the taxable year is within the allowable federal period for carry-over plus the number of years that the net operating loss carry-over adjustment was not deducted as a result of the restriction with respect to tax years beginning in 2009, 2010 or 2011;

W. The taxpayer's pro rata share of an amount that was previously added back to federal taxable income pursuant to section 5200-A, subsection 1, paragraph M by an S corporation of which the taxpayer is a shareholder and by which, absent the S corporation election, the corporation could have reduced its federal taxable income for the taxable year pursuant to section 5200-A, subsection 2, paragraph L;

CC. An amount equal to the value of any prior year addition modification under subsection 1, paragraph DD, but only to the extent that:

(1) Maine taxable income is not reduced below zero;

(2) The taxable year is within the allowable federal period for carry-over plus the number of years that the net operating loss carry-over adjustment was not deducted as a result of the restriction with respect to tax years beginning in 2009, 2010 or 2011;

(3) The amount has not been previously used as a modification pursuant to this subsection; and

(4) The modification under this paragraph is not claimed for any tax year beginning in 2009, 2010 or 2011;

Examples

Example #2.1 – NOL in 2008, all of the loss is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2008. The entire amount of the loss is carried forward; \$25,000 is applied to 2009 and \$65,000 to 2010. All federal carryovers are deferred from tax years 2009, 2010, and 2011 to tax years 2012 and after. A \$25,000 Maine addition modification is entered in the column for tax year 2009 and a \$65,000 addition modification is entered in the column for 2010. 36 M.R.S. § 5122(1)(DD). These addition modifications may be recaptured in 2012 and later years. Here, the \$90,000 total additions in 2009 and 2010 are recaptured with a subtraction modification in the column for tax year 2012. Because the federal loss did not offset any Maine addition modifications in 2008, no other Maine adjustment is required.

| | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Federal income prior to NOL | \$40,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 | \$80,000 | \$90,000 |
| NOL carryback/carryforward | _____ | _____ | _____ | (\$25,000) | (\$65,000) | _____ | _____ |
| Federal taxable income | \$40,000 | \$50,000 | (\$90,000) | \$0 | \$5,000 | \$80,000 | \$90,000 |
| NOL Modifications: | | | | | | | |
| § 5122(1)(DD) | | | | \$25,000 | \$65,000 | | |
| § 5122(2)(CC) | | | | | | | (\$90,000) |
| _____ | _____ | _____ | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | \$40,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 | \$80,000 | \$0 |

Example #2.2 – NOL in 2008, all of the loss is carried back

The taxpayer has a federal net operating loss of \$90,000 in tax year 2008. The entire loss is carried back; \$40,000 is applied to 2006 and \$50,000 to 2007. To reverse the federal carrybacks, a \$40,000 Maine addition modification is entered in the column for tax year 2006 and a \$50,000 addition modification is entered in the column for tax year 2007. The addition modifications in 2006 and 2007 are recaptured as a subtraction modification of \$90,000 in the column for tax year 2012, the first year that the subtraction modification is allowed.

| | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Federal income prior to NOL | \$40,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 | \$80,000 | \$90,000 |
| NOL carryback/carryforward | (\$40,000) | (\$50,000) | _____ | _____ | _____ | _____ | _____ |
| Federal taxable income | \$0 | \$0 | (\$90,000) | \$25,000 | \$70,000 | \$80,000 | \$90,000 |
| NOL Modifications: § 5122(1)(H) | \$40,000 | \$50,000 | | | | | |
| § 5122(2)(H) | | | | | | | (\$90,000) |
| _____ | _____ | _____ | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | \$40,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 | \$80,000 | \$0 |

Example #2.3 – NOL in 2008, some of the loss is carried back, some is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2008. Part of the loss (\$70,000) is carried back; \$20,000 is applied to 2006 and \$50,000 to 2007. The remaining loss (\$20,000) is carried forward to 2009. To reverse the federal carrybacks, a \$20,000 Maine addition modification is entered in the column for tax year 2006 and a \$50,000 addition modification is entered in the column for tax year 2007. The addition modifications in 2006 and 2007 are recaptured as a subtraction modification of \$70,000 in the column for tax year 2012, the first year that the subtraction modification is allowed. The \$20,000 federal carryforward to 2009 must also be reversed through an addition modification in that year. The addition modification in 2009 is recaptured in 2012 with a \$20,000 subtraction modification in the column for 2012.

| | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> |
|---------------------------------|-----------------|-----------------|-------------------|-----------------|-----------------|-----------------|-------------|
| Federal income prior to NOL | \$20,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 | \$80,000 | \$90,000 |
| NOL carryback/carryforward | (\$20,000) | (\$50,000) | | (\$20,000) | | | |
| Federal taxable income | \$0 | \$0 | (\$90,000) | \$5,000 | \$70,000 | \$80,000 | \$90,000 |
| NOL Modifications: § 5122(1)(H) | \$20,000 | \$50,000 | | | | | |
| § 5122(1)(DD) | | | | \$20,000 | | | |
| § 5122(2)(H) | | | | | | | (\$70,000) |
| § 5122(2)(CC) | | | | | | | (\$20,000) |
| Maine taxable income | \$20,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 | \$80,000 | \$0 |

Example #2.4 – NOL in 2008, some of the loss is carried back, some is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2008. Part of the loss (\$70,000) is carried back; \$20,000 is applied to 2006 and \$50,000 to 2007. The remaining loss (\$20,000) is carried forward to 2009. To reverse the federal carrybacks, a \$20,000 Maine addition modification is entered in the column for tax year 2006 and a \$50,000 addition modification is entered in the column for tax year 2007. The 2008 loss is available to offset unrelated Maine addition modifications. In this example, \$5,000 of Maine income in 2008 is offset by the federal loss. In order to prevent that portion of the federal loss used to offset Maine income from also reducing income in a carryforward year, Maine requires an adjustment. The recapture subtraction modification related to the carryback offsets in 2006 and 2007 must be reduced by the amount of addition modification offset in the loss year. In this example, the \$70,000 recapture modification must be reduced by \$5,000, resulting in a subtraction modification of \$65,000 in 2012. The \$20,000 federal carryforward to 2009 must also be reversed through an addition modification in that year. The addition modification in 2009 is recaptured with a \$20,000 subtraction modification in the column for 2012. In this example, the recapture reduction under 36 M.R.S. § 5122(2)(H) keeps the taxpayer from avoiding tax on the \$5,000 unrelated modification in 2008 and also reducing income in 2012 by the full carryback recapture.

| | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> |
|---------------------------------|-----------------|-----------------|-------------------|-----------------|-----------------|-----------------|----------------|
| Federal income prior to NOL | \$20,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 | \$80,000 | \$90,000 |
| NOL carryback/carryforward | (\$20,000) | (\$50,000) | | (\$20,000) | | | |
| Federal taxable income | \$0 | \$0 | (\$90,000) | \$5,000 | \$70,000 | \$80,000 | \$90,000 |
| Maine unrelated modification | | | \$5,000 | | | | |
| NOL Modifications: § 5122(1)(H) | \$20,000 | \$50,000 | | | | | |
| § 5122(1)(DD) | | | | \$20,000 | | | |
| § 5122(2)(H) | | | | | | | (\$65,000) |
| § 5122(2)(CC) | | | | | | | (\$20,000) |
| Maine taxable income | \$20,000 | \$50,000 | (\$85,000) | \$25,000 | \$70,000 | \$80,000 | \$5,000 |

PART 3 –TAX YEARS 2002 THROUGH 2008

For tax years beginning on or after January 1, 2002, Maine decoupled from the Internal Revenue Code regarding net operating loss carrybacks. Unlike prior years, the taxpayer was no longer required to add to income an amount equal to the total NOL incurred in the year of the loss and carried back federally, regardless of how many years the loss was carried back. Any federal carryback, however, was required to be offset by an addition modification in the year to which the carryback was applied. 36 M.R.S. § 5122(1)(H)). A recapture of the carryback addition modification was allowed in years subsequent to the year of the loss. 36 M.R.S. § 5122(2)(H). Net operating loss modification recaptures are limited in tax years 2009 through 2011. For details about these restrictions, see Part 1. Below are the statutory paragraphs related to NOL modifications in effect for tax years 2002-2008.

