



## Net Operating Losses and Combined Groups

**TB-95 - Issued February 18, 2020**

**Tax: Corporation Business Tax**

P.L. 2018, c. 48, and P.L. 2018, c. 131, collectively mandate combined reporting for privilege periods ending on and after July 31, 2019 (beginning on and after August 1, 2018, if a full 12-month privilege period of the managerial member begins August 1, 2018, and ends July 31, 2019). In addition, the laws change the net operating loss and net operating loss carryover regime from pre-allocation to post-allocation for privilege periods ending on and after July 31, 2019. This Technical Bulletin explains various aspects of prior net operating loss conversion carryovers (PNOLs), post-allocation net operating losses, and net operating loss carryovers **in a combined group context** pursuant to N.J.S.A. 54:10A-4.6. (See [TB-94](#), *General Information on the New Net Operating Loss Regime for Tax Years Ending on and After July 31, 2019*, for details on the general changes to net operating losses and net operating loss carryovers. The Division is prepared to release additional guidance on net operating losses in a combined group context as may be necessary.)

For New Jersey purposes, the income starting point is Line 28 of federal Form 1120 (or the corresponding line of any other federal corporate return filed), which is taxable income before net operating loss deductions and special deductions (N.J.S.A. 54:10A-4(k)). New Jersey has its own statutorily created net operating loss calculations. See N.J.S.A. 54:10A-4(k)(6); N.J.S.A. 54:10A-4(u); N.J.S.A. 54:10A-4(v); and N.J.S.A. 54:10A-4.6.h. In order to claim New Jersey net operating losses and net operating loss carryover deductions, a taxpayer must have filed a New Jersey Corporation Business Tax return in the applicable privilege periods. For New Jersey combined returns, there are specific rules governing current year combined group post-allocation net operating losses, prior net operating losses conversion carryovers (PNOLs), and combined group post-allocation net operating loss carryovers.

Regardless of whether the New Jersey combined return is filed on a **mandatory** water's-edge basis or the **elective** world-wide group or affiliated group basis, for purposes of calculating combined group entire net income, current year combined group net operating losses, prior net operating loss carryovers, combined group post-allocation net operating loss carryovers, and tax credits, a combined group must calculate its tax attributes pursuant to N.J.S.A. 54:10A-4.6; N.J.S.A. 54:10A-4.8; N.J.S.A. 54:10A-4.10; N.J.S.A. 54:10A-4.11. Furthermore, because world-wide group and affiliated group bases are elections to file combined returns and calculate group income and attributes as though they were a combined group filing a mandatory combined return, they are also governed by the rules provided in N.J.S.A. 54:10A-4.6.

**Note:** For purposes of applying net operating losses to the combined group's Schedule A, if the combined group has a loss then every member of the group is deemed to have a loss.

Conversely, if the combined group has income then every member is deemed to have income.

**Prior Net Operating Loss Conversion Carryovers (PNOLs)** are governed by N.J.S.A. 54:10A-4(u) which states that:

"'Prior net operating loss conversion carryover' means a net operating loss incurred in a privilege period ending prior to July 31, 2019 and converted from a pre-allocation net operating loss to a post-allocation net operating loss as follows:

(1) As used in this subsection:

'Base year' means the last privilege period ending prior to July 31, 2019.

'Base year BAF' means the taxpayer's business allocation factor as provided in sections 6 through 10 of P.L.1945, c.162 (C.54:10A-6 through C.54:10A-10) for purposes of calculating entire net income for the base year, as such section was in effect for the last privilege period ending prior to July 31, 2019.

'UNOL' means the unabsorbed portion of net operating loss as calculated under paragraph (6) of subsection (k) of this section as such paragraph was in effect for the last privilege period ending prior to July 31, 2019, that was not deductible in previous privilege periods and was eligible for carryover on the last day of the base year **subject to the limitations for deduction under such subsection, including any net operating loss sustained by the taxpayer during the base year.**

