

FINANCE AND ADMINISTRATION CABINET
Department of Revenue
(As Amended at ARRS, August 9, 2019)

103 KAR 16:250. Net operating loss computation and deduction for corporations.

RELATES TO: KRS 141.011, **141.120, 141.121,** 141.200, 141.201, 141.202, **141.901**

STATUTORY AUTHORITY: KRS 131.130, **141.018, 141.050**

NECESSITY, FUNCTION AND CONFORMITY: KRS 131.130(1) authorizes the Department of Revenue to promulgate administrative regulations necessary to administer and enforce Kentucky's tax laws. **KRS 141.150(4) requires the department to promulgate administrative regulations and rules necessary for the proper administration of KRS Chapter 141.** This administrative regulation establishes methods of computing a corporation's net operating loss deduction and application of the deduction to subsequent taxable years on taxable net income as authorized by KRS 141.011, 141.200(11)(c),~~(b)~~ and 141.202(5).

Section 1. Definitions. (1) "Carryforward" has the same meaning as carryover as used in KRS 141.202.

(2) "Combined group" is defined by KRS 141.202(2)(a).

(3)~~(2)~~ "Combined group filer" means a group of corporations filing in accordance with KRS 141.202.

(4)~~(3)~~ "Combined group return" means a return filed under KRS 141.202(3).

(5)~~(4)~~ "Corporation" is defined by:

(a) KRS 141.202(2)(b) for a combined group return; ~~or~~

(b) KRS 141.010(4) for a separate return for periods beginning on or after January 1, 2018;

or

(c) KRS 141.201(2)(d) for an elective consolidated return.

(6)~~(5)~~ "Doing business in this state" is defined by KRS 141.010(7).

(7)~~(6)~~ "Elective consolidated filer" means a corporation as defined in Section 7701(a)(3) of the Internal Revenue Code, 26 U.S.C. 7701(a)(3), filing in accordance with KRS 141.201.

(8)~~(7)~~ "Elective consolidated return" means a return defined under KRS 141.201(2)(b).

(9)~~(8)~~ "Net operating loss" or "NOL" means net operating loss defined under Section 172 of the Internal Revenue Code as adjusted for differences between KRS Chapter 141 and the Internal Revenue Code.

(10)~~(9)~~ "Nexus consolidated filer" means a corporation as defined under KRS 141.010(4) or 141.900(24), filing in accordance with KRS 141.200(8), (9), (10) and (11).

(11)~~(10)~~ "Nexus consolidated return" means a return defined under KRS 141.200(9)(g).

(12)~~(11)~~ "Separate return" is defined by KRS 141.201(2)(c).

(13)~~(12)~~ "Separate return filer" means a corporation filing in accordance with KRS 141.201(3)**(b)**.

Section 2. Computation and Application of Net Operating Loss. (1) Combined group filers, elective consolidated filers, and separate return filers shall compute net operating loss for Kentucky purposes in the following manner:

(a) For elective consolidated filers, the net operating loss shall be multiplied by the group's apportionment factor provided by KRS 141.120 or 141.121;

(b) For combined group filers, the net operating loss of each taxpayer member shall be computed in accordance with KRS 141.202(5)(c);

(c) For separate returns filers, the net operating loss shall be multiplied by the apportion-

ment factor provided by KRS 141.120 or KRS 141.121; and

~~(d) The apportioned net operating loss shall be available for carryforward. [For combined group returns and elective consolidated returns, the net operating loss shall be multiplied by the group's apportionment factor provided by KRS 141.120 or 141.121;~~

~~(b) For separate returns, the net operating loss shall be multiplied by the apportionment factor provided by KRS 141.120 or KRS 141.121; and~~

~~(c) The apportioned net operating loss shall be available for carryforward.]~~

(2) Elective consolidated filer net operating loss carryforward to a combined group return or separate returns. This subsection shall apply if an elective consolidated filer who has incurred net operating losses as a consolidated group will now be filing combined group returns or separate ~~[entity]~~ returns, and establishes how those elective consolidated net operating losses shall be treated for purposes of the combined group returns or separate ~~[entity]~~ returns.

(a) An elective consolidated filer having a net operating loss carryforward on the last elective consolidated return may carry that loss forward to combined group returns or separate returns. The following requirements shall apply to this situation:

1. Determine the post-apportioned elective consolidated group net operating loss carryforward. The elective consolidated group's apportionment factor provided by KRS 141.120, KRS 141.121, or KRS 141.901 shall be used to determine the post-apportioned net operating loss.

2. Determine the years that are in the post-apportioned elective consolidated group net operating loss carryforward. All post-apportioned net operating loss carryforwards shall be used on a first-in-first-out basis (i.e., most recent losses remain).

3. Determine each loss corporation's share of the net operating loss for each year in the following manner:

a. Allocate the post-apportioned elective consolidated group net operating loss carryforward by year to each loss corporation in each year. For a year in which the total loss generated exceeds the carryforward allocated to that year, the post-apportioned net operating loss shall be prorated for that year proportionally based on the loss generated by each member;

b. Add together each loss corporation's allocated share of the losses for each year it was a member of an elective consolidated group; and

c. Carry the separate entity net operating loss carryforward computed in clauses a. and b. of this subparagraph to the first combined group return or separate return due after the elective consolidated return.

~~(b)[4.][No]~~ Prior year net operating loss carryforwards~~[carryforward]~~ shall not be available to separate entities that were not doing business in this state prior to becoming part of an elective consolidated return.

(3) Nexus consolidated filer net operating loss carryforward to a combined group return, an elective consolidated return, or a separate return~~[period]~~. This subsection shall apply if a nexus consolidated filer ceases to exist who had incurred net operating losses as a consolidated group and establishes how those nexus consolidated net operating losses shall be treated.

(a) If a nexus consolidated filer ceases to exist or a member leaves the group and a consolidated net operating loss carryforward exists, that net operating loss carryforward may be carried forward to the combined group return, the elective consolidated return, or the separate returns. The following requirements shall apply to this situation:

1. Determine the pre-apportioned nexus consolidated group net operating loss carryforward.

2. Determine the years that are in the pre-apportioned nexus consolidated group net operating loss carryforward. All pre-apportioned net operating loss carryforwards shall be used on a first-in-first-out basis (i.e., most recent losses remain).

