

The ARTICLES



ACCELERATING THE DEDUCTION OF DISASTER LOSSES

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The economic downturn caused by the coronavirus has had many businesses struggling to find capital. Provisions under the Coronavirus Aid, Relief and Economic Security (CARES) Act of 2020 may provide these much-needed capital sources. However, a provision of pre-pandemic tax law may provide taxpayers with another significant tax and cash flow benefit by accelerating 2020 disaster losses into 2019 taxes.

IRC Section 165(l) is a timing provision that allows a taxpayer to elect to claim a disaster loss in the tax year immediately preceding the year in which the disaster loss was actually sustained. A disaster loss is a loss occurring in a disaster area and attributable to a federally declared disaster, defined per Treasury Regulation 1.165-11(b)(1) as any disaster subsequently determined by the President to warrant assistance by the federal government under the Robert T. Stafford Disaster and Emergency Assistance Act. On March 13, 2020, President Trump made this declaration in connection with the COVID-19 pandemic. Although COVID-19 losses were sustained in 2020, taxpayers now have the option of treating those losses as though the losses were sustained in 2019 for tax purposes. Without Section 165(l), taxpayers would have to wait until they filed their tax returns for 2020 to

claim COVID-19 related losses.

Examples of losses attributable to COVID-19 that might potentially be claimed in 2020 but accelerated to 2019 include the following:

- Closure of stores and facility locations
- The complete abandonment of leasehold improvements
- Permanent retirement of fixed assets
- Disposal of inventory, supplies and other property that has become unsaleable
- Losses from the sale or the exchange of property
- Losses on mark-to-market securities
- Worthless securities (but not bad debts)
- Certain termination payments to cancel contracts, licenses or leases
- Abandonment of pending business transactions for which costs have been capitalized
- Prepayment of events, conferences, etc., where refunds or credits are not provided.

In order to claim a loss under IRC Section 165(l), the taxpayer must be able to show that property losses were directly caused by the COVID-19 pandemic. The loss must be otherwise allowable as a deduction under IRC Section 165, which generally requires that there be basis in tangible or intangible property. The taxpayer must further document that (1) the loss could not be reimbursed through in-

surance or other reimbursement, (2) the loss can be evidenced by closed and completed transactions, and (3) the loss was related to the disaster and sustained during the year when the disaster occurred.

Taxpayers who have already filed their 2019 federal tax return can file an amended return to make the Section 165(l) election to accelerate casualty losses sustained in 2020 into 2019. The taxpayer has six months from the date the original tax return was due, without filing extensions, to file an amended return. The taxpayer must attach Form 4684, Casualties and Thefts, and is also obligated to attach an information statement providing substantiation of the taxpayer's legitimate reliance on Section 165(l). If the taxpayer elects to accelerate COVID-19 losses into 2019, all losses from the disaster must be claimed on the 2019 amended return.

For some taxpayers, pushing the 2020 losses into 2019 could generate or enlarge a net operating loss that could now be carried back to earlier tax years, under provisions of the CARES Act. The pre-CARES provisions under Section 165(l) allowing the acceleration of 2020 disaster losses into 2019 could provide much-needed relief to taxpayers, in addition to other programs established under the CARES Act.