MEMORANDUM

To: Senator Ann Cummings, Chair, Senate Committee on Finance

From: Abby Shepard, Legislative Counsel, Office of Legislative Council

Date: March 26, 2020

Subject: Disaster Loss Income Tax Deduction and Net Operating Loss

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This memorandum provides a general overview of the disaster loss income tax deduction and its potential availability for Vermonters who suffer casualty or theft losses of real or personal property due to the COVID-19 pandemic. This deduction is typically used following natural disasters, such as hurricanes and wildfires. This memorandum also points to the possibility for businesses to claim net operating losses due to the COVID-19 pandemic.

When an individual or a business suffers a casualty or theft loss from a federally declared disaster that occurred in an area warranting public or individual assistance (or both), the taxpayer can deduct those losses that are not covered by insurance. I.R.C. § 165(a). A disaster loss may be claimed for individual business or income-producing property and by corporations, S corporations, and partnerships. On March 13, 2020, the President declared a national emergency under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121, et. seq., which would trigger this benefit for qualified losses. I.R.C. § 165(i)(5).

Taxpayers are allowed to choose the timing of when they deduct the loss from a federally declared disaster. Taxpayers may take the deduction for the year in which they suffered the loss, thus declaring it on their following year's tax return, or they may elect to treat the loss as having occurred in the tax year immediately preceding the year in which the loss was sustained. I.R.C. § 165(i). For example, if a taxpayer sustains disaster losses related to COVID-19 in the spring of 2020, the taxpayer can elect to deduct the loss on their 2019 tax return filed in 2020.

Losses are subject to certain limitations. Losses are allowed only to the extent they exceed 10% of adjusted gross income for each loss claimed, and for individuals whose losses are not incurred in a trade or business or a transaction entered into for profit unconnected to a trade or business, each claim must be reduced by $100. I.R.C. § 165(h).

Additionally, if a taxpayer's loss deduction is more than their income, they may have a net operating loss (NOL). Vermont allows a state-specific NOL deduction that may be carried forward for 10 years, but may not be carried back. 32 V.S.A. §§ 5832 and 5888(4)(B). However, Vermont adds back any federal NOL deduction to corporate Vermont net income. 32 V.S.A. § 5811(18)(A)(i)((III) and (25). In Vermont, NOL is only available to C corporations and composite business filers, but not other pass-through businesses.

Online Resources

IRS
https://www.irs.gov/businesses/small-businesses-self-employed/disaster-assistance-and-emergency-relief-for-individuals-and-businesses

https://www.irs.gov/taxtopics/tc515

IRS Publication 547, Casualties, Disasters, and Thefts:
https://www.irs.gov/publications/p547

IRS Publication 2194, Disaster Resource Guide for Individuals and Businesses:
https://www.irs.gov/pub/irs-pdf/p2194.pdf

Federal Emergency Management Agency: www.fema.gov

Vermont Dept. of Taxes
TB-40, Conversion of Net Operating Loss to Separate Vermont Net Operating Loss: https://tax.vermont.gov/sites/tax/files/documents/TB40.revised10232008.pdf

TB-35 Net Operating Loss:
https://tax.vermont.gov/sites/tax/files/documents/TB35.revised10232008.pdf