3. Determine each loss corporation's share of the net operating loss for each year in the following manner:

a. Allocate the pre-apportioned nexus consolidated group net operating loss carryforward by year to each loss corporation in each year. For a year in which the total loss generated exceeds the carryforward allocated to that year, the pre-apportioned net operating loss shall be prorated for that year proportionally based on the loss generated by each member in that year;

b. Multiply the pre-apportioned net operating loss carryforward amounts as allocated~~[assigned]~~ to the members by the nexus consolidated group's apportionment factor for each year a net operating loss exists to determine the post-apportioned net operating loss carryforward that member may carry forward to~~in~~ the future. The apportionment factor calculation is provided by KRS 141.120, 141.121, or 141.901;

c. Add together the post-apportioned losses generated for each loss corporation during the time in which it was included in a nexus consolidated return; and

d. Carry the separate entity net operating loss carryforward computed in clauses a. to c. of this subparagraph to the first combined group return, elective consolidated return, or separate return due after the nexus consolidated group ceases to exist or after the member leaves the nexus consolidated group.

~~(b)[4.]~~**[No]** Prior year net operating loss carryforwards ~~[carryforward]~~ shall not be available to separate entities that were not doing business in this state prior to becoming part of a nexus consolidated return. To generate a net operating loss in this state, a taxpayer shall be doing business in this state in the year in which the loss is generated.

Section 3. Net Operating Loss Limitation. (1) Corporations that generated net operating losses may carryforward those losses to deduct against taxable net income. The deduction for losses generated for tax years beginning on or after January 1, 2018, shall be limited to eighty (80) percent of the taxable net income as allowed by Section 172 of the Internal Revenue Code.

(2) Nexus consolidated returns shall be subject to the fifty (50) percent limitation as required in KRS 141.200(11)(c).

(3) Taxpayer members of a combined group return that utilize the net operating loss of another taxpayer member that was not a member of the same combined group return in the year in which the net operating loss was originally incurred shall be subject to the fifty (50) percent limitation as required in KRS 141.202~~[/](5)(c)3. or 4.~~

Section 4. Net operating losses by corporations included in a combined group return shall be determined in accordance with KRS 141.202(5)(c).~~[Net Operating Losses by Corporations Included in a Combined Group Return. This section shall apply if a net operating loss is generated by a corporation included in a combined group return.~~

~~(1) Net operating losses generated by corporations included in a combined group shall not be used to offset income of other corporations included in the combined group.~~

~~(2) Net operating losses may be carried forward to subsequent years.~~

~~(3) Net operating losses may only be used if the corporation that generated the loss has taxable net income in subsequent years.~~

~~(4) All net operating loss carryforwards shall be used on a first-in first-out basis (i.e., most recent losses remain).~~

~~(5) No prior year net operating loss carryforward shall be available to separate entities that were not doing business in this state prior to becoming part of a combined group return.]~~

Section 5. This administrative regulation shall apply to the computation of the net operating loss deduction of corporations for taxable years beginning on or after January 1, 2018, except where otherwise noted in this administrative regulation.

Section 6. Examples for the computation and application of net operating losses. The following examples relate to the net operating loss computations found in Sections 2 through 4 of this administrative regulation:

(1) Example 1 – Member Leaves Nexus Consolidated Group Parent Corporation and its three (3) subsidiaries, Sub A, Sub B, and Sub C, have nexus in Kentucky. Parent Corporation files nexus consolidated group returns for Year 1 through Year 4, but Sub A will not be included in the group in Year 4. The nexus consolidated group [Parent Corporation] has a pre-apportioned nexus group NOL carryforward of \$85,000 (\$5,000 from year 1, \$40,000 from year 2, and \$40,000 from year 3) at the end of Year 3 (see Figure 1-1). Apportionment factors for each member are given below (see Figure 1-2).

Figure 1-1

| | Year 1 | Year 2 | Year 3 |
|-------------------------------------|------------|------------|------------|
| Sub A Income/(Loss) | (\$25,000) | (\$25,000) | (\$15,000) |
| Sub B Income/(Loss) | (10,000) | (10,000) | (10,000) |
| Sub C Income/(Loss) | (5,000) | 30,000 | 50,000 |
| Parent Corporation Income/(Loss) | (5,000) | (5,000) | (15,000) |
| Group Income/(Loss) | (\$45,000) | (\$10,000) | \$10,000 |
| Nexus Group NOL Adjustment | 45,000 | 25,000 | 15,000 |
| Group Taxable Income | 0 | 15,000 | 25,000 |
| Accumulating Group NOL Carryforward | \$45,000 | \$70,000 | \$85,000 |

Figure 1-2

| | Year 1 Apportionment Factor | Year 2 Apportionment Factor | Year 3 Apportionment Factor | [Year 4 Apportionment Factor] |
|-------------|-----------------------------|-----------------------------|-----------------------------|-------------------------------|
| Nexus Group | 23% | 28% | 32% | 17%] |

The following steps determine the post-apportioned net operating loss allocated["NOL"] ~~assigned~~ to Sub A when it departs the group as well as the pre-apportioned NOL that will be carried forward by the group to Year 4.

(a) Determine the pre-apportioned group NOL carryforward: \$85,000 (see Figure 1-1).

(b) Determine ~~which~~^{what} years are in the pre-apportioned group NOL carryforward assuming all pre-apportioned NOL carryforward amounts are used on a first-in-first-out basis (i.e., most recent losses remain).

1. Year 3 Losses Remaining: \$40,000
2. Year 2 Losses Remaining: \$40,000
3. Year 1 Losses Remaining: \$5,000

(c) Allocate the pre-apportioned group NOL carryforward by year to each loss corporation in each year. For a year in which the total loss generated exceeds the carryforward allocated to that year, prorate the pre-apportioned NOL carryforward for that year proportionally based on the loss generated by each member (see Figure 1-3).

