

or carried back, beginning with the loss for the earliest taxable year.

(4) *Husband and wife.* The net operating loss carryovers and carrybacks of a husband and wife shall be determined in accordance with this section, but subject also to the provisions of § 1.172-7.

(5) *Corporate acquisitions.* For the computation of the net operating loss carryovers in the case of certain acquisitions of the assets of a corporation by another corporation, see section 381 and the regulations thereunder.

(6) *Special limitations.* For special limitations on the net operating loss carryovers in certain cases of change in both the ownership and the trade or business of a corporation and in certain cases of corporate reorganization lacking specified continuity of ownership, see section 382 and the regulations thereunder.

(7) *Electing small business corporations.* For special rule applicable to corporations which were electing small business corporations under Subchapter S (section 1361 and following), chapter 1 of the Code, during one or more of the taxable years described in section 172 (b)(1), see paragraph (f) of § 1.172-1.

(b) *Portion of net operating loss which is a carryback or a carryover to the taxable year in issue.* (1) A net operating loss shall first be carried to the earliest of the several taxable years for which such loss is allowable as a carryback or a carryover, and shall then be carried to the next earliest of such several taxable years, etc. Except as provided in § 1.172-9, the entire net operating loss shall be carried back to such earliest year.

(2) The portion of the loss which shall be carried to any of such several taxable years subsequent to the earliest taxable year is the excess of such net operating loss over the sum of the taxable incomes (computed as provided in § 1.172-5) for all of such several taxable years preceding such subsequent taxable year.

(3) If a portion of the net operating loss for a taxable year is attributable to a foreign expropriation loss (as defined in section 172(h)) and if an election under paragraph (c) of § 1.172-9 is made with respect to such portion of the net operating loss, then see § 1.172-

9 for the separate treatment of such portion of the net operating loss.

(c) *Illustration.* The principles of this section are illustrated in § 1.172-6.

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 8107, 51 FR 43345, Dec. 2, 1986]

§ 1.172-5 Taxable income which is subtracted from net operating loss to determine carryback or carryover.

(a) *Taxable year subject to the Internal Revenue Code of 1954.* The taxable income for any taxable year subject to the Internal Revenue Code of 1954 which is subtracted from the net operating loss for any other taxable year to determine the portion of such net operating loss which is a carryback or a carryover to a particular taxable year is computed with the modifications prescribed in this paragraph. These modifications shall be made independently of, and without reference to, the modifications required by §§ 1.172-2(a) and 1.172-3(a) for purposes of computing the net operating loss itself.

(1) *Modifications applicable to unincorporated taxpayers only.* In the case of a taxpayer other than a corporation, in computing taxable income and adjusted gross income:

(i) No deduction shall be allowed under section 151 for the personal exemptions (or under any other section which grants a deduction in lieu of the deductions allowed by section 151) and under section 1202 in respect of the net long-term capital gain.

(ii) The amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from sales or exchanges of capital assets.

(2) *Modifications applicable to all taxpayers.* In the case either of a corporation or of a taxpayer other than a corporation:

(i) *Net operating loss deduction.* The net operating loss deduction for such taxable year shall be computed by taking into account only such net operating losses otherwise allowable as carrybacks or carryovers to such taxable year as were sustained in taxable years preceding the taxable year in which the taxpayer sustained the net operating loss from which the taxable

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income is to be deducted. Thus, for such purposes, the net operating loss for the loss year or any taxable year thereafter shall not be taken into account.

Example. The taxpayer's income tax returns are made on the basis of the calendar year. In computing the net operating loss deduction for 1954, the taxpayer has a carryover from 1952 of \$9,000, a carryover from 1953 of \$6,000, a carryback from 1955 of \$18,000, and a carryback from 1956 of \$10,000, or an aggregate of \$43,000 in carryovers and carrybacks. Thus, the net operating loss deduction for 1954, for purposes of determining the tax liability for 1954, is \$43,000. However, in computing the taxable income for 1954 which is subtracted from the net operating loss for 1955 for the purpose of determining the portion of such loss which may be carried over to subsequent taxable years, the net operating loss deduction for 1954 is \$15,000, that is, the aggregate of the \$9,000 carryover from 1952 and the \$6,000 carryover from 1953. In computing the net operating loss deduction for such purpose, the \$18,000 carryback from 1955 and the \$10,000 carryback from 1956 are disregarded. In computing the taxable income for 1954, however, which is subtracted from the net operating loss for 1956 for the purpose of determining the portion of such loss which may be carried over to subsequent taxable years, the net operating loss deduction for 1954 is \$33,000, that is, the aggregate of the \$9,000 carryover from 1952, the \$6,000 carryover from 1953, and the \$18,000 carryback from 1955. In computing the net operating loss deduction for such purpose, the \$10,000 carryback from 1956 is disregarded.

