Casualty Taxation Tidbits
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This year's volatile weather patterns have resulted in widespread and massive damage. The federal income tax treatment of casualty taxation is substantially different as to whether the damage was to production, business property, or personal-use property. Additionally, there are special tax provisions, which are applicable if you sustain a loss in an area declared by the President of the United States to be eligible for federal disaster assistance.

Definition:
A casualty is defined, for tax purposes, as a sudden, unexpected, unusual, and identifiable event that causes damage, destruction or loss of your property.

Documentation:
Most of the following casualty loss provisions require documentation be developed to substantiate the losses and/or the election for the postponement of recognizing gains. Timely action by taxpayers at this time in taking photographs, getting appraisals, and securing third-party documentation can be very important evidence in computing and defending your loss for income tax purposes.

Loss of Business Production:
As a general rule, the loss of production is the loss of anticipated income and is not deductible. However, the production expenses incurred should be included in the regular expense items on this year's Schedule C or F. Accrual taxpayers will report a loss only if the items lost were included in the inventory at the beginning of the year.

Cash method farmers can make an election to include crop insurance proceeds or disaster payments in the tax year following the year in which the crops were damaged, if the taxpayer can show the income from the crops would have been reported in any year following the year the damaged occurred.

Loss of Business Property:
The casualty loss on business property is normally calculated by subtracting the salvage value, insurance, or other reimbursement received from the adjusted basis of the property. However, if the business property is only partially destroyed, the casualty loss is limited to the decrease in fair market value (FMV) or adjusted basis, whichever is less.

For casualty losses on business property, a separate computation must be made for each identifiable asset. These losses are reported on Forms 4684 and 4797. Since these are business asset losses, the losses are not subject to the Schedule D net capital loss deduction of $3,000 per year.

Annual deductions for soil and water conservation expenses are generally limited to 25% of gross farm income. However, ordinary and necessary expenses for maintaining completed soil and water conservation structures are deductible as normal farm business expenses and are not subject to the 25% of gross income limit.

Loss of Personal-Use Property:
Casualty losses are deductible for damage to your home, furniture, car, clothing, and other personal-use property. The casualty is the decrease
in the FMV of the property or its adjusted basis, which ever is less, reduced by any insurance or other reimbursements. There are two unique rules that apply to the casualty of personal-use property. First, you may not deduct the 1st $100 of loss from a casualty of property held for personal use. Second, non-business casualties may be deducted only if the total non-business losses during the year are greater than 10% of adjusted gross income.

**Disaster Area Losses:**
If you have a deductible loss in a federally declared disaster area, you can claim the loss for the year the casualty occurred or you may elect to deduct that loss on your return for the immediate preceding tax year.

**Taxable Gains From a Casualty:**
If you receive insurance or other reimbursement and it is more than your adjusted basis in the destroyed or damaged property, you have a gain from the casualty. The amount received includes any money plus the value of any property received, less any expenses incurred in obtaining the reimbursement.

Generally, you must report your gain as income in the tax year of reimbursement. However, you do not have to recognize your gain if you acquire qualified replacement property and elect to postpone the gain. To postpone all of the gain, the cost of the replacement property must be at least as much as the reimbursement received. There must be an actual reimbursement for you to postpone the gain. The sale of damaged property following the casualty is not a reimbursement and will not qualify for postponement of gain.

Additionally, the replacement property must be "similar or related in service or use" to the property it replaces. To postpone recognition of your gain, the replacement property must be acquired within the "replacement period". The replacement period begins on the date your property was damaged or destroyed. In general, the replacement period ends 2 years after the close of the tax year in which any part of your gain is realized. However, for your main home located in a Presidentially declared disaster area, the replacement period is four years.

**Seek Assistance:**
Citizens that have sustained a casualty loss should seek further advice from a tax professional (now rather than later) for steps to take in determining and substantiating the loss incurred and calculating the cost (tax) basis of their property.

**Additional Information:**
Much of the material for this article was taken from the following IRS Publications, which are free and can be obtained by calling 1-800-TAX-FORM (1-800-829-3676) or online at http://www.irs.ustreas.gov/formspubs/index.html

#225 Farmers Tax Guide
#334 Tax Guide for Small Business
#547 Nonbusiness Disasters, Casualties, and Thefts
#584 Nonbusiness Disaster, Casualty, & Theft Loss Workbook