Figure 1-3

| | <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> |
|--|-----------------|-----------------|-----------------|
| <u>Sub A Loss</u> | <u>\$25,000</u> | <u>\$25,000</u> | <u>\$15,000</u> |
| <u>Total Losses of all Loss Corporations</u> | <u>\$45,000</u> | <u>\$40,000</u> | <u>\$40,000</u> |
| <u>Allocation Percentage</u> | <u>55.56%</u> | <u>62.5%</u> | <u>37.5%</u> |
| <u>Remaining Loss In Group Carryforward</u> | <u>\$5,000</u> | <u>\$40,000</u> | <u>\$40,000</u> |
| <u>Allocated Remaining Sub A Loss</u> | <u>\$2,777</u> | <u>\$25,000</u> | <u>\$15,000</u> |
| | | | |
| <u>Sub B Loss</u> | <u>\$10,000</u> | <u>\$10,000</u> | <u>\$10,000</u> |
| <u>Total Losses of all Loss Corporations</u> | <u>\$45,000</u> | <u>\$40,000</u> | <u>\$40,000</u> |
| <u>Allocation Percentage</u> | <u>22.22%</u> | <u>25.0%</u> | <u>25.0%</u> |
| <u>Remaining Loss In Group Carryforward</u> | <u>\$5,000</u> | <u>\$40,000</u> | <u>\$40,000</u> |
| <u>Allocated Remaining Sub B Loss</u> | <u>\$1,111</u> | <u>\$10,000</u> | <u>\$10,000</u> |
| | | | |
| <u>Sub C Loss</u> | <u>\$5,000</u> | <u>-</u> | <u>-</u> |
| <u>Total Losses of all Loss Corporations</u> | <u>\$45,000</u> | <u>\$40,000</u> | <u>\$40,000</u> |
| <u>Allocation Percentage</u> | <u>11.11%</u> | <u>-</u> | <u>-</u> |
| <u>Remaining Loss In Group Carryforward</u> | <u>\$5,000</u> | <u>\$40,000</u> | <u>\$40,000</u> |
| <u>Allocated Re-</u> | <u>\$556</u> | <u>-</u> | <u>-</u> |

| | | | |
|--|-----------------|-----------------|-----------------|
| <u>Remaining Sub C Loss</u> | | | |
| <u>Parent Corporation Loss</u> | <u>\$5,000</u> | <u>\$5,000</u> | <u>\$15,000</u> |
| <u>Total Losses of all Loss Corporations</u> | <u>\$45,000</u> | <u>\$40,000</u> | <u>\$40,000</u> |
| <u>Allocation Percentage</u> | <u>11.11%</u> | <u>12.5%</u> | <u>37.5%</u> |
| <u>Remaining Loss In Group Carryforward</u> | <u>\$5,000</u> | <u>\$40,000</u> | <u>\$40,000</u> |
| <u>Allocated Remaining Parent Loss</u> | <u>\$556</u> | <u>\$5,000</u> | <u>\$15,000</u> |

| | Year 1* | Year 2 | Year 3 |
|----------------------------|---------|----------|----------|
| Sub A Loss | \$2,777 | \$25,000 | \$15,000 |
| Sub B Loss ** | 1,111 | 10,000 | 10,000 |
| Sub C Loss ** | 556 | - | - |
| Parent Corporation Loss ** | 556 | 5,000 | 15,000 |
| Group NOL | \$5,000 | \$40,000 | \$40,000 |
| ** Remaining Members' NOL | \$2,223 | \$15,000 | \$25,000 |

* Sub A: $\$25,000/\$45,000 \times \$5,000 = \$2,777$
 Sub B: $\$10,000/\$45,000 \times \$5,000 = \$1,111$
 Sub C: $\$5,000/\$45,000 \times \$5,000 = \556
 Parent Corporation: $\$5,000/\$45,000 \times \$5,000 = \556

(d) Multiply the pre-apportioned NOL carryforward amounts allocated[~~assigned~~] to the member that is leaving the group by the nexus consolidated group's apportionment factors in each year an NOL carryforward exists to determine the post-apportioned NOL that member may carryforward to[~~in~~] the future (see Figure 1-4).

Figure 1-4

| | Year 1 | Year 2 | Year 3 |
|--|----------------|-----------------|-----------------|
| <u>Sub A NOL Carryforward</u> | <u>\$2,777</u> | <u>\$25,000</u> | <u>\$15,000</u> |
| <u>Nexus Group Apportionment Factor</u> | <u>23%</u> | <u>28%</u> | <u>32%</u> |
| <u>Post-Appportioned NOL Carryforward Per Year</u> | <u>\$638</u> | <u>\$7,000</u> | <u>\$4,800</u> |
| <u>Accumulating Total</u> | <u>\$638</u> | <u>\$7,638</u> | <u>\$12,438</u> |

| | | | |
|---------------------------|--|--|--|
| <u>Sub A Carryforward</u> | | | |
|---------------------------|--|--|--|

| | Year 1 | Year 2 | Year 3 |
|------------------------------------|---------|----------|----------|
| Sub A NOL Carryforward | \$2,777 | \$25,000 | \$15,000 |
| Nexus Group Apportionment Factor | 23% | 28% | 32% |
| Post-Appportioned NOL Carryforward | \$638 | \$7,000 | \$4,800 |

(e) Add the pre-apportioned NOL carryforward amounts allocated to the remaining members in the group to calculate the nexus consolidated group's carryforward amount (see Figure 1-5).

Figure 1-5

| | Year 1 | Year 2 | Year 3 |
|---------------------------------|---------|----------|----------|
| Remaining Sub B Loss | \$1,111 | \$10,000 | \$10,000 |
| Remaining Sub C Loss | \$556 | - | - |
| Remaining Parent Loss | \$556 | \$5,000 | \$15,000 |
| Group Carryforward Per Year | \$2,223 | \$15,000 | \$25,000 |
| Accumulating Group Carryforward | \$2,223 | \$17,223 | \$42,223 |

~~[The nexus consolidated group will carryforward a pre-apportioned NOL of \$42,223 (\$2,223+\$15,000+\$25,000) to Year 4 (see Figure 1-3), and Sub A will carryforward a postapportioned NOL of \$12,438 (\$638+\$7,000+\$4,800) to Year 4 (see Figure 1-4).]~~

(2) Example 2 – Remaining Nexus Consolidated Group Dissolves.

