How to Plan Around the New Limits on Business Loss Deductions

There's been a big shift in tax planning for business owners, and it's one you'll want to understand if your company ever reports a loss.

When Congress passed OBBBA, it made the excess business loss limitation permanent. So what does that mean for you? Let's break it down.

Under the original rules from the Tax Cuts and Jobs Act, non-corporate taxpayers, sole proprietors, partners, and S corporation shareholders were limited in how much business loss they could use to offset nonbusiness income, like wages or investment gains. Here's how it worked. The cap was set each year, adjusted for inflation, anything above that limit was considered an excess business loss. You couldn't deduct that excess amount in the same year. Instead, it carried forward as a net operating loss, which could offset up to 80% of taxable income in future years.

Originally, this rule was supposed to expire after 2028. Many thought it would fade away, but that's no longer the case. OBBBA made two key changes. First, it made the rule permanent. This is now part of a long-term tax landscape. Second, it added a new twist, called a specified loss. If you had a disallowed loss one year, that same amount now gets added back into your calculation the following year. That can make the limitation a little tighter, since those prior year losses can compound over time.

Aside from that, most of the familiar rules stay the same. Wages, capital gains, Section 198 deductions are excluded from the formula. Disallowed losses still roll forward as net operating losses. Now that the rule is permanent, it's no longer something you can wait out. If your business operates in industries like real estate, farming, startups, or anything with big upfront investments, this rule could limit how much of your loss you can deduct in a single year.

Here's what that means in practice. Less flexibility: You can't use large business losses to completely offset other income. Delayed relief: Losses above that threshold roll forward, so your tax benefit comes later, not immediately. More strategy required: Because disallowed losses can snowball as specified losses, planning ahead becomes even more important.

Some advisors see an upside, though. This change encourages steadier income planning and helps reduce year-to-year volatility in your tax picture. With this rule now permanent, it's time to build it into your long-term tax strategy. Here's how. Run the numbers each year: Work with your tax professional to estimate whether you'll exceed the threshold. Use timing strategies: You might be able to accelerate income or defer losses to make better use of the limits. Review your entity structure: Remember C corporations aren't subject to these restrictions, but changing entities is a big step that should be carefully modeled. Leverage other deductions: Things like credits, section 179 expensing, and bonus depreciation can help manage taxable income effectively. Track carry forwards carefully: Keep detailed records of disallowed losses that roll forward. They're still valuable in future years. Document thoroughly: Especially for partnership or real estate activities, good record keeping will help if the IRS takes a closer look.

By making the excess business loss limitation permanent, Congress turned what was once a temporary rule into a lasting part of the tax code. For business owners, this means adjusting your expectations and planning more strategically. The earlier you start incorporating this rule into your long-term approach, the better you can manage your tax outcomes year after year.