- (2) The prior net operating loss conversion carryover shall be calculated as follows:
  - (A) The taxpayer shall first calculate the tax value of its UNOL for the base year and for each preceding privilege period for which there is a UNOL. The value of the UNOL for each privilege period is equal to the product of (I) the amount of the taxpayer's UNOL for a privilege period, and (II) the taxpayer's base year BAF. This result shall equal the taxpayer's prior net operating loss conversion carryover.
  - (B) The taxpayer shall continue to carry over its prior net operating loss conversion carryover to offset its allocated entire net income as provided in sections 6 through 10 of P.L.1945, c.162 (C.54:10A-6 through C.54:10A-10) for privilege periods ending on and after July 31, 2019. Such carryover periods shall not exceed the twenty privilege periods following the privilege period of the initial loss. The entire amount of the prior net operating loss conversion carryover for any privilege period shall be carried to the earliest of the privilege periods to which the loss may be carried. The portion of the prior net operating loss conversion carryover which shall be carried to each of the other privilege periods shall be the excess, if any, of the amount of the prior net operating loss conversion carryover over the sum of the entire net income, computed without the exclusions permitted in paragraphs (4) and (5) of subsection (k) of this section allocated to this State.
  - (C) The prior net operating loss conversion carryover computed under this subsection shall be applied against the entire net income allocated to this State before the net operating loss carryover computed under subsection (v) of this section." *[emphasis added]*

**Note:** UNOLs are the pre-allocation NOLs that were generated in privilege periods ending before July 31, 2019 (i.e., the privilege periods prior to the effective date of the switch to both combined reporting and post-allocation application of net operating losses).

The limitations governing the UNOLs that are converted to PNOLs from the period in which the UNOLs were sustained by the taxpayer can be found in N.J.S.A. 54:10A-4(k)(6) which states, in part:

"(B) Net operating loss carryover. A net operating loss for any privilege period ending after June 30, 1984 shall be a net operating loss carryover to each of the seven privilege periods following the period of the loss and a net operating loss for any privilege period ending after June 30, 2009 shall be a net operating loss carryover to each of the twenty privilege periods following the period of the loss. The entire amount of the net operating loss for any privilege period (the "loss period") shall be carried to the earliest of the privilege periods to which the loss may be carried. The portion of the loss which shall be carried to each of the other privilege periods shall be the excess, if any, of the amount of the loss over the sum of the entire net income, computed without the exclusions permitted in paragraphs (4) and (5) of this subsection or the net operating loss deduction provided by subparagraph (A) of this paragraph, for each of the prior privilege periods to which the loss may be carried.

...

(D) Change in ownership. Where there is a change in 50% or more of the ownership of a corporation because of redemption or sale of stock and the corporation changes the trade or business giving rise to the loss, no net operating loss sustained before the changes may be carried over to be deducted from income earned after such changes. In addition where the facts support the premise that the corporation was acquired under any circumstances for the primary purpose of the use of its net operating loss carryover, the director may disallow the carryover.

...

(F) Reduction for discharge of indebtedness. A net operating loss for any privilege period ending after June 30, 2014, and any net operating loss carryover to such privilege period, shall be reduced by the amount excluded from federal taxable income under subparagraph (A), (B), or (C) of paragraph (1) of subsection (a) of section 108 of the federal Internal Revenue Code (26 U.S.C. s.108), for the privilege period of the discharge of indebtedness."

**Post Allocation Net Operating Losses and Post Allocation Net Operating Loss Carryovers (NOLs) for tax years ending on and after July 31, 2019**, are governed by N.J.S.A. 54:10A-4(v) which states:

"'Net operating loss deduction' means the amount allowed as a deduction for the net operating loss carryover to the privilege period, calculated as follows:

