FrankelZacharia LLC

Certified Public Accountants

# Deducting Losses for Tax Year 2022

Taxpayers in high tax brackets especially look to deduct any losses they experienced during a tax year. Recent economic conditions make this particularly relevant for 2022. The stock market took several significant hits, and the general environment for businesses has been challenging for several years. Recent changes to the Internal Revenue Code (IRC) may affect how taxpayers can deduct losses. Not every loss that occurred in 2022 will be deductible on that year's tax return. Some losses may carry forward to future years, while others might not be deductible at all. This applies to both business and capital losses. Read on to learn more about limits on deducting losses in 2022.

## Excess Business Loss Limitation

Any taxpayer other than a corporation may find that they cannot deduct as much of their losses as they would like because of the Excess Business Loss (EBL) limitation found in § 461(l) of the IRC. The EBL limits how much business loss a taxpayer can use to offset their non-business income.

The statute defines EBL based on two amounts obtained from taxpayer information and one set by the IRS:

- The total aggregate deductions that are "attributable to [the taxpayer's] trades or businesses," even if they are ultimately not deductible because of the EBL, but not including net operating losses or capital losses ("AD");
- The taxpayer's "aggregate gross income or gain" from those trades or businesses ("AGI"); and
- A threshold amount set by statute ("TA").

Section 461(i)(3) provides the following equation for calculating EBL:

**EBL = AD – (AGI + TA)**

The IRS has set the threshold amount for 2022 at $270,000 for a single taxpayer or $540,000 for a married taxpayer filing jointly.

Suppose a taxpayer has trade or business income of $4 million from one business for 2022, but has another business that lost $8 million. Their EBL would be $3.73 million based on the above equation. Of the $8 million in losses, the taxpayer would be able to deduct $4.27 million. The EBL of $3.73 million would be available in future years as a net operating loss carryforward.

## Limits on Net Operating Loss Deductions

Congress has also set limits on taxpayers' ability to deduct net operating losses (NOLs). Section 172(c) of the IRC defines a "net operating loss" as the difference between the total amount of tax deductions and gross income. A taxpayer that has gross business income of $2 million and deductions of $3 million for a tax year has a NOL of $1 million.

Taxpayers previously could deduct enough NOL to offset their income entirely. Any remaining NOL would carry forward to future tax years for a maximum of 20 years.

Now, taxpayers may only use NOL to offset 80% of their income for the current tax year. This prevents taxpayers from offsetting their income entirely. NOL carryforwards are no longer subject to a 20-year limit, though, so taxpayers may carry them forward indefinitely.

### Limits on Capital Loss Deductions

A capital loss occurs when a taxpayer sells an asset for less than the amount they paid to acquire it. If a taxpayer bought 100 shares of stock in a publicly-traded corporation for $10,000 and sold them for $3,000, they have a capital loss of $7,000.

Section 1211 of the IRC limits the amount of capital losses that a taxpayer may deduct to $3,000 or $1,500 for a married taxpayer filing separately. The taxpayer described above would not be able to deduct the remaining $4,000 from their other income for that tax year. The good news is that § 1212 of the IRC allows them to carry that $4,000 forward to future years with no time limit.

### Wash Sale Rule

The wash sale rule, found in IRC § 1091, also limits capital loss deductions. It states that a taxpayer may not claim a capital loss deduction based on the sale of a stock if, within 30 days before or after the date of the sale, they acquired “substantially identical stock or securities.”

The IRS generally does not view stocks from different companies as being “substantially similar,” even if the companies themselves are similar. The wash rule would probably not apply, therefore, to a taxpayer who sold stock in a tech company at a loss and then bought stock in a competing tech company. The purpose of the rule is to prevent a taxpayer from claiming a loss on their taxes while still maintaining the same position in the stock market.

Contact us at www.fzacpa.com or (402) 496-9100 today to learn more about how we can support your business.