~~(a)(1) This example is a continuation of Example 1. Parent Corporation and its two (2) remaining subsidiaries, Sub B and Sub C, have nexus in Kentucky. Parent Corporation files nexus consolidated group returns for Year 1 through Year 4, but each group member will file separately in Year 5. The group has a preapportioned [Parent Corporation has a preapportioned nexus group] NOL carryforward of \$42,223 at the end of Year 3 (see Figure 1-3). Group apportionment factors for each year are given below (see Figure 2-2). [from Example 1]. Apportionment factors for each member are given below (see Figure 2-2).]~~

Figure 2-1

| | Year 1 | Year 2 | Year 3 | Year 4 |
|---------------------|------------|------------|------------|------------|
| Sub B Income/(Loss) | (\$10,000) | (\$10,000) | (\$10,000) | (\$10,000) |

| | | | | |
|--|---------------------|----------------------|----------------------|--------------|
| Sub C In- come/(L oss) | (5,000) | 30,000 | 50,000 | 60,00 0 |
| Parent Corpo- ration In- come/(L oss) | (5,000) | (5,000) | (15,00 0) | (30,00 0) |
| Group Income (loss) | <u>N/A</u> | <u>N/A</u> | <u>N/A</u> | \$20,0 00 |
| Nexus Group NOL Adjust- ment | <u>N/A</u> | <u>N/A</u> | <u>N/A</u> | 10,00 0 |
| Group Taxable Income | <u>N/A</u> | <u>N/A</u> | <u>N/A</u> | 30,00 0 |
| Group NOL Gener- ated | \$2,22 3* | \$15,00 0* | \$25,00 0* | \$10,0 00 |
| <u>Accu- mulat- ing Group Car- ryfor- ward [Cumu- lative Car- ryfor- ward]</u> | <u>\$2,22 3</u> | <u>\$17,22 3</u> | <u>\$42,22 3</u> | \$52, 223 |

* See "**Group Carryforward Per Year**" amounts from Figure 1-5[3 from Example 1]

Figure 2-2

| | Year 1 Appor- tion- ment Factor | Year 2 Appor- tion- ment Factor | Year 3 Appor- tion- ment Factor | Year 4 Appor- tion- ment Factor |
|------------------------|---|---|---|---|
| Nex us Gro up | 23% | 28% | 32% | 17% |

(b) The following steps determine the post-apportioned NOL that will be carried forward separately by each group member to Year 5 when the nexus consolidated group dissolves.

1. [(a)] Determine the pre-apportioned group NOL carryforward: \$52,223 (see Figure 2-1).

2. [(b)] Determine which[what]years are in the pre-apportioned group NOL carryforward assuming all NOL carryforward amounts are used on a a[the]first-in-first-out basis (i.e., most recent losses remain).

a. [1.] Year 4 Losses Remaining: \$40,000

b. [2.] Year 3 Losses Remaining: \$12,223

3. [(c)] Allocate the pre-apportioned group NOL carryforward by year to each loss corporation in each year. For a year in which the total loss generated exceeds the carryforward allocated to that year, prorate the pre-apportioned NOL carryforward for that year proportionally based on the loss generated by each member (see Figure 2-3).

Figure 2-3

| | <u>Year 3</u> | <u>Year 4</u> |
|--|-----------------|-----------------|
| <u>Sub B Loss</u> | <u>\$10,000</u> | <u>\$10,000</u> |
| <u>Total Losses of all Loss Corporations</u> | <u>\$25,000</u> | <u>\$40,000</u> |
| <u>Allocation Percentage</u> | <u>40%</u> | <u>25%</u> |
| <u>Remaining Loss in Group Carryforward</u> | <u>\$12,223</u> | <u>\$40,000</u> |
| <u>Allocated Remaining Sub B Loss</u> | <u>\$4,890</u> | <u>\$10,000</u> |
| | | |
| <u>Parent Corporation Loss</u> | <u>\$15,000</u> | <u>\$30,000</u> |
| <u>Total Losses of all Loss Corporations</u> | <u>\$25,000</u> | <u>\$40,000</u> |
| <u>Allocation Percentage</u> | <u>60%</u> | <u>75%</u> |
| <u>Remaining Loss in Group Carryforward</u> | <u>\$12,223</u> | <u>\$40,000</u> |
| <u>Allocated Remaining Parent Loss</u> | <u>\$7,333</u> | <u>\$30,000</u> |
| | | |
| <u>Group NOL Per Year</u> | <u>\$12,223</u> | <u>\$40,000</u> |
| <u>Accumulating Group NOL</u> | <u>\$12,223</u> | <u>\$52,223</u> |

| | <u>Year 3</u> | <u>Year 4</u> |
|--------------------------------|-----------------|-----------------|
| <u>Sub B Loss</u> | <u>\$4,890</u> | <u>\$10,000</u> |
| <u>Parent Corporation Loss</u> | <u>\$7,333</u> | <u>30,000</u> |
| <u>Group NOL</u> | <u>\$12,223</u> | <u>\$40,000</u> |

* Sub B: $\$10,000/\$25,000 \times \$12,223 = \$4,890$

Parent Corporation: $\$15,000/\$25,000 \times \$12,223 = \$7,333$

4.[(d)] Multiply the pre-apportioned NOL carryforward amounts allocated~~[assigned]~~ to each member that is leaving the group by the nexus consolidated group's apportionment factor~~[factors]~~ in each year an NOL exists to determine the post-apportioned NOL that member may carry forward to ~~[in]~~ the future (see Figure 2-4).