- (1) Net operating loss carryover. A net operating loss for any privilege period ending on or after July 31, 2019, shall be a net operating loss carryover to each of the twenty privilege periods following the period of the loss. The entire amount of the net operating loss for any privilege period shall be carried to the earliest of the privilege periods to which the loss may be carried. The portion of the loss which shall be carried to each of the other privilege periods shall be the excess, if any, of the amount of the loss over the sum of the entire net income, computed without the exclusions permitted in paragraphs (4) and (5) of subsection (k) of this section allocated to this State.
- (2) Net operating loss. For purposes of this paragraph the term "net operating loss" means the excess of the deductions over the gross income used in computing entire net income, without regard to any net operating loss carryover, and computed without the exclusions in paragraphs (4) and (5) of subsection (k) of this section, allocated to this State pursuant to sections 6 through 10 of P.L.1945, c.162 (C.54:10A-6 through C.54:10A-10).
- (3) Reduction for discharge of indebtedness. A net operating loss for any privilege period ending on or after July 31, 2019, and any net operating loss carryover to such privilege period, shall be reduced by the amount excluded from federal taxable income under subparagraph (A), (B), or (C) of paragraph (1) of subsection (a) of section 108 of the federal Internal Revenue Code, 26 U.S.C. s.108, for the privilege period of the discharge of indebtedness.
- (4) A net operating loss carryover shall not include any net operating loss incurred during any privilege period ending prior to July 31, 2019.
- (5) Change in ownership. Where there is a change in 50% or more of the ownership of a corporation because of redemption or sale of stock and the corporation changes the trade or business giving rise to the loss, no net operating loss sustained before the changes may be carried over to be deducted from income earned after such changes. In addition, where the facts support the premise that the corporation was acquired under any circumstances for the primary purpose of the use of its net operating loss carryover, the director may disallow the carryover; provided, however, this paragraph shall not apply between members of a combined group reported on a New Jersey combined return."

**Taxable Net Income** is defined in N.J.S.A. 54:10A-4(w), which states: "'Taxable net income' means entire net income allocated to this State as calculated pursuant to sections 6 through 8 of P.L.1945, c.162 (C.54:10A-6 through 54:10A-8) as modified by subtracting any prior net operating loss conversion

carryforward calculated pursuant to subsection (u) of this section, and any net operating loss calculated pursuant to subsection (v) of this section.”

**The rules governing PNOLs in a Combined Return Context and Combined Group Post-Allocation NOLs (derived from the unitary business of the combined group) can be found in N.J.S.A. 54:10A-4.6 which states, in part:**

“g. A prior net operating loss conversion carryover incurred by a member of a combined group shall be deducted from the entire net income or loss allocated to this state pursuant to section 19 of P.L.2018, c.48 (C.54:10A-4.7) as follows:

- (1) Such prior net operating loss conversion carryover deduction shall be allowed to offset only the entire net income allocated to this state of the corporation that created the prior net operating loss; the prior net operating loss conversion carryover cannot be shared with other members of the combined group.
- (2) The prior net operating loss conversion carryover deduction **computed under subsection (u) of section 4 of P.L.1945, c.162 (C.54:10A-4)** shall be applied against the entire net income allocated to this state of the corporation that created the prior net operating loss before the net operating loss carryover computed under subsection h. of this section.

The director shall provide regulations establishing rules on how each such corporation shall apply its prior net operating loss conversion carryover against its share of entire net income allocated as if filing on a separate entity basis.

h. A net operating loss carryover incurred by a member of a combined group shall be deducted from entire net income or loss allocated to this State pursuant to section 19 of P.L.2018, c.48 (C.54:10A-4.7) as follows:

- (1) For privilege periods beginning on or after the first day of the initial privilege period for which a combined unitary tax return is required under this section and sections 19, 20, and 23 of P.L.2018, c.48 (C.54:18A-4.7, C.54:18A-4.8, and C.54:18A-4.11), if the computation of a combined group's entire net income allocated to this state results in a net operating loss, a taxable member of such group may carry over the net operating loss allocated to this state, as calculated under this section and sections 19 and 23 of P.L.2018, c.48 (C.54:18A-4.7 and C.54:18A-4.11), and shall be deductible from entire net income derived from the unitary business in a future privilege period to the extent that the carryover and deduction is **otherwise consistent with subsection (v) of section 4 of P.L.1945, c.162 (C.54:10A-4)**.
- (2) Where a taxable member of a combined group has a net operating loss carryover derived from a loss incurred by a combined group in a privilege period beginning on or after the first day of the initial privilege period for which a combined unitary tax return is required under this section and sections 19, 20, and 23 of P.L.2018, c.48 (C.54:18A-4.7, C.54:18A-4.8, and C.54:18A-4.11), then the taxable member may share the net operating loss carryover with other taxable members of the combined group if such other taxable members were members of the combined group in the privilege period that the loss was incurred. Any amount of net operating loss carryover that is deducted by another taxable member of the combined group shall reduce the amount of net operating loss carryover that may be carried over by the taxable member that originally incurred the loss.
- (3) Where a taxable member of a combined group has a net operating loss carryover derived from a loss incurred in a privilege period during which the taxable member was not a member of such combined group, the carryover shall remain available to be deducted by that taxable member or other group members that, in the year the loss was incurred, were part of the same

combined group as such taxable member. Such carryover shall not be deductible by any other members of the combined group.

