

Tax Breaks That Help When Disaster Strikes

When a disaster strikes, tax issues are probably not top of mind. Yet it is reassuring to know that when your property is damaged, destroyed or stolen, you may qualify for tax relief for losses not covered by insurance. To assist victims of property loss or damage in understanding the tax breaks that may be available to them, the Texas Society of CPAs explains the casualty loss tax deduction and how to claim it.

Defining a Casualty Loss

According to the IRS, a casualty is defined as property that is damaged or destroyed from a sudden, unexpected or unusual event. Deductible casualty losses may result from hurricanes, lightning, fires, floods, earthquakes, vandalism, theft, and similar disasters.

Losses that are gradual and progressive do not qualify for the casualty loss deduction. Examples of non-deductible losses include damage from mildew, erosion, wood rot, termites or other insect infestation.

Proving Your Loss

To deduct a property casualty loss, you must prove that there was a casualty loss and when it occurred. To meet this requirement, it is helpful to have photos of the property, news clippings describing the event and police reports, if applicable. You must also have proof that you owned the property or that you are contractually responsible to the owner for any damage to the property. In the case of theft, you should have records documenting the loss and records showing when you discovered items missing, as well as proof that you were the owner of those items and the cost of them.

For both casualty and theft losses, you should retain records of any insurance reimbursement you received or expect to receive for the loss or damaged property. You are not required to submit your documentation with your tax return, but you should have it available in the event of an audit.

Claiming a Casualty Deduction

To claim a casualty loss deduction, complete Form 4684, *Casualties and Thefts*, and use Schedule A to itemize your loss deduction. Both of these forms must be attached to Form 1040. Calculating your loss requires that you determine the adjusted basis in the property before the casualty loss and the decrease in the fair market value of the property as a result of the casualty or theft. From the smaller of these amounts, you must subtract any insurance or other reimbursements that you received.

To arrive at your adjusted basis, start with your original cost to acquire the property, add any capital improvements you've made, and subtract any depreciation if the property is used in business. The fair market value is the price for which you could sell the property to an independent, knowledgeable buyer. An appraisal is typically the best way to determine the fair market value of the property.

Once you have subtracted your insurance reimbursement from the smaller of these amounts, you face two other restrictions. If the property was used for personal purposes, you must further reduce your loss, first by \$100 per casualty event for the year, and then by 10 percent of your adjusted gross income (AGI) for the year in which the loss occurred.

Expediting Claims in Disaster Areas

Generally, a casualty loss is deductible only in the year the event occurred. However, in areas declared a disaster area by the President, you have the option of taking the casualty deduction on the tax return for the year of the loss or on the return of the prior tax year. You do this by filing an amended return.

Congress and the IRS responded to the devastation caused by the 2011 wildfires in Texas by issuing additional tax relief and assistance. Complete details can be found on the IRS website <http://www.irs.gov/newsroom/article/0,,id=245558,00.html>

Since the tax laws related to casualty losses are complex, consulting with a CPA can help you to sort through the requirements and prepare your return expeditiously.