DOWNTURN TAX PLANNING

CASE FOR LOSSES: DISASTER LOSSES

By: Layton L. Pace, Esq.

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On March 13, 2020, President Trump declared a national emergency related to the Covid-19 pandemic. Subsequently, he has approved major disaster declarations for all 50 states and the District of Columbia. Here is a link from the Congressional Research Service that details the declarations: https://crsreports.congress.gov/product/pdf/R/R46326. According to that website, those declarations are the first major disaster declarations issued under the Stafford Act for an infectious disease outbreak.

So what does the declaration mean for income taxes? Section 165(i) of the Internal Revenue Code allows taxpayers who have suffered losses caused by a Presidentially-declared disaster to make an election to treat the losses as incurred in the previous year. In other words, a taxpayer suffering a loss caused by a declared major disaster in 2020 can elect to claim the loss in 2019. When coupled with the 5-year net operating loss (NOL) carryback rules contained in the recently enacted CARES Act, a taxpayer conceivably could carry back a disaster loss suffered in 2020 to 2014 to obtain a tax refund. Wow! A previous article explains that the yet to be enacted HEROES Act may shorten the 5-year carryback period.

So what is the catch? Not many would say for sure how rules will apply to various losses suffered during the Covid-19 pandemic. The losses in the past have occurred from hurricanes, tornadoes, fires, etc., casualty events where facts often strongly connect a sudden event to the loss. But think about the types of losses that may have some connection to the pandemic: out-of-season or otherwise non-salable inventory, stock losses, abandoned equipment, closed facilities, etc.

Many are waiting for the IRS and Treasury to issue guidance on how to treat certain losses that taxpayers suffer during the pandemic and what positions the government intends to challenge under various circumstances. The IRS and Treasury have issued much guidance quickly on other tax issues related to the CARES Act provisions, with the intent of putting money back into the hands of taxpayers via quick tax refunds. Disaster losses may be no different.

Additionally, an election to treat 2020 losses as 2019 losses is revocable within certain time limits, so taxpayers may reevaluate their tax positions as 2020 and the pandemic continue.

Lastly, although California conforms generally to Section 165(i), California has not conformed to the CARES Act provisions. Accordingly, NOLs suffered in 2019 and 2020 cannot be carried back to earlier years. Moreover, proposed California budget provisions would suspend the use of NOLs in 2020-2022 for larger taxpayers. Therefore, it appears that claiming a loss in 2019, which does not create or add to an NOL, potentially could accelerate California tax savings versus claiming the loss in 2020.

The preceding discussion is not and should not be construed as legal or tax advice or representation on specific legal matters for any client or jurisdiction, but rather as a general commentary. The information provided should not be acted upon without specific legal advice based on particular situations.

  (310) 379-5805