- (4) A net operating loss carryover shall not include any net operating loss incurred during any privilege period beginning prior to the first day of the initial privilege period for which a combined unitary tax return is required under this section and sections 19 and 23 of P.L.2018, c.48 (C.54:18A-4.7 and C.54:18A-4.11)." *[emphasis added]*

## **Prior Net Operating Loss Conversion Carryovers (PNOLs) and Combined Groups**

For tax years ending *prior* to July 31, 2019, net operating losses were calculated on a pre-allocation basis pursuant to N.J.S.A. 54:10A-4(k)(6). For tax years ending *on and after* July 31, 2019, **any unused unexpired net operating loss carryovers that were calculated pursuant to N.J.S.A. 54:10A-4(k)(6) must be converted to allocated prior net operating loss conversion carryovers (PNOLs)**. PNOLs are then used to reduce the allocated entire net income of the taxpayer.

**Note:** In order to have New Jersey net operating losses and net operating loss carryovers converted to PNOLs, a taxpayer must have filed a New Jersey Corporation Business Tax return in the applicable privilege periods. (See [TB-94](#), *General Information on the New Net Operating Loss Regime for Tax Years Ending on and After July 31, 2019*.)

PNOLs cannot be used to increase a current year loss. If the amount reported on the Entire Net Income/(Loss) line of the combined group's tax return is negative (i.e., a loss) for the group privilege period, the members of the combined group cannot use the PNOLs.

If the total combined group amount reported on the Entire Net Income/(Loss) line of the combined group's New Jersey combined return is positive (i.e., income), a member can use their own PNOLs to offset their portion of the group's allocated entire net income. Members are not permitted to share PNOLs pursuant to N.J.S.A. 54:10A-4.6. The member must apply its own PNOLs before applying a combined group post-allocation net operating loss conversion carryover. However, if the member's portion of allocated entire net income is still more than zero after subtracting the PNOLs, the member can then subtract their portion of the combined group's post-allocation net operating loss carryovers. N.J.S.A. 54:10A-4.6.g applies to all combined group filing methods.

**Note:** See below for further discussion about PNOLs and members that are partially included in combined groups.

## **Combined Group Post-Allocation Net Operating Losses/Loss Carryovers**

For tax years ending on and after July 31, 2019, N.J.S.A. 54:10A-4.6.h mandates New Jersey combined group net operating loss deductions and New Jersey combined group net operating loss carryovers be calculated on a post-allocation basis.

If the total combined group amount reported on the Entire Net Income/(Loss) line of the combined group's New Jersey combined return is negative, that loss becomes the combined group's post-allocation net operating loss which is then carried over by the taxable members of the combined group. This combined group post-allocation net operating loss can be carried over for a maximum of 20 subsequent tax years. Taxable members are entitled to a respective share of the combined group post-allocation net operating loss and that net operating loss becomes their carryover for subsequent periods.

**Note:** Combined group net operating losses and combined group net operating loss carryovers cannot offset a member's income from activities that are independent of the unitary business of the

combined group. Net operating losses and net operating loss carryovers generated by a member's activities that are independent of the combined group generally cannot offset the combined group entire net income.

### **Sharing Combined Group Post-Allocation Net Operating Losses/Loss Carryovers**

Taxable members can *only* share the combined group post-allocation net operating losses with other taxable members that were part of the same combined group in the period in which the loss was generated. The taxable member that shared the loss must reduce the member's respective portion of the combined group post-allocation net operating loss by the amount that was shared. If a non-taxable member becomes a taxable member of the combined group, then the other taxable members may share their respective portion of the combined group post-allocation net operating loss carryovers with that new taxable member. If a taxable member leaves the combined group, the taxable member takes its portion of the combined group post-allocation net operating loss carryovers for its own use outside the combined group, and the combined group cannot use this portion of the combined group post-allocation net operating loss carryovers.