(ii) *Recomputation of percentage limitations.* Unless otherwise specifically provided in this subchapter, any deduction which is limited in amount to a percentage of the taxpayer's taxable income or adjusted gross income shall be recomputed upon the basis of the taxable income or adjusted gross income, as the case may be, determined with the modifications prescribed in this paragraph. Thus, in the case of an individual the deduction for medical expenses would be recomputed after making all the modifications prescribed in this paragraph, whereas the deduction for charitable contributions would be determined without regard to any net operating loss carryback but with regard to any other modifications so prescribed. See, however, the regulations under paragraph (g) of § 1.170-2 (relating to charitable contributions carry-

over of individuals) and paragraph (c) of § 1.170-3 (relating to charitable contributions carryover of corporations) for special rules regarding charitable contributions in excess of the percentage limitations which may be treated as paid in succeeding taxable years.

Example 1. For the calendar year 1954 the taxpayer, an individual, files a return showing taxable income of \$4,800, computed as follows:

Salary	\$5,000
Net long-term capital gain	4,000
Total gross income	9,000
Less: Deduction allowed by section 1202 in respect of net long-term capital gain	2,000
Adjusted gross income	7,000
Less:	
Deduction for personal exemption	\$600
Deduction for medical expense (\$410 actually paid but allowable only to extent in excess of 3 percent of adjusted gross income)	200
Deduction for charitable contributions (\$2,000 actually paid but allowable only to extent not in excess of 20 percent of adjusted gross income)	\$1,400
	\$2,200
Taxable income	4,800

In 1955 the taxpayer undertakes the operation of a trade or business and sustains therein a net operating loss of \$3,000. Under section 172(b)(2), it is determined that the entire \$3,000 is a carryback to 1954. In 1956 he sustains a net operating loss of \$10,000 in the operation of the business. In determining the amount of the carryover of the 1956 loss to 1957, the taxable income for 1954 as computed under this paragraph is \$3,970, determined as follows:

Salary	\$5,000
Net long-term capital gain	4,000
Total gross income	9,000
Less: Deduction for carryback of 1955 net operating loss	3,000
Adjusted gross income	6,000
Less:	
Deduction for medical expense (\$410 actually paid but allowable only to extent in excess of 3 percent of adjusted gross income as modified under this paragraph)	\$230

Deduction for charitable contributions (\$2,000 actually paid but allowable only to extent not in excess of 20 percent of adjusted gross income determined with all the modifications prescribed in this paragraph other than the net operating loss carryback)	1,800
	2,030
Taxable income	3,970

Example 2. For the calendar year 1959 the taxpayer, an individual, files a return showing taxable income of \$5,700, computed as follows:

Salary	\$5,000
Net long-term capital gain	4,000
Total gross income	9,000
Less: Deduction allowed by section 1202 in respect of net long-term capital gain	2,000
Adjusted gross income	7,000
Less:	
Deduction for personal exemption	\$600
Standard deduction allowed by section 141	\$700
	\$1,300
Taxable income	5,700

In 1960 the taxpayer undertakes the operation of a trade or business and sustains therein a net operating loss of \$4,700. In 1961 he sustains a net operating loss of \$10,000 in the operation of the business. Under section 172(b)(2), it is determined that the entire amount of each loss, \$4,700 and \$10,000, is a carryback to 1959. In determining the amount of the carryover of the 1961 loss to 1962, the taxable income for 1959 as computed under this paragraph is \$3,870, determined as follows:

Salary	\$5,000
Net long-term capital gain	4,000
Total gross income	9,000
Less: Deduction for carryback of 1960 net operating loss	4,700
Adjusted gross income	4,300
Less: Standard deduction	430
Taxable income	3,870

(iii) *Minimum limitation.* The taxable income, as modified under this paragraph, shall in no case be considered less than zero.

(3) *Electing small business corporations.* For special rule applicable to corporations which were electing small business corporations under Subchapter S (section 1361 and following), Chapter 1 of the Code, during one or more of the taxable years described in section 172(b)(1), see paragraph (f) of § 1.172-1.

(4) *Qualified real estate investment trust.* Where a net operating loss is carried over to a qualified taxable year (as defined in § 1.172-10(b)) ending after October 4, 1976, the real estate investment trust taxable income (as defined in section 857(b)(2)) shall be used as the "taxable income" for that taxable year to determine, under section 172(b)(2), the balance of the net operating loss available as a carryover to a subsequent taxable year. The real estate investment trust taxable income, however, is computed by applying the rules applicable to corporations in paragraph (a)(2) of this section. Thus, in computing real estate investment trust taxable income for purposes of section 172(b)(2), the net operating loss deduction for the taxable year shall be computed in accordance with paragraph (a)(2)(i) of this section. The principles of this subparagraph may be illustrated by the following examples:

Example 1. Corporation X, a calendar year taxpayer, is formed on January 1, 1977. X incurs a net operating loss of \$100,000 for its taxable year 1977, which under section 172(b)(2), is a carryover to 1978. For 1978 X is a qualified real estate investment trust (as defined in § 1.172-10(b)) and has real estate investment trust taxable income (determined without regard to the deduction for dividends paid or the net operating loss deduction) of \$150,000, all of which consists of ordinary income. X pays dividends in 1978 totaling \$120,000 that qualify for the deduction for dividends paid under section 857(b)(2)(B). The portion of the 1977 net operating loss available as a carryover to 1979 and subsequent years is \$70,000 (i.e., the excess of the amount of the net operating loss (\$100,000) over the amount of the real estate investment trust taxable income for 1978 (\$30,000), determined by taking into account the deduction for dividends paid allowable under section 857(b)(2)(B) and without taking into account the net operating loss of 1977).

