Turning 2020 Losses into 2019 Deductions

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Sensiba San Filippo, LLP

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Today's Presenter

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» Tax Principal

With almost 40 years of accounting experience, Tim specializes in real estate tax planning, compliance, and consulting for medium-sized to large, closely-held companies, partnerships, and fiduciaries. He has extensive experience in advising on complex real estate transactions.

Disclaimer & Acknowledgements

This presentation is a high-level summary and discussion of certain aspects of the 'Coronavirus Aid, Relief, and Economic Security Act" ("CARES Act"), which became law on March 27, 2020 as well as other existing sections of the Internal Revenue Code. It is a summary of the text of the law.

This presentation is intended for educational purposes only and should not be relied upon as authority or legal advice. As with all legislation, many aspects are subject to interpretation, both by the IRS and taxpayers' representatives, and is subject to change. Please seek the advice of your tax advisor should you wish to employ some of the techniques suggested by the presenter.

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Understanding Sec. 165(i) Basics

- What happened?
- What does this mean?
- What are the qualifying criteria?
- What are examples of potential losses?
- Which losses do not qualify?
- How do you make the election?
- What else do you need to know?
- Examples
- Q&A session

Individuals vs. Businesses

Casualty loss vs. Business Deduction:

Casualty Loss – Sudden and unexpected, may not have to be recognized

Business Deduction – Must otherwise be deductible under the Code and must be recognized

Sec. 165(i) Election – Occurs in and as a result of a ederally declared disaster area.

Taxpayers may elect to claim 2020 losses in 2019 tax year

What happened?

- On March 13, 2020, the President issued an emergency declaration under the Robert T. Stafford Disaster Relief and Emergency Assistance Act in response to the ongoing Coronavirus Disease 2019 (COVD-19) pandemic

What does this mean?

- Section 165(i) is now available
- Emergency declaration creates the opportunity to claim losses attributable to COVID-19 on a 2019 return, reducing current income and reducing cash tax payments or potentially allowing refunds
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Taxpayers may elect to claim 2020 losses in 2019 tax year

What is the qualifying criteria for Section 165(i) election?

- To be eligible to deduct a disaster loss in the preceding year, a taxpayer must establish that the loss:

    - is deductible under Section 165(i),
    - is attributable to a federally declared disaster,
    - occurs in the disaster area, and
    - is not compensated by insurance or otherwise

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Taxpayers may elect to claim 2020 losses in 2019 tax year

What are examples of potential losses that could be claimed in 2020, but accelerated to 2019, if directly attributable to COVID-19?

- Personal protection equipment
- Inventory scrapped due to spoilage during government shutdown
- Worthless securities (not bad debts)
- Closure costs of store and facility locations
- Complete abandonment of leasehold improvements
- Permanent retirement of fixed assets
- Abandonment of pending business deals

Taxpayers may elect to claim 2020 losses in 2019 tax year

- Termination payments to cancel contracts, leases or licenses
- Prepaid event, travel, conference space, hotel rooms, etc. when taxpayer is not provided a refund or credit
- Prepaid raw materials or other items to fulfill a contract and the contract has been cancelled
- Losses from sale or exchange of property

Taxpayers may elect to claim 2020 losses in 2019 tax year

What are examples of potential losses that would not qualify to be accelerated to 2019 under section 165?

- A decline in fair market value of the property attributable to buyer resistance which attached to the property
- An appraisal reflecting speculative estimates of loss
- Lost revenues
- Goodwill losses are difficult to write off under section 165 and the facts and circumstances need to be carefully analyzed

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Making the Section 165(i) Election

The procedures for making the Section 165(i) election are included in Rev. Proc. 2016-53

A taxpayer must include with the original federal tax return or amended federal tax return, an election statement indicating the taxpayer is making a Section 165(i) election

A taxpayer must provide the name or a description of the disaster, the state in which the damaged or destroyed property was located and "Section 165(i) Election" on the top of Form 4684

A taxpayer must provide all underlying information by attaching a statement if no room on the form

Reportable Transaction Filing Requirements

Losses claimed under Section 165 trigger reportable transaction rules – Form 8886, Reportable Transaction Disclosure Statement

Corporation: $10 million deduction in any single taxable year or $20 million in any combination of taxable years

Partnership with corporate partners only: $10 million in any single taxable year or $20 million in any combination of taxable years

Flow through entities: $2 million in any single taxable year or $4 million in any combination of taxable years

Individuals: $2 million in any single taxable year or $4 million in any combination of taxable years.

Affected Industries

Restaurants

Hospitality

Manufacturing

Medical Practices

Real Estate

Retail

Venture Capital/Private Equity

Worthless Stock Deduction

Only applies to a Parent’s disposition of a subsidiary

Worthless Partnership Interest

Is the worthless deduction concept applicable to partnership interests?

In the context of an investment in an illiquid partnership interest that will be difficult to dispose of, the loss deduction can arise from either:

An abandonment of the partnership interest or

A declaration that the partnership interest is worthless

Rev. Rul. 93-80 provides that a loss incurred on the abandonment or worthlessness of a partnership interest is an ordinary loss if sale or exchange treatment does not apply.

Questions?

Thank You!

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