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Tips to Know for Deducting Losses from a Disaster

The IRS wants taxpayers to know it stands ready to help in the event of a disaster. If a taxpayer suffers damage to their home or personal property, they may be able to deduct the loss they incur on their federal income tax return. If their area receives a federal disaster designation, they may be able to claim the loss sooner (see # 4 below).

Ordinarily, a deduction is available only if the loss is major and not covered by insurance or other reimbursement.

Here are tips taxpayers should know about deducting casualty losses:

1. Casualty loss. A taxpayer may be able to deduct a loss based on the damage done to their property during a disaster. A casualty is a sudden, unexpected or unusual event. This may include natural disasters like hurricanes, tornadoes, floods and earthquakes. It can also include losses from fires, accidents, thefts or vandalism.

2. Normal wear and tear. A casualty loss does not include losses from normal wear and tear.

3. Covered by insurance. If a taxpayer insured their property, they must file a timely claim for reimbursement of their loss. If they don't, they cannot deduct the loss as a casualty or theft. The loss is reduced by the amount of the reimbursement received or expected to be received.

4. When to deduct. As a general rule, deduct a casualty loss in the year it occurred. However, if a taxpayer has a loss from a federally declared disaster, they may have a choice to deduct the loss on their return for the year the loss occurred or on an original or amended return for the immediately preceding tax year.

If a disaster loss occurs in 2017, the taxpayer doesn't need to wait until the end of the year to claim the loss. They can instead choose to claim it on their 2016 return. Claiming a disaster loss on the prior year's return may result in a lower tax for that year, often producing a refund. Review both tax years to determine which return generates the larger refund.

5. Amount of loss. Figure the amount of loss using the following steps:

* Determine the adjusted basis in the property before the casualty. For property a taxpayer buys, the basis is usually its cost to them.

* Determine the decrease in fair market value, (FMV), of the property as a result of the casualty. FMV is the price for which a person could sell their property to a willing buyer. The decrease in FMV is the difference between the property's FMV immediately before and immediately after the casualty.

* Subtract any insurance or other reimbursement received or expected to be received from the smaller of those two amounts.

6. $100 rule. After figuring the casualty loss on personal-use property, reduce that loss by $100. This reduction applies to each casualty-loss event during the year.

7. 10 percent rule. Reduce the total of all casualty or theft losses on personal-use property for the year by 10 percent of the taxpayer's adjusted gross income.

8. Form 4684. Complete Form 4684, Casualties and Thefts, to report the casualty loss on a federal tax return. Claim the deductible amount on Schedule A, Itemized Deductions.

9. Business or income property. Some of the casualty loss rules for business or income property are different from the rules for property held for personal use.

Avoid scams. The IRS will never initiate contact using social media or text message. First contact generally comes in the mail.

If you have any questions about how these rules apply to your particular situation, contact our office so we can assist you.

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