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 is 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 your tax advisor as quickly after the disaster or casualty as possible
Questions and Comments

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