California Wildfires – 2007 Income Tax Consequences

IRS Grants Tax Relief for Southern California Wildfire Victims (10/29/07)

- Presidential disaster areas declared: Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara and Ventura counties
- Affected taxpayers have the option of claiming disaster-related casualty losses on their federal income tax returns in either 2006 or 2007
- Affected taxpayers claiming the disaster loss on last year's return should put the disaster designation "California Wildfires" at the top of the form so that the IRS can expedite the processing of the refund

How do you Calculate your Disaster Loss?

- Determine your adjusted basis in the property before the disaster loss (generally the original purchase price plus improvements less depreciation deducted)
- Determine the decrease in fair market value of the property as a result of the disaster loss. Appraisals are highly recommended (before and after the disaster loss)
- From the smaller of the amounts determined in (1) and (2), subtract any insurance or other reimbursement you received or expect to receive.

Figuring the Disaster Loss Deduction: An Example

- Adjusted basis of property $500,000 (A)
- FMV before disaster loss $850,000

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- FMV after disaster loss $250,000
- Decrease in FMV $600,000 (B)
- Loss [smaller of (A) or (B)] $500,000
- Subtract insurance received $375,000
- Loss after reimbursement $125,000

Note: This $125,000 loss must be in excess of 10% of adjusted gross income to receive a tax benefit.

The Prior Example Showed a Loss of $125,000

- This loss may be deducted on the taxpayer's 2007 return (to be filed by 4/15/08).
- The loss may be deducted on the taxpayer's 2006 return (file an amended return for 2006). THIS MUST BE FILED BY APRIL 15, 2008.
- The taxpayer decides which year the deduction is more beneficial.

What if my Insurance Proceeds Have Not Been Received?

(When I need to file my 2007 income tax return)

- You should estimate the amount you expect to receive in insurance proceeds.
- If you later find the insurance reimbursement was different that what you expected, you adjust your return in the year received.

Is it Possible to Have a Gain when I've Lost my Home?

- Yes, if your insurance reimbursement exceeds the lower of your adjusted basis and decrease in FMV, you have a gain.
- HOWEVER, that gain is not currently taxable if you build a replacement property:

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Main home: replace within four years after the close of the first tax year in which your gain is realized

Other property: replace within two years after the close of the first tax year in which your gain is realized.

What Resources are Available for Additional Information?

- IRS Publication 2194 (Disaster Losses Kit for Individuals). This publication has good worksheets to help quantify your property losses. www.irs.gov
- IRS Publication 547 (Casualties, Disasters, and Thefts). www.irs.gov
- FTB Publication 1034 (Disaster Loss). www.ftb.ca.gov

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