



EXTENSION



Disaster and Casualty Losses: Related Tax Rules

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Introduction

- Casualty losses: sudden, unexpected, or unusual event (not gradual deterioration)
- Deductible losses: theft, vehicle or equipment accident, fire (not willfully set) , flood, tornado, earthquake, lightning, freeze, terrorist attack, vandalism, volcanic eruption, or government ordered demolition or relocation

Extent of Loss

- Compare the Fair Market Value (FMV) of the property immediately before and after the casualty
- Type of property has different rules
 - Business use property
 - Raised production
 - Purchased assets (depreciable vs non-depreciable)
 - Cost-share for replacing or repairing
 - Personal use property
- If insured, could result in a gain or a loss

Tax Rules

- Business Use Property (look at each item)
 - Remaining tax basis (cost less depreciation)
 - Insurance or disaster payment
 - Casualty gain, elect to replace asset to postpone
 - Casualty loss, current deduction
- Personal Use Property (look at each item)
 - Insured or not
 - Itemized deduction subject to limits
 - Reduce loss by \$100 for each event, and
 - Reduce above total by 10% of adj. gross income

Ex. 1: Machinery & Equipment

- Combine completely destroyed
- Adj. Tax Basis = \$99,234 (180,000 cost – 80,766 depr.)
- FMV before = \$110,000 & FMV after = zero
- Deductible loss is lesser of:
 - Adj. tax basis = \$99,234, or
 - Decline in FMV = \$110,000
- If insured for \$100,000, then a \$766 taxable gain
- Buying a replacement combine for at least \$100,000 results in none of the gain being taxable

Ex. 2: Machinery Shed

- Roof lost from tornado, the only item damaged
- Repair cost to restore shed = \$24,500
- Deductible loss is \$24,500 unless it was insured
- If insured and the reimbursement was \$20,000
 - Deductible loss is \$4,500 (24,500 – 20,000)
- If insured and the reimbursement was \$26,000
 - Taxable gain \$1,500 (26,000 - 24,500)

Ex. 3: Fences

- Fence destroyed by accidental fire
- Adj. Tax Basis = zero (fences were fully depreciated)
- FMV change does not matter, cost was already deducted.
- Deductible loss is zero
- If farmer gets a cost share payment to replace fence, report the cost share payment as income and deduct the cost of the fence using depreciation

Ex. 4: Breeding, Dairy, or Draft Animals

- Raised animals have zero tax basis
- Purchased animals may have a tax basis if not fully depreciated
- If gain occurs from a sale or indemnity payment, gain can be deferred by electing to replace animals
- A loss is deductible

Ex. 4: Breeding, Dairy, or Draft Animals (cont.)

- Replacement rules vary depending upon the casualty causing the sale or loss
- Diseased animals: condemnation reimbursement = 1 year replacement period with dollar for dollar & head for head
- Weather related sale: 4 year replacement and dollar for dollar (federal disaster area)
- Other loss with insurance or disaster payment: 1 year replacement period with dollar for dollar & head for head

Ex. 5: Livestock Purchased for Resale

- Tax treatment: cash vs. accrual taxpayer
- Cash basis: cost of animal deducted in the year that the animal is sold or casualty loss occurs
- Accrual basis:
 - Loss occurring in year of purchase; deduct the cost of animal
 - Loss occurring in year after purchase; year of purchase the cost is included in inventory and in year of loss, a deduction is not allowed

Ex. 6: Raised Animal for Sale

- Costs of raising the animal are deducted in the year that they are paid
- The animal will have a zero tax basis when lost to a casualty event
- NOTE: In both examples 5 and 6, the future income that is expected from the sale is not allowed as a deduction

Ex. 7: Raised Crops, Plants, and Produce for Sale

- Costs of raising the crop are deducted in the year that they are paid
- The production will have a zero tax basis when lost to a casualty event
- The future income that is expected from the sale is not allowed as a deduction
- If insured, the indemnity payment is included in income

Ex. 8 & 9: Stored Feed, Tools, and Supplies

- Cost of these items is deducted in the year paid
- The casualty will not result in a deductible loss
- The tax basis in these items is zero
- If insured, the indemnity payment is included in income

Loss of Personal Property

- Tax Cuts and Jobs Act of 2017 greatly impacted deductibility (1/1/18 to 12/31/25)
- Loss deductible only if the casualty occurs in a Federal Declared Disaster Area
- Loss is subject to itemized deduction limits
 - Reduce loss by \$100 for each event, and
 - Reduce above total by 10% of adj. gross income

Ex. 10: Loss of Home

- Look at the adj. tax basis and compare to change in fair market value
- Adj. Tax Basis = \$207,500 (200,000 cost + 7,500 improvement)
- FMV before = \$250,000 & FMV after = zero
- Deductible loss is lesser of:
 - Adj. tax basis = \$207,500, or
 - Decline in FMV = \$250,000
- Insured for \$185,000, then \$22,500 casualty loss before itemized deduction adjustment

Ex. 11: Damage to Personal Vehicle

- Paid \$35,000 for the vehicle
- Adj. Tax Basis = \$35,000 (not a depreciable asset)
- FMV before = \$12,000 & FMV after = \$1,000
- Insurance company paid \$12,000
- Expense to repair vehicle is \$9,000
- Potential gain is \$3,000 ($12,000 - 9,000$), but it is a personal use asset, so no taxable gain

Ex. 12: Loss of Home Contents

- Need to have the purchase price of items lost to the casualty
- Compare purchase price to decline in FMV
- Adjust the smaller of the above amounts by the insurance payment received
- This amount is then subject to the itemized deduction adjustment

Reconstructing Records

- IRS Pub 2194, Disaster Resource Guide: prescribed methods to reconstruct records
- Likely essential for tax purposes, getting federal assistance, or insurance purposes
- Historical information most likely lost but can be reconstructed for real property, vehicles, machinery, equipment, personal property, business records, etc.

Documenting Losses

- Photographs (before and after loss)
- Inventories (receipts for purchase less use)
- Tax Records (depreciation schedule)
- Federal Disaster Declaration reports

References

- RuralTax.org: “Disaster Losses and Related Tax Rules” (RTE 2021-06)
 - Examples for different property or assets
 - How to reconstruct your records
 - List of helpful IRS publications and resources
- Be sure to consult you tax advisor as quickly after the disaster or casualty as possible

Questions and Comments

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