Tax Outlook Under New Casualty Loss Rules

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The Emergency Economic Stabilization Act of 2008 includes several important tax law modifications for casualty and theft losses. Significantly, the new law increases the deduction floor for 2009 while providing a special tax break for victims in disaster areas.

Starting point

The tax regulations say that you can qualify for a casualty loss deduction if damage is caused by an event that is "sudden, unexpected or unusual." This includes not only natural disasters such as tornadoes, hurricanes and earthquakes, but also automobile collisions and frozen pipes bursting. The same basic rules apply to theft of your property.

The amount you can deduct each year depends on whether the property damaged is personal or business property. For personal property, the deduction on a 2008 return is limited to the excess above 10% of your adjusted gross income (AGI) after subtracting a $100 "floor" per casualty or theft event. For example, if your AGI for 2008 was $100,000 and you suffered a $20,000 loss to personal property last year, the deduction is limited to $9,900 ([$20,000 – $100] – [10% of $100,000]).

In contrast, there are no such limits for business property. The full amount of the eligible loss can be deducted on the company's return.

The amount that is eligible for the deduction is the lesser of (1) the difference in the property's value before and after the casualty or (2) the adjusted basis in the property.

Of course, you must reduce the deductible amount by any insurance proceeds received.

Finally, there is a special tax break if a loss is suffered in an area designated as a federal disaster area. You can elect to claim the deductible loss on your tax return for the year prior to the year in which the loss occurred.

New rules

The floor for each casualty and theft loss is increased from $100 to $500, but for 2009 only. Going back to our previous example, your deduction would be reduced to $9,500 for a $20,000 casualty loss occurring in 2009.

On the other hand, the new law completely eliminates the 10%-of-AGI limit for losses in federal disaster areas. Thus, if you suffer a $20,000 loss in a disaster area in 2009, you would be able to deduct $19,500 ($20,000 – $500), no matter what your AGI is. The change is effective for tax years beginning after 2007 and before 2010.

Furthermore, the new law allows nonitemizers to deduct personal casualty losses in disaster areas, in addition to claiming the usual standard deduction. This change applies to tax years beginning after 2007.

Reminder

Make sure you claim the maximum tax deduction you are entitled to when you file your 2008 return. Consult your Henry & Horne, LLP tax professional if you need assistance and to answer any of your questions.

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