Example 2. (i) Assume the same facts as in *Example 1*, except that the \$150,000 of real estate investment trust taxable income (determined without the net operating loss deduction or the dividends paid deduction) consists of \$80,000 of ordinary income and \$70,000 of net capital gain. The amount of capital gain dividends which may be paid for 1978 is limited to \$50,000, that is, the amount of the real estate investment trust taxable income for 1978, determined by taking into account the net operating loss deduction for the taxable year, but not the deduction for dividends paid (\$150,000 minus \$100,000). See § 1.857-6(e)(1)(ii).

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(ii) X designated \$50,000 of the \$120,000 of dividends paid as capital gains dividends (as defined in section 857(b)(3)(C) and § 1.857-6(e)). Thus, \$70,000 is an ordinary dividend. Since both ordinary dividends and capital gains dividends are taken into account in computing the deduction for dividends paid under section 857(b)(2)(B), the result will be the same as in *Example (1)*; that is, the portion of the 1977 net operating loss available as a carryover to 1979 and subsequent years is \$70,000.

(b) [Reserved]

[T.D. 6500, 25 FR 11402, Nov. 26, 1960, as amended by T.D. 6862, 30 FR 14428, Nov. 18, 1965; T.D. 6900, 31 FR 14641, Nov. 17, 1966; T.D. 7767, 46 FR 11263, Feb. 6, 1981; T.D. 8107, 51 FR 43346, Dec. 2, 1986]

§ 1.172-6 Illustration of net operating loss carrybacks and carryovers.

The application of § 1.172-4 may be illustrated by the following example:

(a) *Facts.* The books of the taxpayer, whose return is made on the basis of the calendar year, reveal the following facts:

Taxable year	Taxable income	Net operating loss
1954	\$15,000	
1955	30,000	
1956		(\$75,000)
1957	20,000	
1958		(150,000)
1959	30,000	
1960	35,000	
1961	75,000	
1962	17,000	
1963	53,000	

The taxable income thus shown is computed without any net operating loss deduction. The assumption is also made that none of the other modifications prescribed in § 1.172-5 apply. There are no net operating losses for 1950, 1951, 1952, 1953, 1964, 1965, or 1966.

(b) *Loss sustained in 1956.* The portions of the \$75,000 net operating loss for 1956 which shall be used as carrybacks to 1954 and 1955 and as carryovers to 1957, 1958, 1959, 1960, and 1961 are computed as follows:

(1) *Carryback to 1954.* The carryback to this year is \$75,000, that is, the amount of the net operating loss.

(2) *Carryback to 1955.* The carryback to this year is \$60,000, computed as follows:

Net operating loss \$75,000

Less:
 Taxable income for 1954 (computed without the deduction of the carryback from 1956) 15,000
 Carryback 60,000

(3) *Carryover to 1957.* The carryover to this year is \$30,000, computed as follows:

Net operating loss \$75,000
 Less:
 Taxable income for 1954 (computed without the deduction of the carryback from 1956) \$15,000
 Taxable income for 1955 (computed without the deduction of the carryback from 1956 or the carryback from 1958) 30,000
 45,000
 Carryover 30,000

(4) *Carryover to 1958.* The carryover to this year is \$10,000, computed as follows:

Net operating loss \$75,000
 Less:
 Taxable income for 1954 (computed without the deduction of the carryback from 1956) \$15,000
 Taxable income for 1955 (computed without the deduction of the carryback from 1956 or the carryback from 1958) 30,000
 Taxable income for 1957 (computed without the deduction of the carryover from 1956 or the carryback from 1958) 20,000
 65,000
 Carryover 10,000

(5) *Carryover to 1959.* The carryover to this year is \$10,000, computed as follows:

Net operating loss \$75,000
 Less:
 Taxable income for 1954 (computed without the deduction of the carryback from 1956) \$15,000
 Taxable income for 1955 (computed without the deduction of the carryback from 1956 or the carryback from 1958) 30,000
 Taxable income for 1957 (computed without the deduction of the carryover from 1956 or the carryback from 1958) 20,000
 Taxable income for 1958 (a year in which a net operating loss was sustained) 0
 65,000
 Carryover 10,000

(6) *Carryover to 1960.* The carryover to this year is \$0, computed as follows:

Net operating loss \$75,000
 Less:
 Taxable income for 1954 (computed without the deduction of the carryback from 1956) \$15,000