

Election to Claim Loss in Preceding Tax Year

This is a response to a tax alert regarding loss claims in the preceding tax year.

Dear Client:

The President recently declared parts of this area as a disaster area eligible for federal assistance. While I hope that you haven't been a victim, if you did suffer a loss as a result of the disaster, you may be able to recoup a portion of that loss through a tax deduction. Moreover, you can elect to claim the loss in either of two years: This year, the tax year in which the loss occurs, or in the immediately preceding year.

Choosing to take the deduction in the preceding year may increase the tax savings from the loss and may enable you to get a refund from IRS before you even file your tax return for the year the loss occurred. For example, a loss that occurs this year can be claimed on this year's return, which won't be filed until early next year. But if you elect to claim the loss last year (by claiming it either on your original return or an amended return), you can generally expect to receive the refund within a matter of weeks. This can help to pay some of your repair costs.

Losses that qualify – A loss only qualifies for this tax break if the declared disaster or emergency caused the loss. So keep copies of local newspaper articles or photos that will help prove that your loss was caused by the specific disaster.

The loss must have occurred in a federally declared disaster area. I know which areas these are. And I can determine if you have deductible disaster loss, and make the necessary computations to properly advise you as to the most advantageous course of action.

Which year to deduct – Determining the most beneficial year in which to claim the loss requires a careful evaluation of your entire tax picture for both years, including filing status, amount of income and other deductions, and the applicable tax rates.

The higher your marginal tax rate, the more valuable the deduction is. For example, a \$4,000 deduction saves \$1,120 for a taxpayer in the 28% tax bracket, but is worth \$1,320 to a taxpayer in the 33% bracket.

Ordinarily, casualty losses are deductible only to the extent they exceed 10% of your adjusted gross income (AGI). Where this rule applies, a larger amount of AGI will cut into your allowable loss deduction. The good news is that the 10%-of-AGI limit on personal casualty losses (but not the \$100 [\$500 for 2009] per-casualty floor) was waived for federally declared disasters in 2008 and 2009.

How to claim deduction – To claim the disaster loss on your return for last year, an election statement must be prepared and attached to the return. The statement, which I can draft for you, must include specific information about the time, place, and nature of the disaster that caused the loss.

Non-itemizers can't take disaster loss deduction – Individual taxpayers who don't itemize deductions can't deduct their disaster losses. Although non-itemizers were allowed an additional standard deduction for net losses from federally declared disasters occurring in 2008 or 2009, this isn't available for disasters occurring in 2010 or later years.

Casualty gains – Sometimes, a disaster may actually result in a gain for tax purposes. This may occur where the insurance proceeds you receive exceed your tax basis in the destroyed property. If that happens, there are several ways to exclude or postpone the tax on the gain. If you think you might be in a gain position, please let me know and I will go over these options.

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