Figure 2-4

| | Year 3 | Year 4 |
|--|----------------|-----------------|
| <u>Sub B NOL Carryforward</u> | <u>\$4,890</u> | <u>\$10,000</u> |
| <u>Nexus Group Apportionment Factor</u> | <u>32%</u> | <u>17%</u> |
| <u>Sub B Post-Apportioned NOL Carryforward</u> | <u>\$1,564</u> | <u>\$1,700</u> |
| <u>Accumulating Sub B Post-Apportioned NOL Carryforward</u> | <u>\$1,564</u> | <u>\$3,264</u> |
| | | |
| <u>Parent Corporation NOL Carryforward</u> | <u>\$7,333</u> | <u>\$30,000</u> |
| <u>Nexus Group Apportionment Factor</u> | <u>32%</u> | <u>17%</u> |
| <u>Parent Corp Post-Apportioned NOL Carryforward</u> | <u>\$2,346</u> | <u>\$5,100</u> |
| <u>Accumulating Parent Post-Apportioned NOL Carryforward</u> | <u>\$2,346</u> | <u>\$7,446</u> |

| | Year 3 | Year 4 |
|--|--------------------|---------------------|
| [Sub B NOL Carryforward] | \$4,890 | \$10,000 |
| Nexus Group Apportionment Factor | 32% | 17% |
| Sub B Post-Apportioned NOL Carryforward | \$1,564 | \$1,700 |
| Parent Corporation NOL Carryforward | \$7,333 | \$30,000 |
| Nexus Group Apportionment Factor | 32% | 17% |
| Parent Corp Post-Apportioned NOL Carryforward | \$2,346 | \$5,100 |

~~Sub B will carryforward a post-apportioned NOL of \$3,264 (\$1,564+\$1,700) to Year 5, and Parent Corporation will carryforward a post-apportioned NOL of \$7,446 (\$2,346+\$5,100) to Year 5 (see Figure 2-4). The total post-apportioned NOLs carried forward to Year 5 is \$10,710 (see Figure 2-4).]~~

(3) Example 3 – Member Leaves Elective Consolidated Group.

(a)/(1) Parent Corporation and its three **(3)** subsidiaries, Sub A, Sub B, and Sub C, file elective consolidated group returns for Year 1 through Year 4, but Sub A will not be included in the group in Year 4. ~~The group has a post-apportioned~~ [Parent Corporation has a post-apportioned elective consolidated group] NOL carryforward of \$23,500 at the end of Year 3 (see Figure 3-1).

Figure 3-1

| | Year 1 | Year 2 | Year 3 |
|-------------------------------------|-------------------|------------------|----------------|
| Sub A In-come/(Loss) | (\$25,000) | (\$25,000) | (\$15,000) |
| Sub B In-come/(Loss) | (10,000) | (10,000) | (10,000) |
| Sub C In-come/(Loss) | (5,000) | 30,000 | 50,000 |
| Parent Corporation In-come/(Loss) | (5,000) | (5,000) | (15,000) |
| Group In-come/(Loss) | (\$45,000) | (\$10,000) | \$10,000 |
| Group Apportionment Factor | 50% | 40% | 30% |
| <u>Taxable Net In-come/(Loss)</u> | <u>(\$22,500)</u> | <u>(\$4,000)</u> | <u>\$3,000</u> |
| NOL Generated/(Used) | 22,500 | 4,000 | (3,000) |
| Accumulating Group NOL Carryforward | \$22,500 | \$26,500 | \$23,500 |

(b) The following steps determine the post-apportioned NOL allocated [assigned] to Sub A when it departs the group as well as the post-apportioned NOL that will be carried forward by the group to Year 4.

1. (a) Determine the post-apportioned group NOL carryforward: \$23,500 (see Figure 3-1).

2. (b) Determine which[what] years are in the post-apportioned group NOL carryforward assuming all post-apportioned NOL carryforward amounts are used on a first-in-first-out basis (i.e., most recent losses remain).

a. (1.) Year 3 No NOL Generated

b. (2.) Year 2 Losses Remaining: \$4,000

c. (3.) Year 1 Losses Remaining: \$19,500

3. (c) Prorate the post-apportioned group NOL carryforward by year to each loss corporation in each year proportionally based on the loss generated by each member (see Figure 3-2).

Figure 3-2

| | Year 1 | Year 2 |
|---------------------------------------|----------|----------|
| Sub A Loss | \$25,000 | \$25,000 |
| Total Losses of all Loss Corporations | \$45,000 | \$40,000 |
| Allocation Percentage | 55.56% | 62.5% |
| Remaining Loss in Group Carryforward | \$19,500 | \$4,000 |

| | | |
|--|----------|----------|
| Allocated Remaining Sub A Loss Per Year | \$10,833 | \$2,500 |
| Accumulating Sub A Loss | \$10,833 | \$13,333 |
| | | |
| REMAINING GROUP | | |
| Sub B Loss | \$10,000 | \$10,000 |
| Total Losses of all Loss Corporations | \$45,000 | \$40,000 |
| Allocation Percentage | 22.22% | 25% |
| Remaining Loss in Group Carryforward | \$19,500 | \$4,000 |
| Allocated Remaining Sub B Loss Per Year | \$4,333 | \$1,000 |
| | | |
| Sub C Loss | \$5,000 | - |
| Total Losses of all Loss Corporations | \$45,000 | \$40,000 |
| Allocation Percentage | 11.11% | - |
| Remaining Loss in Group Carryforward | \$19,500 | \$4,000 |
| Allocated Remaining Sub C Loss Per Year | \$2,167 | - |
| | | |
| Parent Corporation Loss | \$5,000 | \$5,000 |
| Total Losses of all Loss Corporations | \$45,000 | \$40,000 |
| Allocation Percentage | 11.11% | 12.5% |
| Remaining Loss in Group Carryforward | \$19,500 | \$4,000 |
| Allocated Remaining Parent Corporation Loss Per Year | \$2,167 | \$500 |
| | | |
| Remaining Group NOL Per Year | \$8,667 | \$1,500 |
| Accumulating Remain- ing Group NOL Car- ryforward | \$8,667 | \$10,167 |

| | Year 1* | Year 2** |
|--------------------------------|----------|-------------|
| Sub A Loss | \$10,833 | \$2,500 |
| Sub B Loss *** | 4,333 | 1,000 |
| Sub C Loss *** | 2,167 | - |
| Parent Corporation Loss *** | 2,167 | 500 |

| | | |
|---|---------------------|--------------------|
| Group NOL | \$19,500 | \$4,000 |
| *** Remaining Members' Loss (per year) | \$8,667 | \$1,500 |

* Sub A: $\$25,000/\$45,000 \times \$19,500 = \$10,833$

Sub B: $\$10,000/\$45,000 \times \$19,500 = \$4,333$

Sub C: $\$5,000/\$45,000 \times \$19,500 = \$2,167$

Parent Corporation: $\$5,000/\$45,000 \times \$19,500 = \$2,167$

** Sub A: $\$25,000/\$40,000 \times \$4,000 = \$2,500$

Sub B: $\$10,000/\$40,000 \times \$4,000 = \$1,000$

Parent Corporation: $\$5,000/\$40,000 \times \$4,000 = \500

The elective consolidated group will carryforward a total post-apportioned NOL of \$10,167 to Year 4, and Sub A will carryforward a total post-apportioned NOL of \$13,333 to Year 4 (see Figure 3-2).