§5122. Modifications

1. Additions. Federal adjusted gross income shall be increased by:

E. The amount of any deduction claimed for the taxable year under the United States Internal Revenue Code, Section 172 which has previously been used to offset the modifications provided by this subsection;

H. The absolute value of the amount of any net operating loss arising from tax years beginning on or after January 1, 1989 but before January 1, 1993, that arises from an S corporation with total assets for the year of at least \$1,000,000 and the absolute value of the amount of any net operating loss arising from tax years beginning on or after January 1, 2002 that, pursuant to the United States Internal Revenue Code, Section 172, are being carried back for federal income tax purposes to the taxable year by the taxpayer;

M. The absolute value of the amount of any net operating loss arising from a tax year beginning or ending in 2001 that the taxpayer, pursuant to Section 102 of the federal Job Creation and Worker Assistance Act of 2002, Public Law 107-147, carries back more than 2 years to the taxable year for federal income tax purposes;

2. Subtractions. Federal adjusted gross income shall be reduced by:

H. For each taxable year subsequent to the year of the loss, an amount equal to the absolute value of the net operating loss arising from tax years beginning on or after January 1, 1989 but before January 1, 1993, for which federal adjusted gross income was increased in accordance with subsection 1, paragraph H, and the absolute value of the amount of any net operating loss arising from tax years beginning on or after January 1, 2002, for which federal adjusted gross income was increased in accordance with subsection 1, paragraph H and that, pursuant to the Code, Section 172 was carried back for federal income tax purposes, less the absolute value of loss used in the taxable year of loss to offset any addition modification required by subsection 1, but only to the extent that:

(1) Maine taxable income is not reduced below zero;

(2) The taxable year is within the allowable federal period for carry-over; and

(3) The amount has not been previously used as a modification pursuant to this subsection;

P. An amount equal to the absolute value of any net operating loss arising from a tax year beginning or ending in 2001 for which federal adjusted gross income was increased in accordance with subsection 1, paragraph M and that, pursuant to Section 102 of the federal Job Creation and Worker Assistance Act of 2002, Public Law 107-147, was carried back more than 2 years to the taxable year for federal income tax purposes, but only to the extent that:

(1) Maine taxable income is not reduced below zero;

(2) The taxable year is either within 2 years prior to the year in which the loss arose or within the allowable federal period for carry-over of net operating losses; and

(3) The amount has not been previously used as a modification pursuant to this subsection;

V. The taxpayer's pro rata share of an amount that was previously added back to federal taxable income pursuant to section 5200-A, subsection 1, paragraph H by an S corporation of which the taxpayer is a shareholder and by which, absent the S corporation election, the corporation could have reduced its federal taxable income for the taxable year pursuant to section 5200-A, subsection 2, paragraph H;

W. The taxpayer's pro rata share of an amount that was previously added back to federal taxable income pursuant to section 5200-A, subsection 1, paragraph M by an S corporation of which the taxpayer is a shareholder and by which, absent the S corporation election, the corporation could have reduced its federal taxable income for the taxable year pursuant to section 5200-A, subsection 2, paragraph L;

Examples

Example #3.1 – NOL in 2005, all of the loss is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2005. The entire amount of the loss is carried forward; \$25,000 is applied to 2006 and \$65,000 to 2007. Because the federal loss did not offset any unrelated Maine addition modifications in 2005, no Maine adjustment is required in 2006 or 2007.

| | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|
| Federal income prior to NOL | \$40,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | _____ | _____ | _____ | (\$25,000) | (\$65,000) |
| Federal taxable income | \$40,000 | \$50,000 | (\$90,000) | \$0 | \$5,000 |
| | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | \$40,000 | \$50,000 | (\$90,000) | \$0 | \$5,000 |

