Death and Taxes — A monthly column on tax issues and estate planning

Marjorie Rawls Roberts, Esq., P.C.

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When Disaster Strikes

Tax Planning for Hurricanes

Hurricane season runs from June 1 to November 30 each year, and island residents and tourists alike hold their collective breaths until it passes. In recent years, all major hurricanes have missed the U.S. Virgin Islands, but long-term residents still measure their island lives as "before Hugo" and "after Hugo but before Marilyn" and "after Marilyn." Predictions are that this will be an active year for hurricanes, with the National Oceanic and Atmospheric Administration predicting 13 to 17 named storms, with seven to ten becoming hurricanes and three to five storms developing into major hurricanes.

That's the bad news. The good news is that when a hurricane strikes, taxpayers can deduct un-reimbursed losses resulting from property damage or destruction caused by the storm. For non-business property, the loss deduction is limited by applying a $100 floor to each personal casualty. Also, the total annual deduction for all personal casualty losses is limited to the amount that exceeds 10 percent of the taxpayer's adjusted gross income (by way of reference, line 37 of the 2006 Form 1040). Casualty losses are generally deductible in the year that the loss is sustained, but cannot be deducted while there is a reasonable prospect of being reimbursed by insurance or other means.

To calculate a non-business property loss, the deductible amount of the loss is the value of the destroyed portion or the adjusted basis of the property, whichever is less, reduced by any insurance or other compensation received. The value of the destroyed portion is the difference between the value of the property immediately before and immediately after the casualty. In "non tax talk" this means that if your home is worth $500,000 after the hurricane strikes and $1 million before, but your basis in the house (what you paid plus cost of improvements) is $400,000, and you get $300,000 in insurance proceeds, then you can deduct $100,000 (before the $100 floor and 10 percent limitation).

To calculate the value of the destroyed property (that is, the decline in the fair market value of the property), a taxpayer can use one of two methods. The taxpayer can compare the appraised value of the damaged property immediately before and immediately after the casualty, or use the cost of repairing the damaged property as long as the costs do not take care of more than the damaged suffered. (You can't get a tax credit for upgrades to your property).

Taxpayers don't like to think about hurricane damage in advance, but there are a number of steps that taxpayers can take to protect themselves in the event that a hurricane strikes. In order to ensure that they can take the maximum allowable casualty loss, taxpayers should keep good records to determine their basis and the value of their property before a storm hits. Moreover, these records should be kept in duplicate, with at least one copy outside the home in a hurricane-proof location. Taxpayers should also take comprehensive photos or videos of their property and keep them outside the home. (These tips also will help in supporting an insurance claim).

Taxpayers should be prepared to support a claim for a casualty loss deduction with evidence showing:

1. The loss occurred as a direct result of the casualty (pre-hurricane photos or videos are helpful here).
2. A description of the property.
3. The taxpayer's ownership of the property. (You can't take a deduction for property you rent).
4. The cost or other basis of the property including improvements (evidenced by purchase contract, checks, and receipts).
5. Fair market value of property before and after the casualty. (Regular appraisals can be beneficial here).
6. Salvage value.
7. The amount of any insurance or other compensation, including repairs provided by disaster relief agencies.

No one likes to contemplate the potential damage that a hurricane can cause. However, a little advance planning can definitely help in ensuring that taxpayers are able to benefit fully from the casualty loss deduction when filing their income tax returns.

Suggestions for future columns should be sent to AskJorie@TradewindsHouseandHome.com.

The information provided in this column is not legal advice and readers should consult with their professional advisors to determine how this information may apply to their specific circumstances.