(4) Example 4 – Remaining Elective Consolidated Group Dissolves.

(a) This example is a continuation of Example 3.

Parent Corporation and its two **(2)** remaining subsidiaries, Sub B, and Sub C, file elective consolidated group returns for Year 1 through Year 4, but each group member will either file separately or as part of a combined group in Year 5. The elective consolidated group has a post-apportioned NOL carryforward of \$13,167 at the end of Year 4. [in Year 5. Parent Corporation has a post-apportioned elective consolidated group NOL carryforward of \$10,167 at the end of Year 3-](see Figure 4-1).

Figure 4-1

| | Year 1 | Year 2 | Year 3 | Year 4 |
|--|------------|------------|------------|------------|
| Sub B Income/(Loss) | (10,000) | (10,000) | (10,000) | (15,000) |
| Sub C Income/(Loss) | (5,000) | 30,000 | 50,000 | 25,000 |
| Parent Corporation Income/(Loss) | (5,000) | (5,000) | (15,000) | (20,000) |
| Group Income/(Loss) | <u>N/A</u> | <u>N/A</u> | <u>N/A</u> | (\$10,000) |
| Group Apportionment Factor | <u>N/A</u> | <u>N/A</u> | <u>N/A</u> | 30% |
| NOL Remaining per year* [Generated (Used/ Remaining | \$8,667** | \$1,500* | \$ - | 3,000 |

| | | | | |
|--|---------------|--------------|--------------|--------------|
| Per Year)] | | | | |
| Accumulat- ing Group NOL Car- ryforward | \$8,66 7** | \$10,1 67 | \$10,1 67 | \$13, 167 |

* See Figure 3-2 from Example 3.

** Year 1 NOL of \$8,667 is already reduced by the \$3,000 NOL utilized in year 3 (See Figure 3-1)

(b) The following steps determine the post-apportioned NOL that will be carried forward separately by each group member to Year 5 when the elective consolidated group dissolves.

1.[(a)] Determine the post-apportioned group NOL carryforward: \$13,167 (see Figure 4-1).

2.[(b)] Determine which[what] years are in the post-apportioned group NOL carryforward assuming all post-apportioned NOL carryforward amounts are used on a first-in-first-out basis (i.e., most recent losses remain).

a.[1.] Year 4 Losses Remaining: \$3,000

b.[2.] Year 3 No NOL Generated

c.[3.] Year 2 Losses Remaining: \$1,500

d.[4.] Year 1 Losses Remaining: \$8,667

3.[(e)] Prorate the post-apportioned group NOL carryforward by year to each loss corporation in each year proportionally based on the loss generated by each member (see Figure 4-2).
Figure 4-2

| | <u>Year</u> <u>1*</u> | <u>Year 2*</u> | <u>Year 4</u> |
|--|--------------------------|----------------|-----------------|
| <u>Sub B Loss</u> | | | <u>\$15,000</u> |
| <u>Total Losses</u> <u>of all Loss</u> <u>Corporations</u> | | | <u>\$35,000</u> |
| <u>Allocation</u> <u>Percentage</u> | | | <u>42.85%</u> |
| <u>Remaining</u> <u>Loss in Group</u> <u>Carryforward</u> | | | <u>\$3,000</u> |
| <u>Allocated</u> <u>Remaining</u> <u>Sub B Loss</u> <u>Per Year</u> | <u>\$4,333</u> | <u>\$1,000</u> | <u>\$1,286</u> |
| <u>Accumulating</u> <u>Sub B NOL</u> <u>Carryforward</u> | <u>\$4,333</u> | <u>\$5,333</u> | <u>\$6,619</u> |
| | | | |
| <u>Allocated</u> <u>Remaining</u> <u>Sub C Loss</u> <u>Per Year</u> | <u>\$2,167</u> | = | = |
| <u>Accumulating</u> <u>Sub C NOL</u> <u>Carryforward</u> | <u>\$2,167</u> | <u>\$2,167</u> | <u>\$2,167</u> |
| | | | |

| | | | |
|---|----------------|-----------------|-----------------|
| <u>Parent Corporation Loss</u> | | | <u>\$20,000</u> |
| <u>Total Losses of all Loss Corporations</u> | | | <u>\$35,000</u> |
| <u>Allocation Percentage</u> | | | <u>57.15%</u> |
| <u>Remaining Loss in Group Carryforward</u> | | | <u>\$3,000</u> |
| <u>Allocated Remaining Parent Loss Per Year</u> | <u>\$2,167</u> | <u>\$500</u> | <u>\$1,714</u> |
| <u>Accumulating Parent NOL Carryforward</u> | <u>\$2,167</u> | <u>\$2,667</u> | <u>\$4,381</u> |
| | | | |
| <u>Accumulating Group NOL Carryforward</u> | <u>\$8,667</u> | <u>\$10,167</u> | <u>\$13,167</u> |

* See Figure 3-2 from Example 3

NOTE: Year 3 is omitted from Figure 4-2. The \$3,000 NOL utilized in Year 3 was accounted for in the Year 1 remaining losses.

