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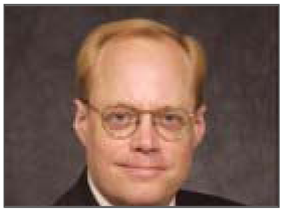

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Why Many Storm Losses Are Not Tax Deductible

Eric Lenz helps clean out a friend's trailer after it was destroyed by Superstorm Sandy on Nov. 1, 2012 in Highlands, New Jersey. (Image credit: Getty Images via @daylife)

The tax treatment of casualty losses involves damage control, not tax planning. The loss has occurred and you must deal with it. The only question is how much it costs, and that's where taxes come into play.

If you can deduct a loss the government picks up part of its cost. Usually, though, casualty loss deductions sound better than they are. First, let's look at definitions.

Surprisingly, the tax code and Treasury Regulations don't define a "casualty loss." The courts have addressed it case-by-case. It's clear that the event causing a loss must be identifiable, must damage property, and must be sudden, unexpected or unusual in nature.

Clearly, Sandy qualifies. Progressive deterioration such as termite infestation and dry rot do not. Measuring a decline in value can be especially tough, but sometimes the question is whether the loss is a casualty at all.

In *Chamales v. Commissioner*, a couple bought a $2.85 million home adjacent to where O.J. Simpson allegedly murdered Nicole Brown

Simpson and Ronald Goldman. Chamales claimed a casualty loss because the media, sightseers, and refuse reduced the value of their property. The Tax Court denied the deduction, finding that it was not a fire, storm or shipwreck, and that any damage was a mere temporary decline in market value.

But since Sandy clearly qualifies as a casualty, how do you measure and claim your loss? Your loss is reduced by any insurance payment you receive, so you can only claim amounts not reimbursed. Second, your deduction can't exceed your adjusted basis or the fair market value of the property, whichever is less.

Finally, only amounts exceeding 10% of your adjusted gross income plus $100 are deductible. You can lose up to 10% of your annual income by casualty and receive no deduction. Only amounts ***exceeding*** the 10% figure qualify.

Still, exactly what's a loss and what you can claim to exceed these high figures can be debated. In *Finkbohner v. United States*, the court upheld a casualty loss where a home was damaged by floodwaters. That clearly qualified, but ***measuring*** it was something else.

Most of the claimed loss was not from actual ***damage*** to the house, but rather from permanent damage to its marketability. The worry over floodplains lead to permanent buyer resistance in the area. Over the IRS' objections, the court agreed that this reduced value was real and could be measured.

Casualty loss tax deductions usually aren't worth as much as people think. Insurance recoveries and how they are taxed are another matter. If you are receiving insurance money, especially from business or investment property, get some sound tax advice.

Robert W. Wood practices law with Wood LLP, in San Francisco. The author of more than 30 books, including Taxation of Damage Awards & Settlement Payments (4th Ed. 2009 with 2012 Supplement, Tax Institute), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.