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Understanding and Utilizing Net Operating Losses (NOLs):

How Puerto Rican businesses can carry forward or backward their NOLs to offset taxable income.

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Net operating losses (NOLs) can be a boon for corporations that experience a down year, allowing them to offset taxable income in other years. But, NOLs come with complex rules and limitations, so it's important to understand your options. This article will answer all your frequently asked questions about NOLs, including what they are, how to calculate them, whether they can be carried back or forward, how to claim them, and what limitations and special rules apply. By the end, you'll have the knowledge you need to use NOLs to your corporation's advantage.

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Collaborated in the preparation of this article.

What is a Net Operating Loss?

Net operating losses (NOLs) in Puerto Rico are defined in Section 1033.14(a) of the Puerto Rico Internal Revenue Code as the excess of deductions and exemptions over gross income after certain adjustments. The following exceptions, additions, and limitations must be considered to arrive at the allowable NOL for tax purposes:

- Additions: Tax-exempt interest (net of any applicable deductions) must be included in gross income.
- Limitations:
  - No deduction for NOLs is allowed.
  - The amount deductible of losses from sales or exchanges of capital assets shall not exceed the amount of the gains from such sales or exchanges.
  - Deductions not related to the principal business of a taxpayer (other than a corporation) are limited to the gross income from the non-related activities.

- Exception: Compensation received or accrued due to rendering personal services as an employee or pension for services rendered shall be excluded from gross income.

The NOLs can be deducted for determining both the net taxable income for regular tax as well as for Alternative Minimum Tax and must be reported on Schedule G of the Income tax return.

Can I carry forward the losses? Can I carry them back?

Yes, the NOLs can be carried over to future years, but not indefinitely. The carryover period depends on the taxable year in which the NOL was generated, as follows:

Taxable year beginning	Carryover for
Before January 1, 2005	Seven (7) years
After December 31, 2004, and before January 1, 2013	Twelve (12) years
After December 31, 2012	Ten (10) years

In the case of NOLs for Alternative Minimum Tax purposes, the expiration dates are the same as for regular NOLs.

Regarding carryback rules, these do not apply in Puerto Rico with the exception of losses incurred in 2020; which we will touch upon later on in the article, in the special rules section.

How much of the NOLs can be claimed?

The amount of NOLs that can be deducted in a given year is also limited. Same as with the carryover periods, the limitation depends on the taxable year in which the NOL was generated. As portrayed below in the tables, the taxable years applicable to NOL limitations for regular tax and Alternative Minimum Tax vary.

Regular Tax

The following table summarizes the NOL limitation rules for regular tax purposes.

If generated on taxable years beginning	Limitation:
After December 31, 2012, and before January 1, 2015	No more than 90% of the net income
After December 31, 2014, and before January 1, 2019	No more than 80% of the net income
After December 31, 2018	No more than 90% of the net income

Alternative Minimum Tax

In the case of the NOLs from Alternative Minimum Tax, the NOLs available to be claimed are limited as follows:

If generated on taxable years beginning	Limitation:
Before January 1, 2015	No more than 80% of the alternative minimum net income
After December 31, 2014	No more than 70% of the alternative minimum net income

Special rules for NOLs:

There are also a few special rules that apply to NOLs in Puerto Rico. For example:

Individuals with net losses in their trade or business for three consecutive years, from taxable years beginning after December 31, 2014, and before December 31, 2018, are limited to claiming 50% of the loss from the third year and thereafter.

Entities that sell fifty percent (50%) or more of their stock or interest may have their NOL carryover limited to the amount of net income generated from the same commercial activity or trade or business that generated the NOL. This will not apply if, immediately after the sale, exchange, transfer, or acquisition of stock or share the transferor who owned fifty percent (50%) or more of the value of the stocks or shares, on the date of the transaction also owns fifty percent (50%) or more of the value of the acquirer of such stocks or shares.

Special Rule for Net Operating Losses from 2020

Act. 57-2020, known as the "Complementary Law to Address the Effects of the COVID-19 Emergency on the Puerto Rican Economy" established special rules for NOLs generated in 2020 due to the COVID-19 pandemic. These NOLs are not subject to the 90% limitation, but they must be claimed after all NOLs from previous years have been claimed.

Another important aspect to mention is that under Act 57-2020, there was an option to carry back the 2020 net operating losses for two years, but this was only available up until the filing date of the 2020 income tax return, which means that this option expired.

To calculate and claim the 2020 NOL deduction, the income tax return must include the Worksheet for the Determination of the Net Operating Loss Deduction from Previous Years. In the following example, we will explain how to complete the worksheet to determine the losses to be used on your return:

We are preparing the 2022 income tax return, and the entity has the following net operating losses reported on Schedule G for 2019 $100,000; 2020 $100,000; 2021 $30,000. For 2022 the entity has a net operating income of $100,000.

Step one: Determine the limitation for the losses from prior years not related to 2020. In this case, we have the $100,000 from 2019 and these losses are limited to 90% of the net operating income from the current year. The Net operating income for 2022 is $100,000, the amount of losses from 2020 that can be claimed on the 2022 Income tax return is $90,000 (100,000 net operating income x 90%).

Step two: Determine the adjusted net income before losses from previous years from 2020. Our net operating income will be $10,000 (100,000-90,000).

Step three: Determine the Net operating losses from 2020 directly related to the Covid-19 Emergency. Our losses related to the COVID-19 Emergency are $100,000.

Step four: Determine the amount to be claimed from the 2020 net operating loss. Our net operating income after the deduction of the net operating losses from previous years before 2020 is $10,000. The 2020 Net Operating losses have no limitations, which means that we can claim a total of $10,000 from the 2020 losses.

Step five: Determine the Carryforward Net Operating Losses for future years. From the losses of 2019 we have a balance of $10,000 (after claiming $90,000, on our 2022 Income tax return), from the loss of 2020 we have a balance of $90,000 (after claiming $10,000) and from the loss of 2021 we still have a balance of $30,000 since we did not claim any of them. This means that on our Schedule G we will have a total of available Net operating losses of $130,000.

This is just one example of how taxpayers can maximize the benefits of NOLs. By understanding the rules and options available, taxpayers can make the best decisions for their individual circumstances.

We are committed to keeping you informed of all the latest developments in laws and regulations that affect businesses in Puerto Rico. We can help you navigate the complex tax landscape to ensure that you are taking advantage of all the available benefits. Contact us to learn more about how we can help you.





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