Tax & Business Alert – December 2025

Abstract: Losses are a real possibility for businesses, whether they're new or well-established. The federal tax code may help soften the blow by allowing businesses to apply losses to offset taxable income in future years, subject to certain limitations.

NOL deductions can ease the pain of business losses

For income tax purposes, a business loss generally occurs when a business's deductions for the year exceed its revenue. Any business, whether new or established, can face losses. Fortunately, the net operating loss (NOL) deduction can turn the pain of a loss this year into tax savings for next year and, perhaps, beyond.

How to qualify

Tax inequities can exist between businesses with stable income and those with fluctuating income. The NOL deduction helps address those inequities. It essentially lets the latter average out their income and losses over the years and pay tax accordingly.

For a business to qualify for the NOL deduction, the loss generally must be caused by deductions related to your business (Schedule C and F losses or Schedule K-1 losses from partnerships or S corporations), casualty and theft losses from a federally declared disaster, or rental property (Schedule E).

Determination of an NOL generally doesn't include:

- Capital losses in excess of capital gains,
- Exclusion for gains from the sale or exchange of qualified small business stock,
- Nonbusiness deductions in excess of nonbusiness income,
- The NOL deduction, and
- The Section 199A qualified business income deduction.

Individuals and C corporations are eligible for the NOL deduction. While partnerships and S corporations generally aren't eligible, their partners and shareholders can claim individual NOLs based on their separate shares of business income and deductions.

Limits apply

NOL deductions can't offset more than 80% of taxable income for the year. Any excess NOLs can be carried forward indefinitely.

Suppose your NOL carryforward is more than your taxable income for the year you carry it to. If so, you may have an NOL carryover. That's the excess of the NOL deduction over your modified taxable income for the carry-forward year. If your NOL deduction includes multiple NOLs, you must apply them against your modified taxable income in the same order you incurred them, beginning with the earliest.

Next steps

When it comes to business losses, the rules are complex, especially the interaction between NOLs and other potential tax breaks. Contact us for help charting your best path forward.

Sidebar:

Excess business losses may be limited

Under the Tax Cuts and Jobs Act (TCJA), an "excess" business loss limitation went into effect in 2021. That limitation applies at the partner or shareholder level, for partnerships or S corporations, after applying the outside basis, at-risk and passive activity loss limitations.

Under the excess business loss rule, noncorporate taxpayers' business losses can offset only business-related income or gain, plus other income (such as salary, self-employment income, interest, dividends and capital gains) up to an inflation-adjusted threshold. For 2025, that threshold is $313,000, or $626,000 for married couples filing jointly. For 2026, the limit is reduced to $256,000 and $512,000, respectively. Any “excess” losses are carried forward and treated as net operating losses (NOLs).

Under the TCJA, the excess business loss limitation had been scheduled to expire after December 31, 2026. However, the Inflation Reduction Act extended it through 2028, and the OBBBA makes it permanent.