| | <u>Year 1**</u> | <u>Year 2**</u> | <u>Year 4*</u> |
|--------------------------------|-----------------|-----------------|----------------|
| <u>Sub B Loss</u> | <u>4,333</u> | <u>1,000</u> | <u>1,286</u> |
| <u>Sub C Loss</u> | <u>2,167</u> | <u>-</u> | <u>-</u> |
| <u>Parent Corporation Loss</u> | <u>2,167</u> | <u>500</u> | <u>1,714</u> |
| <u>Group NOL</u> | <u>\$8,667</u> | <u>\$1,500</u> | <u>\$3,000</u> |

* Sub B: $\$15,000/\$35,000 \times \$3,000 = \$1,286$

Parent Corporation: $\$20,000/\$35,000 \times \$3,000 = \$1,714$

** See Figure 3-2 from Example 3

Sub B will carryforward a post-apportioned NOL of \$6,619 ($\$4,333 + \$1,000 + \$1,286$) to Year 5, Sub C will carryforward a post-apportioned NOL of \$2,167 to Year 5, and Parent Corporation will carryforward a post-apportioned NOL of \$4,381 ($\$2,167 + \$500 + \$1,714$) to Year 5 (see Figure 4-2). The total post-apportioned NOLs carried forward to Year 5 is \$13,167 (see Figure 4-2).]

(5) Example 5-[:] Sharing of Kentucky Net Operating Losses within a Combined Group.

(a) Parent Corporation and its three (3) subsidiaries, Sub A, Sub B, and Sub C, file a combined return in 2019, the first year in which a combined return is required. All entities have nexus in Kentucky and are taxpayer members of the combined group. The combined group has apportionable group net income of \$50,000 in 2019. The 2019 apportionment factors for the members of the group are shown in Figure 5-1 below. The members also report the following apportioned NOL carryforwards from 2017 and 2018 (Figure 5-1).

Figure 5-1

| | <u>Parent</u> | <u>Sub A</u> | <u>Sub B</u> | <u>Sub C</u> |
|---|-----------------|-----------------|-----------------|-----------------|
| <u>2019 Group Income</u> | <u>\$50,000</u> | <u>\$50,000</u> | <u>\$50,000</u> | <u>\$50,000</u> |
| <u>2019 Apportionment Factor</u> | <u>20%</u> | <u>10%</u> | <u>10%</u> | <u>5%</u> |
| <u>2019 Taxable Income</u> | <u>\$10,000</u> | <u>\$5,000</u> | <u>\$5,000</u> | <u>\$2,500</u> |
| <u>2017 NOL Carryforward*</u> | <u>\$2,000</u> | <u>\$12,000</u> | <u>\$3,500</u> | <u>\$0</u> |
| <u>2018 NOL Carryforward*</u> | <u>\$5,000</u> | <u>\$0</u> | <u>\$1,700</u> | <u>\$0</u> |
| <u>* 2017 (and earlier years) NOL can be applied against 100 percent of taxable income. 2018 (and later years) NOL is limited to eighty (80) percent of net income.</u> | | | | |

(b) The following calculation determines the maximum allowable NOL deduction available to each entity (See Figure 5-2). This amount may exceed (or be less than) the actual amount of prior year NOL available within the group. The maximum allowable NOL deduction available to each entity is the sum of:

1. NOLs generated by the entity in 2017 and previous years; plus
2. NOLs generated by the entity in 2018, up to a maximum of eighty (80) percent of the entity's 2019 taxable income; plus
3. NOLs generated by other taxpayer members of the group in years before a combined return was required, up to a maximum of fifty (50) percent of the 2019 taxable income of the entity that is utilizing the NOL. (Note that losses from years in which a combined report was required may be shared between taxpayer members of the combined group without reference to the fifty (50) percent limitation, ***if provided that*** the entities sharing the losses were members of the combined group in the year the loss was generated).

Figure 5-2

| <u>NOL Limitations</u> | <u>Parent</u> | <u>Sub A</u> | <u>Sub B</u> | <u>Sub C</u> |
|--|------------------|-----------------|----------------|----------------|
| <u>2017 and Prior NOLs (Up to 100% of 2019 taxable income)</u> | <u>\$ 10,000</u> | <u>\$5,000</u> | <u>\$5,000</u> | <u>\$2,500</u> |
| <u>Max Amount of Allowable 2018 NOL (Up to 80% of 2019 Taxable Income)</u> | <u>\$ 8,000</u> | <u>\$ 4,000</u> | <u>\$4,000</u> | <u>\$2,000</u> |
| <u>Max of Al-</u> | <u>\$</u> | <u>\$</u> | <u>\$2,500</u> | <u>\$1,250</u> |

| | | | | |
|---|--------------|--------------|--|--|
| <u>lowable Shared Amount (Up to 50% of 2019 Taxable Income)</u> | <u>5,000</u> | <u>2,500</u> | | |
|---|--------------|--------------|--|--|

(c) The following steps determine the utilization of the available NOL by each entity and each entity's resulting taxable income and NOL carryforward to 2020 (See Figure 5-3).

1. Subtract the entity's available 2017 (and earlier) NOL amount from the entity's 2019 taxable income on a first-in-first-out basis (i.e. most recent losses remain), up to 100 percent[100%] of 2019 taxable income;

2. Subtract the entity's 2018 NOL up to the maximum allowable 2018 NOL (eighty (80) percent of 2019 taxable income) from the amount remaining after Step 1; **and**

3. Subtract the NOL amounts available to be shared from other taxpayer members of the combined group up to the maximum allowable shared amount (**fifty (50) percent[50%]** of 2019 taxable income) from the amount remaining after Step 2.

(d)[In no case can] The utilization of NOLs **to** reduce taxable income **shall not be reduced** below zero **under any circumstances[0]**. If group NOLs exceed available income, the remaining NOL may be carried forward.

