Casualty and Theft Losses

Casualty and Theft Losses

The loss of business or personal property may provide a deduction on your individual income tax return. But first you need to determine if the loss qualifies for a deduction.

What is a Casualty?

A casualty is the damage, destruction or loss of property that results from an identifiable event that is sudden, unexpected or unusual. An event that is sudden is swift, not gradual or progressive. An automobile accident is a good example. It's usually over before you realize it. An event that is unexpected is one that is generally unanticipated and unintended. An event that is unusual is one that is not normally associated with the activity in which you are participating. In other words, it's one that is not a day-to-day occurrence.

A casualty can be from a number of different causes such as weather, fire, earthquake, terrorist attack or government-ordered demolition, just to name a few. Other events, though sudden and unexpected, will generally not qualify as a casualty loss. For example, the loss of an antique vase that breaks when a family pet knocks it over would not qualify.

Progressive deterioration, such as termite damage, is also not an eligible casualty loss. Even though it is an unexpected and unusual event, it results from a steadily operating cause rather than a sudden event. On the other hand, the loss of a diamond that fell out of its setting can lead to a casualty loss deduction, depending on how it was lost.

Proof of Casualty

The IRS may request to see proof of the casualty deduction. You should be able to show the type of casualty, such as a car accident, hurricane, tornado, storm, fire, etc. and when it occurred. Retain proof of your ownership in the property. However, if you leased the property, be able to show your contractual liability to the owner for the damages that occurred. Lastly, you need proof of any reimbursement (or potential reimbursement).

What is a Theft?

A theft is the taking and removing of money or property with the intent to deprive the owner of that property. To be considered a theft, it must be identified as illegal under the laws of the state where it occurred and it must have been done with criminal intent.

A theft includes the taking of money or property by blackmail, burglary, embezzlement, extortion, kidnapping for ransom, larceny and robbery.

Proof of Theft

The IRS may request to see proof of the theft loss deduction. You should be able to show when you discovered the property was missing and evidence that the property was actually taken illegally. Retain proof of ownership of the property taken illegally. Lastly, you need proof of any reimbursement (or potential reimbursement).

How to Determine the Loss

The first step in determining the amount of your loss is to figure out what the property is worth. For most items, the investment is what you or someone else paid for the property.

Tip: This is where good recordkeeping pays off, especially when it comes time to value an item you purchased many years ago.

You also need to know the change in value of the property before the event compared to after the event. If the decline in value is less than your cost, then it is this smaller amount that is used to determine the loss. This amount is then decreased by any insurance or other reimbursement on the property. That insurance or other reimbursement can actually lead to income from the casualty instead of a loss, in which case different rules can apply to limit reporting of that income.

With certain exceptions, a loss on property you own and use personally is subject to some or all of the following reductions:

1) Your deduction per item will be reduced by $100;
2) The aggregate total of all casualty and theft items will be reduced by 10% of your adjusted gross income; and
3) The 2% Schedule A rule that limits the deduction for property used as an employee.

When to Report the Loss

Generally, a casualty is reported in the year of the event and a theft is reported in the year it is discovered. However, you may be able to take advantage of special provisions if the casualty occurred in an eligible federal disaster area. If the loss is in an eligible federal disaster area, you can amend last year's tax return to claim the loss, instead of waiting until the end of the year to file a return. Claiming a loss on an amended return will generally produce a refund that can certainly come in handy to meet living expenses and restore your property much faster.

Special Considerations

You may also be allowed special consideration if the casualty is addressed through an income tax relief provision.

The IRS highly publicizes who are eligible for special considerations and what those are. The special considerations can vary from one qualified federal disaster area to another.

For large casualties affecting numerous people, it is not uncommon for the IRS to create a publication to help you and your preparer sort through all the special provisions that may be available to you if you were affected by that particular casualty. Visit the Tax Relief in Disaster Situations webpage on IRS.gov.

Tax Liability Consulting
2570 Idaho Street
Elko, NV 89801
Phone: 775-738-4845
Fax: 775-777-3894
www.nevadataxman.com