

Casualty losses

Taxpayers who experience certain types of major personal casualties may be able to recoup some of their losses through tax savings.

An itemized deduction may be available for personal losses from fires, storms, car accidents, and similar "sudden, unexpected, or unusual" events. Losses from theft are included as well.

The deduction is only available for physical damage or loss to your property. Thus, if you are in an automobile accident and pay for the damage done to the other driver's car, the cost does not qualify. Similarly, if you're injured in the accident, your medical bills do not qualify as part of your casualty loss (although, of course, they may result in a medical expense deduction).

The loss is not always the decline in economic value you suffer. It's measured as *the lesser of* (a) the drop in value and (b) your basis in the property (usually, your cost).

Example: Dan bought an antique vase for \$500 which rose in value to \$3,000. It was damaged in a fire after which it was worth only \$1,000. For casualty loss purposes, the loss is only \$500 even though the economic loss was \$2,000 ($\$3,000 - \$1,000$). The lesser of cost (\$500) and drop in value (\$2,000) is used.

It may be difficult to establish these elements. If you have your original receipt, you can show your cost. In some cases, appraisals will be needed to establish pre- and post- loss values. Sometimes, repair costs can be used as a measure of drop in value.

Next, the loss figure is reduced by three amounts. In many cases, these reductions result in no deduction being available.

First, to the extent you are insured, you must reduce your loss by your reimbursement. You shouldn't fail to file an insurance claim in the hope of increasing your deduction. In this event, the IRS will reduce your loss by the insurance reimbursement you could have received.

Next, for each casualty, you must reduce your loss amount by \$100. Note that this reduction is per "event," and not per item damaged. Thus, if a storm knocks over a tree which damages your car and home, you have three property losses (tree, car, house) and only one \$100 reduction. Casualty losses from Hurricanes Katrina, Rita, and Wilma are not subject to the \$100 reduction.

Third, after combining all your losses under the above guidelines, you must reduce them by 10% of adjusted gross income (AGI). Only the loss amount above this "floor" can be deducted. This final limitation is often the one that wipes out the deduction. For example, if your AGI is \$75,000, your losses (determined as described above) are only deductible to the extent they exceed \$7,500 (10% of \$75,000). Casualty losses from Hurricanes Katrina, Rita, and Wilma aren't subject to the 10% of AGI floor.

Except for "disaster losses" (below), the deduction is taken in the year the loss is incurred (or, for a theft, the year it's discovered).

Also bear in mind that not every casualty results in a loss for tax purposes. There is such a thing as a "casualty gain." For instance, suppose a taxpayer buys a house for \$100,000

(his tax basis) and it increases in value to \$300,000 over the years. If it's destroyed and the taxpayer receives close to \$300,000 in insurance, he will have a gain of close to \$200,000 since his basis was only \$100,000. In many cases, tax on a casualty gain can be avoided or deferred. Please call me so we can review your options if this situation applies to you.

Disaster losses. If your loss is from a disaster in an area designated by the President as a disaster area, you can elect to take your loss in the year before it was incurred. This may increase the tax savings from the loss and may entitle you to a refund earlier than if you waited to file the loss year's return.