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CASUALTY LOSSES

By Victor Sy, CPA, MBA

When disaster strikes, we lose valuable property. We also suffer from emotional distress. We hope that you will learn enough from this article to help ease the trauma and the financial burden as we seek solace from Uncle Sam through tax refunds or lesser tax payments.

1. You may deduct a loss from the complete or partial destruction of property resulting from an identifiable event of a sudden, unexpected or unusual nature such as fire, storm, floods, or earthquake. Progressive deterioration from a steady operating cause such as ordinary wear and tear of a house or the gradual sinking of building foundation is not casualty.
2. The amount of personal casualty loss is the lesser of the difference between the fair market value of the property immediately before and after the casualty and the adjusted basis of the property.
3. A personal casualty loss is subject to \$100 floor and **10% of adjusted gross income** limitation. In other words, you can only deduct losses in excess of 10% of your adjusted gross income.

Special rules apply to losses in disaster areas that have been declared by the President of the United States and are eligible for federal disaster assistance:

1. Losses from fire or flood in 2009 can be considered sustained the year before - in 2008, even though repairs and replacements will be made in 2009 or later years. There are times when a loss might be sustained in the year after the casualty such as when a tree dies a year after it is damaged by a blizzard the year before.
2. You may elect to deduct a disaster loss before the loss occurred. In other words, you may elect to deduct a 2009 loss in 2008 as though the event occurred in 2008. This could save you taxes immediately without waiting until 2010 when you file your 2009 taxes. In some cases, the disaster loss might even result in a net operating loss that could bring refund through a carryback to prior years. On the other hand, deducting your loss in 2009 might save you taxes if you expect to be in a higher bracket in the subsequent year.
3. You must have filed the election with your 2008 return by April 15, 2009.
4. If your principal home was damaged by the earthquake or any other disaster, you may exclude gain from insurance proceeds for personal property that was not scheduled under your insurance policy.
5. Other insurance proceeds received for your home or its contents may be treated as common pool of funds; therefore, no gain shall be recognized from unscheduled personal property loss proceeds.
6. The replacement period for a new house is extended from the normal two years to four years.
7. These new rules are also extended to renters as well. Renters who receive insurance proceeds related to the earthquake or other disasters qualify for the disaster loss relief.

8. If the insurance is more than the basis of your property, you may elect to defer the gain by buying a replacement property. The exchange rules are relaxed by allowing you to replace it with a similar or related service or use property.

So far, we only have discussed the federal side of disaster losses. Let us talk about **state disaster losses**:

1. Disaster areas must be declared by the President of the United States or the Governor of California.
2. California allows a carryover of disaster losses.
3. You may carryover 100% of unused disaster losses up to five years and up to 50% for up to an additional ten years. This gives you fifteen years total.
4. You may file a claim for reassessment of your property. If a timely claim is filed, you may defer the payment of the installment due in April 2009 without any penalty or interest until the assessor has reassessed the property and a corrected bill is sent to you. Remember that this deferral does not apply to property taxes paid through impound accounts. You may want to act on this right away by getting out of your impound contract with your bank or mortgage company.

Here are some additional tips for you:

1. It is a good idea to photograph your home or other property while the damage is apparent. Do not clean up first then photograph. Emotions are still high at this time and auditors are probably sympathetic to you, but if you get picked up for an audit three years later, times will have changed. The level of sentiment would have diminished and you will need all the proof that you can get. This is reality.
2. A good valuation is critical. Use a qualified appraiser. Do not base your valuation from sentimental value or general decline in market value. Bring a copy of the photographs, the appraisal, and other documents from the Department of Building and Safety and ask your tax preparer to photocopy and attach some of these documents to your return.
3. Use Form 4684 for claiming your loss from casualty.
4. You must make a timely filed claim for insurance reimbursement; otherwise, you cannot deduct personal-use property damage as a tax deduction.
5. All casualty losses are treated as “business” losses for purposes of computing Net Operating Losses (NOLs). Thus, you may carryback your loss three years or carryforward 15 years. This means that you could claim refunds for 2005 back to 2004 and forward to the year 2019.