CARRYOVER Hotline

Richard Malamud, Esq., CPA

How to Make Money from Tax Returns That Are Too Old to Amend For a Refund

If a tax return was filed more than three years ago, you can't amend it to change that year's tax bill.

But you may be able to change what you reported on that year's return to save taxes in later years.

This is an opportunity that many people overlook. *How to use it...*

carryover opportunities

Many tax return items can be carried over from one year to the next. *Examples...*

- Capital losses, which are deductible against salary of only $3,000 a year.
- Net operating losses.
- Charitable contributions that exceed percentage-of-income deduction limits.
- Passive activity losses from real estate that exceed passive income.
- Alternative Minimum Tax (AMT) credit carryovers.

Obviously, the calculation of a carryover item in one year affects not only that year's return but also the amounts carried over to later years.

Key: If a carryover item was miscalculated on a return that is more than three years old, it can be corrected now to correct the amount of tax reported on returns filed within the last three years.

Example: On a 1995 return filed in April of 1996—just over three years ago—you reported the sale of a capital asset at a break-even price. But in a recent review of your records you just discovered that you miscalculated your basis in the asset, and really had a $9,000 loss.

You can now change the amount reported on the over-three-year-old sale to a $9,000 loss. Assuming no other capital transactions, you become able to report a $3,000 capital loss for the 1995, 1996, and 1997 returns you filed in April of 1996, 1997, and 1998.

You will get no tax saving from the $3,000 capital loss on the return filed in 1996—the three-year limit has passed, so the tax savings from that year's capital loss are gone forever. But you can file amended returns for the other two years to claim loss carryforward deductions—and tax refunds.

Tax Hotline interviewed Richard Malamud, Esq., CPA, professor, department of accounting and law, California State University Dominguez Hills, in Carson, California.

do what the IRS does

The IRS can also go back more than three years to disallow an item that leads to carryforwards in later years.

Example: When an individual claimed carryforward investment losses and tax credits from a past investment in a partnership, the Tax Court let the IRS go back more than three years to redetermine the original loss and credit amounts—sharply reducing them. The IRS couldn't change the original year's tax bill, but the individual lost his carryforwards. (*Robert J. Reilly,* TC Memo 1989-312.)

Since the IRS is willing to use this tactic, you should be, too—and the IRS itself says you can.

Case: A taxpayer wanted to increase a net operating loss (NOL) that originated on a return filed four years ago. Being unsure of how the statute of limitations applied, the taxpayer asked the IRS for a private ruling on the matter. *IRS ruling:* The taxpayer can increase the loss reported four years earlier to increase the NOLs carried over onto later-filed returns (*Letter Ruling* 9504032).

Types of tax-saving carryovers you may increase from a prior year...

- Capital loss carryovers.
- AMT carryovers—many people don't realize they exist.
- Passive activity loss carryovers—many people make mistakes with the complex rules.
- Charitable contributions carryovers—you forgot to report a contribution.
- Investment interest expense carryovers—interest was underreported.
- NOL carryovers where more deductions are found, adding to the original loss.
- Home office deduction carryforwards—you didn't deduct a qualified home office, but if you had, the deduction would have been limited by your net business income, creating a carryover.

More possibilities may exist in the details of your tax returns.

the paperwork

Although the IRS says you can change an item creating a carryover in a "closed" tax year, it has not specified any procedures for doing so.

There's no point in filing an amended return for the closed year—you can't change that year's tax bill, and that year's tax bill is not the one you are trying to change.

Instead, file amended returns for subsequent years and attach a statement explaining what you are doing. You might want to attach to the statement a copy of an amended return filled out for the closed year—even though you never filed it—to make clear to the IRS what you are doing and where the increased carryover you are claiming originated. TH

"They're even more brazen than they used to be."