

Hello. It looks like you're using an ad blocker that may prevent our website from working properly. To receive the best experience possible, please make sure any blockers are switched off and refresh the page.

If you have any questions or need help you can email us

TAX

Tax Court Imposes Limit on Capital Losses

Notably, you may use a loss to offset a short-term gain realized earlier in the year that would otherwise be taxed at a high ordinary income tax rate.

Ken Berry • Nov. 18, 2022



At this time of year, taxpayers may harvest capital losses to offset capital gains and up to \$3,000 of ordinary income. But don't be greedy. In a new case, *Powell, TC Sum. Op.*

2022-19, 9/26/22, a couple tried to deduct a six-figure loss against ordinary income, based on the language in the tax return instructions, to no avail.

Basic premise: Capital gains and losses are treated as short-term gains or losses if you've held the asset a year or less and long-term gains or losses if you've owned it for more than a year. Gains and losses are "netted" when you file your tax return to produce the final results.

If you're still showing a capital loss for the year after offsetting capital gains, you may use the excess loss to offset up to \$3,000 of high-taxed ordinary income. Currently, the top ordinary income tax rate is 37%. If an excess loss remains, you carry over the remainder to next year and so on. In other words, a large capital loss realized in 2022 might be used to offset capital gains in 2023 and subsequent years.

As the end of the year approaches, investors often try to time securities sales to their tax advantage. Notably, you may use a loss to offset a short-term gain realized earlier in the year that would otherwise be taxed at a high ordinary income tax rate.

Facts of the new case: An individual who is a computer programmer and his spouse, are residents of Ohio. They filed a joint tax return in 2017.

On their 2017 return, the couple reported the following: wage income of \$61,234; taxable interest of \$953; ordinary dividends of \$245; taxable individual retirement account distributions of \$38,392; unemployment compensation of \$10,112; Social Security benefits of \$13,982, of which \$11,885 was reported as taxable; and a \$123,822 long-term capital loss. The capital loss was reported on Schedule D.

Accordingly, the taxpayers reported -\$1,001 of adjusted gross income (AGI) for 2017 as a result of the capital loss. Because they reported no taxable income, they claimed a \$10,873 refund, the amount of federal income tax withheld from their wages. However, the IRS then issued them a notice about a math error. It adjusted their 2017 Form 1040 to limit their capital loss to \$3,000. The case ended up in the Tax Court.

Just semantics: The taxpayers noted that that the Schedule D instructions say to enter the smaller of their loss of \$123,822 or the \$3,000 limit. They argued that both numbers were negative, so the huge capital loss was actually the smaller of the two, The IRS countered by referencing language that indicated that both numbers should be treated as positives.

Not surprisingly, the Tax Court sided with the IRS. It limited the loss to \$3,000 and said the excess can be carried over.

Lessons to be learned: Don't try to buck the system. The IRS won't back down from long-standing principles and you're not likely to prevail on these types of issues before the Tax Court.

Tax • Taxes • Internal Revenue Service (IRS) • Article • Capital Gains • capital losses • Income Taxes

CPAPA is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors.

© 2022 Firmworks, LLC. All rights reserved