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Casualty Losses Effects on Taxes

The following is a brief overview of casualty losses and how they might impact your tax return. The information provided is by no means complete; contact this office for further details.

Casualty Loss Definition - A casualty refers to the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual.

- A **sudden** event is one that is swift, not gradual or progressive.
- An **unexpected** event is one that is ordinarily unanticipated and unintended.
- An **unusual** event is one that is not a day-to-day occurrence and that is not typical of the activity in which you were engaged.

Disaster Losses - Disaster losses are casualty losses that occur in a geographical area that has been declared a disaster region by the President of the United States. Generally, any available tax deduction for a casualty loss must be taken on the return for the year in which it occurs. However, if the casualty occurs in a designated disaster region, the loss can be taken either on the loss year's return or on the return for the year prior to the loss. The decision as to when to take the loss depends upon a number of factors and should be carefully analyzed in order to determine which year is most beneficial for the taxpayer. Factors to consider include:

- The tax brackets for each year - From purely a tax standpoint, each year should be carefully examined in order to determine which will provide the greater overall tax benefit without wasting other tax benefits.
- The need for immediate cash - The primary purpose of the special rules allowing the casualty loss to be claimed on the prior year's return is to provide taxpayers access to a tax refund without needing to wait - often many months - to file their return for the year of the loss.
- Self-Employment tax - Self-employed taxpayers will also need to consider whether to take a business casualty loss that affects inventory in the current or prior year since the loss can offset the self-employment tax as well as income taxes.
- Whether the loss will be used up - If the casualty loss is not fully used up in the year in which it is first deducted, it can create a net operating loss (NOL). An NOL can be taken back to prior years or carried forward to future years and used as a deduction on carryback or carry-forward returns. If such an NOL is considered, care should be taken to analyze the benefit from the potential loss carryback versus carrying the loss forward.

Net Operating Loss - Generally, taxpayers may carry their net operating loss back 2 years and forward 20 years until it is used up. NOLs resulting from casualties may, by election, be carried back 3 years.

Determining the Loss - Generally, the deductible loss is the lesser of the cost or fair market value of each item lost or damaged in the casualty. Once the loss is determined for each individual item, those amounts are added together to determine the total loss for each separate casualty event.

Business or Personal Casualty - Casualty losses are categorized as either business or personal casualty losses. Business losses are fully deductible without limitations, whereas personal casualty losses are first reduced by \$100 for each event, after which the total of all of the events for the year is reduced by 10% of your annual income (AGI). In addition, for personal casualty losses, you must itemize your deductions in order to take advantage of the loss.

Insurance Reimbursement - Your casualty loss must be reduced by the amount of any insurance reimbursement. Generally, if you are insured for your loss and the insurance company offers you an amount that the insurance company deems to be the FMV of the item or items lost or damaged in the casualty, you will generally not have a casualty loss unless the combination of insurance loss limits and deductibles exceeds the personal loss limitations.

Filing Relief - The IRS will generally provide filing relief for affected individuals and businesses within a Presidentially declared disaster zone, including extensions for filing tax returns, entity returns, information returns, and making deposits. The duration of these extensions will vary depending on the facts and circumstances of the disaster.

All workers assisting with relief activities in the covered disaster areas who are affiliated with a recognized government or philanthropic organization are generally also eligible for relief. Watch for IRS announcements related to each event.

If you have incurred a casualty or disaster loss, please contact this office so that we may provide you with guidance related to claiming and documenting your loss.

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