Figure 5-3

| | <u>Parent</u> | <u>Sub A</u> | <u>Sub B</u> | <u>Sub C</u> |
|--------------------------------------|-------------------|------------------|------------------|------------------|
| <u>2019 Taxable Income</u> | <u>\$10,000</u> | <u>\$ 5,000</u> | <u>\$5,000</u> | <u>\$2,500</u> |
| <u>Less: Entity's 2017 NOL</u> | <u>(\$ 2,000)</u> | <u>(\$5,000)</u> | <u>(\$3,500)</u> | <u>\$0</u> |
| <u>Taxable Income Remaining</u> | <u>\$ 8,000</u> | <u>\$0</u> | <u>\$1,500</u> | <u>\$2,500</u> |
| <u>Less: Entity's 2018 NOL</u> | <u>(\$ 5,000)</u> | <u>N/A</u> | <u>(\$1,500)</u> | <u>\$0</u> |
| <u>Taxable Income Remaining</u> | <u>\$ 3,000</u> | <u>\$0</u> | <u>\$ 0</u> | <u>\$2,500</u> |
| <u>Less: Shared NOL</u> | <u>(\$ 3,000)</u> | <u>N/A</u> | <u>N/A</u> | <u>(\$1,250)</u> |
| <u>Net Taxable Income After NOLD</u> | <u>\$0</u> | <u>\$0</u> | <u>\$0</u> | <u>\$ 1,250</u> |
| <u>NOL Carryforward to 2020</u> | <u>\$0</u> | <u>\$ 2,750*</u> | <u>\$200**</u> | <u>\$0</u> |

*After sharing of NOLs, Sub A carries forward \$2,750 of its 2017 NOL into 2020.

****Sub B carries forward \$200 of its 2018 NOL into 2020 (\$1,700 - \$1,500).**

(6) Example 6-1: Sharing of Kentucky Net Operating Losses within a Combined Group that includes a Non-Taxpayer Member.

(a) Parent Corporation and its three (3) subsidiaries, Sub A, Sub B, and Sub C, file a combined return in 2020. Sub A does not have nexus in Kentucky and is included in the group under the unitary principle. The combined group has apportionable group net income of \$50,000 in 2020. The 2020 apportionment factors for the members of the group are shown below. The members also report the following post-apportioned NOL carryforwards from 2018, a year in which each entity filed separately, and 2019, a year in which the group filed a combined return (Figure 6-1).

Figure 6-1

| | <u>Parent</u> | <u>Sub A</u> | <u>Sub B</u> | <u>Sub C</u> |
|----------------------------------|-----------------|-----------------|-----------------|-----------------|
| <u>2020 Group Income</u> | <u>\$50,000</u> | <u>\$50,000</u> | <u>\$50,000</u> | <u>\$50,000</u> |
| <u>2020 Apportionment Factor</u> | <u>20%</u> | <u>0%</u> | <u>10%</u> | <u>5%</u> |
| <u>2020 Taxable Income</u> | <u>\$10,000</u> | <u>\$0</u> | <u>\$5,000</u> | <u>\$2,500</u> |
| <u>2018 NOL Carryforward</u> | <u>\$0</u> | <u>\$12,000</u> | <u>\$0</u> | <u>\$0</u> |
| <u>2019 NOL Carryforward</u> | <u>\$7,500</u> | | <u>\$5,000</u> | <u>\$1,000</u> |

(b) The maximum allowable NOL deduction available to each entity is equal to eighty (80) percent of its taxable income (See Figure 6-2).

Figure 6-2

| <u>NOL Limitations</u> | <u>Parent</u> | <u>Sub B</u> | <u>Sub C</u> |
|-----------------------------------|----------------|----------------|----------------|
| <u>80% of 2020 Taxable Income</u> | <u>\$8,000</u> | <u>\$4,000</u> | <u>\$2,000</u> |

(c) Figure 6-3 shows the utilization of the available NOL deduction by each entity and each entity's resulting taxable income and NOL carryforward to 2021. As the 2019 NOLs were generated in a year in which a combined report was required, they can be shared among taxpayer members of the group, subject to the eighty (80) percent limitation. Since Sub A does not have Kentucky nexus in 2020, it is not a taxpayer member and therefore its 2018 NOLs cannot be utilized by other group members. Sub A cannot utilize its 2018 losses until it has Kentucky source income.

Figure 6-3

| | <u>Parent</u> | <u>Sub A</u> | <u>Sub B</u> | <u>Sub C</u> |
|------------------------------------|------------------|--------------|------------------|------------------|
| <u>2019 Taxable Income</u> | <u>\$10,000</u> | <u>\$0</u> | <u>\$5,000</u> | <u>\$2,500</u> |
| <u>Less: Entity's Own 2019 NOL</u> | <u>(\$7,500)</u> | <u>n/a</u> | <u>(\$4,000)</u> | <u>(\$1,000)</u> |

| | | | | |
|---|-----------------|-----------------|----------------|-----------------|
| <u>Taxable Income Remaining</u> | <u>\$ 2,500</u> | <u>\$0</u> | <u>\$1,000</u> | <u>\$1,500</u> |
| <u>Less: Shared NOL</u> | <u>(\$ 500)</u> | <u>N/A</u> | <u>\$ 0</u> | <u>(\$ 500)</u> |
| <u>Taxable Income Remaining</u> | <u>\$ 2,000</u> | <u>\$0</u> | <u>\$1,000</u> | <u>\$1,000</u> |
| <u>2018 NOL Remaining</u> | <u>\$0</u> | <u>\$12,000</u> | <u>\$0</u> | <u>\$0</u> |
| <u>2019 NOL Remaining</u> | <u>\$0</u> | <u>\$0</u> | <u>\$0**</u> | <u>\$0</u> |

(d)**Figure 6-4 shows how Sub B's NOLs were shared among the group.

Figure 6-4

| | |
|---|------------------|
| <u>Sub B 2019 NOL</u> | <u>\$5,000</u> |
| <u>Offset Max of 80% of Sub B 2020 Income</u> | <u>(\$4,000)</u> |
| <u>NOL Remaining</u> | <u>\$1,000</u> |
| <u>Utilized by Parent (up to 80% limit)</u> | <u>(\$ 500)</u> |
| <u>NOL Remaining</u> | <u>\$ 500</u> |
| <u>Utilized by Sub C</u> | <u>(\$ 500)</u> |
| <u>NOL Remaining</u> | <u>\$ 0</u> |

DANIEL BORK, Commissioner

APPROVED BY AGENCY: June 6, 2019

FILED WITH LRC: June 7, 2019 at 2 p.m.

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