Overview of Tax Rules Relative to Casualty Losses

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Introduction

Casualty losses which result in economic loss to an individual may result in a tax deductible loss which can reduce federal income tax either in the year of the loss or the prior tax year if the taxpayer elects to report the casualty loss by amending the prior year’s income tax return. Rules relative to personal losses differ from rules for business losses. This fact sheet briefly discusses these rules.

Casualty Loss Defined

The Internal Revenue Code (IRC) defines a casualty loss as an event which is sudden, unexpected as a result of a disaster such as a fire (not willfully set), storm (e.g., hurricane or tornado), shipwreck, or other casualty, or from theft (IRC § 165).

Personal Casualty Loss

Personal casualty losses are those which are not business related such as a fire or damage from a hurricane to the taxpayer’s principle residence. Personal losses are subject to two adjustments. Each loss event is subject to a $100 floor and net losses for the tax year are deductible to the extent the casualty loss exceeds 10% of the taxpayer’s adjusted gross income (AGI). The taxpayer must make adjustments for any insurance reimbursement received as a result of the casualty.

Example: Bill suffered damage to his principle residence from Hurricane Matthew. The structural damage was estimated to be $75,000 to the roof, garage and windows. Bill’s insurance company issued him a claims check for $50,000 based on insurance coverage Bill purchased. Bill’s AGI for tax year was $50,000.

| Estimated Casualty: $75,000 |
| Less Insurance: -50,000 |
| Less $100 floor -100 |
| Less 10% AGI -5,000 |
| Deductible Casualty Loss $19,900 |

Bill would report this casualty loss on IRS Form 4684, Casualties and Thefts, Section A – Personal Use Property. Since this is a personal casualty loss, the $19,900 is reported on Schedule A, Itemized Deductions where it is added with other deductions such as mortgage interest, state income taxes and property taxes which Bill may take against AGI as part of the calculation to arrive at taxable income.
Business Casualty Loss

Business casualty losses are treated similarly to personal casualty losses except the $100 floor and 10% of AGI adjustments are not used. Further, cleanup costs, which are not part of the casualty loss, are able to be deducted as ordinary and necessary business expenses against business income. These cleanup expenses are reported on the business’s reporting tax forms: Schedule C, Profit or Loss from Business; Schedule F, Profit or Loss from Farming for sole proprietors; IRS Form 1065 for partnerships and LLCs taxed as a partnership; and IRS Form 1120 or 1120-S for corporations.

Businesses will use IRS Form 4684, Section B – Business and Income Producing Property, to calculate the business casualty loss. However, a business casualty loss is reported on an appropriate business form such as IRS Form 4797, Sale of Business Assets for a sole proprietor, for example.

Resources

IRS uses its web page, www.irs.gov, to provide timely information regarding any large natural disaster such as a hurricane and any postponements of tax due dates such as payroll tax deposits and tax filing deadlines (March, 1, March 15, April 15, September 15, and October 15). IRS will also use local and regional media to inform citizens of any changes in due date timing.

IRS Topic 515 Discusses Casualties, Disaster and Theft Losses

www.irs.gov/taxtopics/tc515.html

IRS Publication 547, Casualties, Disaster and Thefts, discusses both personal and business circumstances in more detail as they relate to casualty reporting for deduction purposes.


Rural Tax Education Fact Sheet: Involuntary Conversion of Business Assets, RTE / 2016-03 provides additional discussion should the casualty loss result in a gain when, for example, insurance proceeds exceed adjusted basis of business assets. This fact sheet can be accessed at www.ruraltax.org.

Taxpayers who suffer casualty losses following an unexpected event are strongly encouraged to seek competent income tax professional to see how the casualty loss rules apply to their specific circumstances.