Example #3.2 – NOL in 2005, all of the loss is carried back

The taxpayer has a federal net operating loss of \$90,000 in tax year 2005. The entire loss is carried back; \$40,000 is applied to 2003 and \$50,000 to 2004. To reverse the federal carrybacks, a \$40,000 Maine addition modification is entered in the column for tax year 2003 and a \$50,000 addition modification is entered in the column for tax year 2004. The addition modifications in 2003 and 2004 are recaptured as subtraction modifications of \$25,000 in the column for tax year 2006 and \$65,000 for tax year 2007. Because the federal loss did not offset any unrelated Maine addition modifications in 2005, no other Maine adjustment is required in 2006 or 2007.

| | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> |
|---------------------------------|-------------------|-------------------|-------------|-------------|-------------|
| Federal Income prior to NOL | \$40,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | <u>(\$40,000)</u> | <u>(\$50,000)</u> | _____ | _____ | _____ |
| Federal Taxable Income | \$0 | \$0 | (\$90,000) | \$25,000 | \$70,000 |
| NOL Modifications: § 5122(1)(H) | \$40,000 | \$50,000 | | | |
| § 5122(2)(H) | | | | (\$25,000) | (\$65,000) |
| | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | \$40,000 | \$50,000 | (\$90,000) | \$0 | \$5,000 |

Example #3.3 – NOL in 2005, some of the loss is carried back, some is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2005. Part of the loss (\$70,000) is carried back; \$20,000 is applied to 2003 and \$50,000 to 2004. The remaining loss (\$20,000) is carried forward to 2006. To reverse the federal carrybacks, a \$20,000 Maine addition modification is entered in the column for tax year 2003 and a \$50,000 addition modification is entered in the column for tax year 2004. The addition modifications in 2003 and 2004 are recaptured as subtraction modifications of \$5,000 in the column for tax year 2006 and \$65,000 for tax year 2007. Because the federal loss did not offset any unrelated Maine addition modifications in 2005, no other Maine adjustment is required in 2006 or 2007.

| | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> |
|--------------------------------|-------------------|-------------------|-------------|-------------------|-------------|
| Federal Income prior to NOL | \$20,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | <u>(\$20,000)</u> | <u>(\$50,000)</u> | _____ | <u>(\$20,000)</u> | _____ |
| Federal Taxable Income | \$0 | \$0 | (\$90,000) | \$5,000 | \$70,000 |
| NOL Modification: § 5122(1)(H) | \$20,000 | \$50,000 | | | |
| § 5122(2)(H) | | | | (\$5,000) | (\$65,000) |
| | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | \$20,000 | \$50,000 | (\$90,000) | \$0 | \$5,000 |

Example #3.4 – NOL in 2005, some of the loss is carried back, some is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2005. Part of the loss (\$70,000) is carried back; \$20,000 is applied to 2003 and \$50,000 to 2004. The remaining loss (\$20,000) is carried forward to 2006. To reverse the federal carrybacks, a \$20,000 Maine addition modification is entered in the column for tax year 2003 and a \$50,000 addition modification is entered in the column for tax year 2004. Since no addition modification is necessary in 2005, the full amount of the federal loss is available to offset unrelated Maine

addition modifications in that year. In this example, \$5,000 of Maine income in 2005 is offset by the federal loss. In order to prevent that portion of the federal loss used to offset Maine income in 2005 from also reducing income in a carryforward year, Maine requires an adjustment. The amount of the recapture subtraction modification claimed in 2007, which is related to the carryback offsets in 2003 and 2004, must be reduced by the amount of addition modification that is offset in the loss year. In this example, the \$70,000 recapture modification must be reduced by \$5,000, resulting in a subtraction modification of \$65,000 in the column for 2007. In this example, the recapture reduction under section 5122(2)(H) keeps the taxpayer from avoiding tax on the \$5,000 unrelated modification in 2005 and also reducing income in future years by the full carryback recapture. Notice that, in 2006, the NOL carryforward combined with a Maine subtraction modification unrelated to the NOL results in a negative amount for Maine net income. Since Maine has no state-level NOL, negative income amounts have no effect on Maine income tax.

| | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> |
|---------------------------------|-------------------|-------------------|-------------|-------------------|-------------|
| Federal Income prior to NOL | \$20,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | <u>(\$20,000)</u> | <u>(\$50,000)</u> | _____ | <u>(\$20,000)</u> | _____ |
| Federal Taxable Income | \$0 | \$0 | (\$90,000) | \$5,000 | \$70,000 |
| Maine unrelated modifications | (\$3,000) | \$4,000 | \$5,000 | (\$6,000) | \$7,000 |
| NOL Modifications: § 5122(1)(H) | \$20,000 | \$50,000 | | | |
| § 5122(2)(H) | | | | | (\$65,000) |
| | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | \$17,000 | \$54,000 | (\$85,000) | (\$1,000) | \$12,000 |

PART 4 –TAX YEAR 2001

For tax years beginning or ending in 2001, Maine was in conformity with the Internal Revenue Code regarding net operating losses carried back two years, but generally decoupled from federal carrybacks of more than two years. In the year of the loss, the taxpayer was required to add to income an amount equal to the total NOL incurred in that year and carried back federally. This addition modification was required under 36 M.R.S. § 5122(1)(D). A second addition modification was required for 2001 losses carried back to tax years 1995, 1996, 1997, or 1998. This modification applied to the year to which the NOL was carried and was equal to the amount of the federal NOL carried back to that year. 36 M.R.S. § 5122(1)(M). A third addition modification was required in a carryforward year if a portion of the loss was carried forward federally and a Maine addition modification was offset in the loss year. See 36 M.R.S. § 5122(1)(E) and example #4.4. Below are the statutory paragraphs related to NOL modifications in effect for tax year 2001.

§ 5122. Modifications

1. Additions. Federal adjusted gross income shall be increased by:

D. For income tax years beginning before January 1, 2002, the amount of any net operating loss in the taxable year that has been carried back to previous years pursuant to the Code, Section 172;

E. The amount of any deduction claimed for the taxable year under the United States Internal Revenue Code, Section 172 which has previously been used to offset the modifications provided by this subsection;

H. The absolute value of the amount of any net operating loss arising from tax years beginning on or after January 1, 1989, but before January 1, 1993, that arises from an S corporation with total assets for the year of at least \$1,000,000 and that, pursuant to the United States Internal Revenue Code, Section 172, are being carried back for federal income tax purposes to the taxable year by the taxpayer;

M. The absolute value of the amount of any net operating loss arising from a tax year beginning or ending in 2001 that the taxpayer, pursuant to Section 102 of the federal Job Creation and Worker Assistance Act of 2002, Public Law 107-147, carries back more than 2 years to the taxable year for federal income tax purposes;

2. Subtractions. Federal adjusted gross income shall be reduced by:

H. For each taxable year subsequent to the year of the loss, an amount equal to the absolute value of the net operating loss arising from tax years beginning on or after January 1, 1989, but before January 1, 1993, for which federal adjusted gross income was increased in accordance with subsection 1, paragraph H and that pursuant to the Code, Section 172 was carried back for federal income tax purposes, but only to the extent that:

(1) Maine taxable income is not reduced below zero;

(2) The taxable year is within the allowable federal period for carry-over; and

(3) The amount has not been previously used as a modification pursuant to this subsection;

P. An amount equal to the absolute value of any net operating loss arising in a tax year beginning or ending in 2001 for which federal adjusted gross income was increased in accordance with subsection 1, paragraph M and that, pursuant to Section 102 of the federal Job Creation and Worker Assistance Act of 2002, Public Law 107-147, was carried back more than 2 years to the taxable year for federal income tax purposes, but only to the extent that:

(1) Maine taxable income is not reduced below zero;

(2) The taxable year is either within 2 years prior to the year in which the loss arose or within the allowable federal period for carry-over of net operating losses;

(3) The amount has not been previously used as a modification pursuant to this subsection;

Examples

Example #4.1 – NOL in 2001, all of the loss is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2001. The entire amount of the loss is carried forward; \$25,000 is applied to 2002 and \$65,000 to 2003. No addition modification is required in the loss year because none of the loss was carried back at the federal level. Further, because the federal loss did not offset any Maine addition modifications in 2001, no Maine adjustment is required in 2002 or 2003.

| | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> | <u>2003</u> |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|
| Federal income prior to NOL | \$40,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | | | | (\$25,000) | (\$65,000) |
| Federal taxable income | \$40,000 | \$50,000 | (\$90,000) | \$0 | \$5,000 |
| | | | | | |
| Maine taxable income | \$40,000 | \$50,000 | (\$90,000) | \$0 | \$5,000 |

Example #4.2 – NOL in 2001, all of the loss is carried back

The taxpayer has a federal net operating loss of \$90,000 in tax year 2001. The entire loss is carried back; \$40,000 is applied to 1998 and \$50,000 to 1999. A \$90,000 Maine addition modification, equal to the federal loss carryback, is entered in the column for tax year 2001 and a second addition modification of \$40,000 is entered in the column for tax year 1998. Maine accepts the federal carryback to 1999, since it is within the allowable two-year carryback window. The carryback to 1998, however, must be reversed through an addition modification because that carryback is beyond the allowable two-year time period. The addition modification in 1998 may be recaptured as a subtraction modification in subsequent years, within the

ordinary carryback/carryover time period for federal losses. In this example, a subtraction modification is entered in the column for tax year 2000 to accomplish that recapture.

| | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> | <u>2003</u> |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Federal Income prior to NOL | \$40,000 | \$50,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | (\$40,000) | (\$50,000) | | | | |
| Federal Taxable Income | \$0 | \$0 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL Modifications: § 5122(1)(D) | | | | \$90,000 | | |
| § 5122(1)(M) | \$40,000 | | | | | |
| § 5122(2)(P) | | | (\$40,000) | | | |
| Maine taxable income | \$40,000 | \$0 | \$10,000 | \$0 | \$25,000 | \$70,000 |

Example #4.3 – NOL in 2001, some of the loss is carried back, some is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2001. Part of the loss (\$70,000) is carried back; \$20,000 is applied to 1999 and \$50,000 to 2000. In this example, since only a portion of the loss is carried back, only that portion must be added back to Maine income in the loss year. Also, because the loss is not carried back more than two years at the federal level, an addition modification is not required in any carryback year. The addition modification in 2001 brings Maine net income for the taxpayer to negative \$20,000. Since Maine does not have a state-level NOL, there are no adjustments for this \$20,000 of negative Maine income. The negative \$20,000 is equal to the amount of the federal loss carryforward which, in this example, is applied to reduce the 2002 federal taxable income. No other Maine adjustment is required.

| | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> | <u>2003</u> |
|--------------------------------|-------------|-------------|-------------|-------------|-------------|
| Federal Income prior to NOL | \$20,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | (\$20,000) | (\$50,000) | | (\$20,000) | |
| Federal Taxable Income | \$0 | \$0 | (\$90,000) | \$5,000 | \$70,000 |
| NOL Modification: § 5122(1)(D) | | | \$70,000 | | |
| Maine taxable income | \$0 | \$0 | (\$20,000) | \$5,000 | \$70,000 |

Example #4.4 – NOL in 2001, some of the loss is carried back, some is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2001. Part of the loss (\$70,000) is carried back; \$20,000 is applied to 1999 and \$50,000 to 2000. The remaining loss (\$20,000) is carried forward to 2002. Only that portion of the loss carried back must be added back to Maine income in the loss year. As a result, the amount that is used as a federal carryforward is available in the year of the loss to offset unrelated Maine addition modifications. In this example, \$5,000 of Maine income in 2001 is offset by the federal loss. To prevent that portion of the federal loss used to offset Maine income in 2001 from also reducing income in a carryforward year, Maine requires an adjustment. This modification is located in the table below under tax year 2002 as an addition of \$5,000. The addition modification under section 5122(1)(E) keeps the taxpayer from avoiding tax on the \$5,000 unrelated modification in 2001 and also reducing income in future years by the full carryover amount. Of the \$20,000 loss carryforward, \$5,000 is used to offset Maine income in 2001. Therefore, the \$20,000

carryforward must be reduced by that \$5,000 in 2002. Notice that, in 1999, the NOL carryback combined with a Maine subtraction modification unrelated to the NOL results in a negative amount for Maine net income. Since Maine has no state-level NOL, negative income amounts have no effect on Maine income tax.

| | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> | <u>2003</u> |
|--------------------------------------|-------------------|-------------------|-------------------|-------------------|-----------------|
| Federal Income prior to NOL | \$20,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | <u>(\$20,000)</u> | <u>(\$50,000)</u> | _____ | <u>(\$20,000)</u> | _____ |
| Federal Taxable Income | \$0 | \$0 | (\$90,000) | \$5,000 | \$70,000 |
| Maine unrelated modifications | (\$3,000) | \$4,000 | \$5,000 | (\$6,000) | \$7,000 |
| NOL Modifications: | | | | | |
| § 5122(1)(D) | | | \$70,000 | | |
| § 5122(1)(E) | | | | \$5,000 | |
| Maine taxable income | <u>(\$3,000)</u> | <u>\$4,000</u> | <u>(\$15,000)</u> | <u>\$4,000</u> | <u>\$77,000</u> |

PART 5 -- TAX YEAR 2000 AND EARLIER

From 1993 through 2000, Maine was in conformity with the Internal Revenue Code regarding net operating losses, so all federal carryback amounts were accepted for Maine income tax purposes. In the year of the loss, however, the taxpayer was required to add to income an amount equal to the NOL incurred in that year and carried back federally. This addition modification was required by 36 M.R.S. § 5122(1)(D). A second addition modification was required in a carryforward year if a portion of the loss was carried forward federally and a Maine addition modification was offset in the loss year. See 36 M.R.S. § 5122(1)(E) and example #5.4. Below are the statutory paragraphs related to NOL modifications in effect for tax year 2000.

§ 5122. Modifications

1. Additions. Federal adjusted gross income shall be increased by:

D. The amount of any net operating loss in the taxable year which has been carried back to previous years pursuant to the Code, Section 172;

E. The amount of any deduction claimed for the taxable year under the United States Internal Revenue Code, Section 172 which has previously been used to offset the modifications provided by this subsection;

H. The absolute value of the amount of any net operating loss arising from tax years beginning on or after January 1, 1989, but before January 1, 1993, that arises from an S corporation with total assets for the year of at least \$1,000,000 and that, pursuant to the United States Internal Revenue Code, Section 172, is being carried back for federal income tax purposes to the taxable year by the taxpayer;

2. Subtractions. Federal adjusted gross income shall be reduced by:

H. For each taxable year subsequent to the year of the loss, an amount equal to the absolute value of the net operating loss arising from tax years beginning on or after January 1, 1989 but before January 1, 1993, for which federal adjusted gross income was increased in accordance with subsection 1, paragraph H and that pursuant to the Code, Section 172 was carried back for federal income tax purposes, but only to the extent that:

(1) Maine taxable income is not reduced below zero;

(2) The taxable year is within the allowable federal period for carry-over; and

(3) The amount has not been previously used as a modification pursuant to this subsection;

Examples

Example #5.1 – NOL in 2000, all of the loss is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2000. The entire amount of the loss is carried forward; \$25,000 is applied to 2001 and \$65,000 to 2002. No addition modification is required in the loss year because none of the loss was carried back at the federal level. Further, because the federal loss did not offset any Maine addition modifications in 2000, no Maine adjustment is required in 2001 or 2002.

| | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> |
|-----------------------------|-------------|-------------|-------------|-------------|-------------|
| Federal income prior to NOL | \$40,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | _____ | _____ | _____ | (\$25,000) | (\$65,000) |
| Federal taxable income | \$40,000 | \$50,000 | (\$90,000) | \$0 | \$5,000 |
| | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | \$40,000 | \$50,000 | (\$90,000) | \$0 | \$5,000 |

Example #5.2 – NOL in 2000, all of the loss is carried back

The taxpayer has a federal net operating loss of \$90,000 in tax year 2000. The entire loss is carried back; \$40,000 is applied to 1998 and \$50,000 to 1999. A \$90,000 Maine addition modification, equal to the federal loss carryback, is entered in the column for tax year 2000. The addition modification in the year of the loss brings federal income for the taxpayer to zero for 2000. No other adjustment is required.

| | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> |
|--------------------------------|-------------|-------------|-------------|-------------|-------------|
| Federal Income prior to NOL | \$40,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | (\$40,000) | (\$50,000) | _____ | _____ | _____ |
| Federal Taxable Income | \$0 | \$0 | (\$90,000) | \$25,000 | \$70,000 |
| NOL Modification: § 5122(1)(D) | _____ | _____ | \$90,000 | _____ | _____ |
| | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | \$0 | \$0 | \$0 | \$25,000 | \$70,000 |

Example #5.3 – NOL in 2000, some of the loss is carried back, some is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2000. Part of the loss (\$70,000) is carried back; \$20,000 is applied to 1998 and \$50,000 to 1999. The remaining loss (\$20,000) is carried forward to 2001. Only that portion of the loss carried back must be added back to Maine income in the loss year. The addition modification in 2000 brings Maine net income for the taxpayer to a loss of \$20,000. This \$20,000 loss is equal to the amount of the federal loss carryforward which, in this example, is applied to reduce the 2001 federal taxable income. No other Maine adjustment is required.

| | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> |
|--------------------------------|-------------------|-------------------|-------------|-------------------|-------------|
| Federal Income prior to NOL | \$20,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | <u>(\$20,000)</u> | <u>(\$50,000)</u> | _____ | <u>(\$20,000)</u> | _____ |
| Federal Taxable Income | \$0 | \$0 | (\$90,000) | \$5,000 | \$70,000 |
| NOL Modification: § 5122(1)(D) | | | \$70,000 | | |
| | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | \$0 | \$0 | (\$20,000) | \$5,000 | \$70,000 |

Example #5.4 – NOL in 2000. some of the loss is carried back, some is carried forward

The taxpayer has a federal net operating loss of \$90,000 in tax year 2000. Part of the loss (\$70,000) is carried back; \$20,000 is applied to 1998 and \$50,000 to 1999. The remaining loss (\$20,000) is carried forward to 2001. Only that portion of the loss carried back must be added back to Maine income in the loss year. As a result, the amount that is used as a federal carryforward is available in the year of the loss to offset unrelated Maine addition modifications. In this example, \$5,000 of Maine income in 2000 is offset by the federal loss. To prevent that portion of the federal loss used to offset Maine income in 2000 from also reducing income in a carryforward year, Maine requires an adjustment. This adjustment is located in the table below under tax year 2001 as an addition of \$5,000. The addition modification under section 5122(1)(E) keeps the taxpayer from avoiding tax on the \$5,000 unrelated modification in 2000 and also reducing income in future years by the full carryover amount. Of the \$20,000 loss carryforward, \$5,000 is used to offset Maine income in 2000. Therefore, the \$20,000 carryforward must be reduced by that \$5,000 in 2001. Notice that, in 1998, the NOL carryback combined with a Maine subtraction modification unrelated to the NOL results in a negative amount for Maine net income. Since Maine has no state-level NOL, negative income amounts have no effect on Maine income tax.

| | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> |
|---------------------------------|-------------------|-------------------|-------------|-------------------|-------------|
| Federal Income prior to NOL | \$20,000 | \$50,000 | (\$90,000) | \$25,000 | \$70,000 |
| NOL carryback/carryforward | <u>(\$20,000)</u> | <u>(\$50,000)</u> | _____ | <u>(\$20,000)</u> | _____ |
| Federal Taxable Income | \$0 | \$0 | (\$90,000) | \$5,000 | \$70,000 |
| Maine unrelated modifications | (\$3,000) | \$4,000 | \$5,000 | (\$6,000) | \$7,000 |
| NOL Modifications: § 5122(1)(D) | | | \$70,000 | | |
| § 5122(1)(E) | | | | \$5,000 | |
| | _____ | _____ | _____ | _____ | _____ |
| Maine taxable income | (\$3,000) | \$4,000 | (\$15,000) | \$4,000 | \$77,000 |