When a new taxpayer joins an established combined group that is filing New Jersey combined returns, the new member can bring with them any separate post-allocation net operating loss carryovers that they have from previously filed New Jersey Corporation Business Tax returns. These carryovers can only be used by the new member and cannot be shared with other members of the combined group pursuant to N.J.S.A. 54:10A-4.6.h(3). Additionally, the preexisting members cannot share any combined group post-allocation net operating loss carryovers that were generated in privilege periods prior to the new member joining the group. However, if the combined group's allocated entire net income is positive for the year, the new member can use its separate post-allocation net operating loss carryover (that it brought with it) against its portion of the combined group allocated entire net income. If the member has income from separate activities that is being reported on Schedule X, the member may be eligible to use its separate post-allocation net operating loss carryovers to offset that income.

Combined group post-allocation net operating loss carryovers can only be shared with members that were part of the same combined New Jersey return when the losses were generated. Thus, if multiple members join a new combined group and they have combined group post-allocation net operating loss carryovers that were generated when they were both part of another combined group that filed a New Jersey combined return, they can then share those losses with each other but not the other taxable members of the new combined group.

**Note:** The members of the combined group must keep accurate books and records to prevent the double use and/or inadvertent sharing of post-allocation net operating loss carryovers.

### **Affiliated Group Basis Combined Returns and Post-Allocation Net Operating Losses/Loss Carryovers**

For New Jersey affiliated group basis combined returns, the managerial member makes the election to include all of the larger affiliated group of corporations under common ownership, regardless of whether the members are unitary. This is an election to deem all of the activities as one single business. As such, **all** of the activities, income, and tax attributes of the affiliated group members are included in the combined group and **members cannot complete Schedule X** (which is the schedule where taxpayers report activities that are independent of any combined group activities). There would be no separate post-allocation net operating losses or separate post-allocation net operating loss carryovers in the privilege periods where a New Jersey affiliated group combined return is filed. Thus, for an affiliated group combined return, there would not be separate business activity net operating losses and separate business activity net operating loss carryovers, unless a taxpayer becomes a member of the affiliated group at a later time. In years that the affiliated group basis combined return is filed, there would be only

combined group post-allocation net operating losses and combined group post-allocation net operating loss carryovers determined in the same manner and sharable in accordance with N.J.S.A. 54:10A-4.6.h.

## **Water's Edge and World-Wide Basis Combined Groups with Members that have Activities Independent of the Combined Group**

If a member has activities that are independent of the activities of the combined group, the member is considered a partially included member of the group. If the partially included member's separate business activities are part of another combined group's activities, the member reports those activities with that group. However, if the partially included member has activities that are not related to **any** combined group activities, the member will use Schedule X to report the separate portion of its business operations. Schedule X is used in lieu of filing a separate return to calculate the New Jersey taxable income from the separate activity that must be reported on Part III of Schedule A of the CBT-100U.

If a partially included member has a loss on the Entire Net Income/(Loss) line of Schedule X, this loss becomes the member's post-allocation net operating loss from its activities. **This is a separate net operating loss consistent with N.J.S.A. 54:10A-4(v) and must be used as if it was a separate return loss.** The member cannot share these separate post-allocation net operating losses. The member's separate business activity post-allocation net operating loss carryovers can only be used by the member to offset its separate business activity allocated entire net income after the member uses its PNOLs. These separate post-allocation net operating losses and post-allocation net operating loss carryovers can only be claimed and/or used on Schedule X while the member is part of the combined group.

If a partially included member has income on the Entire Net Income/(Loss) line of Schedule X, the member can use their PNOLs to offset the separate activity income. If the member's Schedule X allocated Entire Net Income is still greater than zero after subtracting its PNOLs, the member may then subtracts its separate business activity post-allocation net operating loss carryovers from their separate business activity allocated entire net income.

The member must keep accurate books and records to prevent the double use of the same PNOLs.

The Division of Taxation is in the process of drafting regulations addressing the topics covered by this Technical Bulletin.

**Note:** A Technical Bulletin is an informational document that provides guidance on a topic of interest to taxpayers and may describe recent changes to the relevant laws, regulations, and/or Division policies. It is accurate as of the date issued. However, taxpayers should be aware that subsequent changes to the applicable laws, regulations, and/or the Division's interpretation thereof may affect the accuracy of a Technical Bulletin. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.