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Tax Newsletter

FAQs About Casualty Loss Deductions
Maximize tax benefits for 2021

Under current tax law, individual taxpayers are not permitted to deduct casualty losses from catastrophic events like Hurricane Ida, wildfires and floods…right? Wrong. Although recent legislation has tightened the rules, you may still claim deductions, within certain limits, for losses incurred in a federally designated disaster area.

Following are the answers to some **frequently asked questions** (FAQs) about write-offs for personal casualty losses.

Q. What were the previous rules for casualty losses?

A. Prior to the Tax Cuts and Jobs Act (TCJA) of 2017, you could deduct losses to personal property that were caused by a "sudden, unexpected or unusual" event. Typically, this included damage or destruction from natural disasters, but also applied to, say, an automobile collision or water pipes bursting during a winter freeze.

Q. What were the key limits?

A. The amount of deductible loss, which was reduced by any insurance reimbursements you received, was further limited by these two rules.

- Only the excess above 10% of your adjusted gross income (AGI) was deductible.
- The amount of the loss had to be reduced by $100 for each event.

For instance, if your AGI was $100,000 and you incurred one $20,000 unreimbursed loss, your deduction was $9,900.

Q. How do you figure out the deductible amount?

A. It is equal to the lesser of (1) your adjusted basis of your property or (2) the decrease in fair market value of your property resulting from the casualty. For income-producing property (e.g., rental real estate) that is completely destroyed, the amount of the loss is limited to your adjusted basis in the property

Q. What are the current rules for casualty losses?

A. The TCJA generally suspends the casualty loss deduction for 2018 through 2025, but there is an exception for losses in a federally designated disaster area. In this case, you may still deduct casualty losses to personal property, subject to the prevailing limits.

Q. What are the limits for 2021?

A. In the years following the TCJA, Congress temporarily tweaked some of the rules. For instance, it eliminated the usual 10%-of-AGI limit, while increasing the reduction floor from $100 to $500 for certain disaster-area losses incurred in 2020. However, the usual limits generally apply for losses incurred in 2021, absent any further legislation.

Q. When do you claim the casualty loss deduction?

A. Generally, the loss is claimed on the tax return for the year in which the casualty occurred. However, a **special election** is available for losses in a federally designated disaster area: You can choose to deduct the loss on the tax return for the year *preceding* the actual event.

For example, if you suffer a loss during hurricane season in 2021, you do not have to wait until you file your 2021 return. Instead, you can obtain faster relief by filing an amended 2020 return or, if you have an automatic filing extension, by claiming the loss on the 2020 return due by October 15, 2021. Similarly, for a loss incurred early in 2022, you may claim the loss on the 2021 return due by April 15, 2022.

How to Bridge a Retirement Shortfall
Practical ideas for closing the gap

People are living longer these days than they did 20, ten or even five years ago. Of course, that is good news, but it also means that you may have to provide yourself with a bigger cushion in retirement than you had initially intended. What's more, there is uncertainty over future Social Security benefits as the rolls of retirees continue to swell. As a result, you could face a personal shortfall, especially if you incur unforeseen expenses from a medical condition or some other situation.

What should you do? The first thing is not to panic. Even if retirement is looming, you may be able to make up lost ground quickly or take other steps to protect yourself. Here are several practical ideas to consider.

- **Ramp up your retirement savings.** For example, if you participate in a 401(k) plan where you work, you can generally defer up to $19,500 to your account in 2021. This figure is increased to $26,000 for those who are age 50 or over. Just a few years of contributions at or near the maximum level can significantly bolster your account.

- **Work on the budget.** Now that you are aware of a longer life expectancy, you might want to dial down your expectations. Make realistic estimates about the income you expect to be coming in and the expenses going out. Although you will likely be paying less for housing and other items like life insurance—especially if your children are already adults—consider the impact of potential increases in some expenses like travel expenditures.

- **Move to a smaller home.** For most people, housing is the largest overall cost, representing on average more than one-third of overall spending. If your kids have flown the coop but you are still living in the large home where you raised them, it may be time to downsize. In addition, you might want to move to a state with a different climate, taking state income taxes into account. Of course, various other factors—such as proximity to family and personal preferences—will come into play.

- **Refinance your current home**. If you decide to stay put, you should probably refinance an existing mortgage if you are paying a rate higher than the current rates. Thus far in 2021, mortgage rates have hovered near historic lows. Even if rates rise slightly, as expected, you may save tens of thousands of dollars over time by refinancing. Note that your interest payments will generally continue to be tax-deductible.

- **Do not quit for good.** Just because you have reached retirement age does not mean you have to stop working completely. If needed, you could pursue part-time employment, preferably in a line of work you enjoy. For some individuals, working full-time a little longer is also a viable option.

Everyone's situation is different. Therefore, maybe none of these ideas or only some of them are right for you. The most important thing to do is to assess your financial status and go from there.

Fast Tax Write-Offs for Building Parts
Conducting a cost segregation study

Generally, it takes a long time—39 years to be exact—to fully recover the cost of a business building through regular depreciation deductions. However, your business may benefit from faster write-offs if it conducts a "cost segregation study." In effect, the study breaks out certain building components so the costs can be deducted over a shorter period of time.

Furthermore, the favorable tax treatment available through a cost segregation study has been enhanced by recent tax legislation. Under the Tax Cuts and Jobs Act (TCJA) and the Coronavirus Aid, Relief, and Economy Security (CARES) Act, you may recover the cost of certain components even faster than before.

Background: Normally, the cost of a building is recovered through depreciation deductions over the lengthy time period of 39 years, as required by the Modified Accelerated Cost Recovery System (MACRS). Conversely, personal property may be written off over shorter time periods based on a "useful life" of, say, five or seven years. Regulations define "personal property" as tangible depreciable property (other than buildings and their structural components) that is used in industries such as transportation and communications and certain other specialized types of property.

A cost segregation study identifies those components that are eligible for faster write-offs. It then reclassifies those assets as personal property assets, thereby shortening the total depreciation time.

Note: The IRS may challenge these deductions and has frequently done so in the past. In several recent cases, the courts have ruled that parts of a commercial building may be treated like personal property only if they relate to the equipment used in a business located in the building. This may include components such as HVAC systems, plumbing systems in restaurant kitchens and removable carpeting.

Typically, the cost segregation study will rely on engineering reports, mechanical and electrical plans and architectural drawings in compliance with IRS guidelines. Because the write-off periods for components often depend on the use of the building, taxpayers are generally advised to enlist the services of a qualified professional who is experienced in the particular industry in question. When it is handled properly, the cost segregation study should be able to meet IRS standards.

Tax enhancements: Under the TCJA, 50% first-year bonus depreciation is doubled to 100% for qualified property placed in service after September 27, 2017 and before January 1, 2023. Beginning in 2023, bonus depreciation will be gradually phased out until it is disappears completely after 2026. This will provide even faster tax write-offs for business building owners.

In addition, the CARES Act fixes a glitch in the TCJA relating to "qualified improvement property" (QIP). QIP includes qualified leasehold improvements, qualified retail improvements and qualified restaurant property. The CARES Act approves a 15-year cost recovery period for QIP as was originally intended by lawmakers.

Caution: This is not a do-it-yourself proposition. Have a professional provide guidance every step of the way.

When One IRA Rollover Is Enough

Generally, you can roll over funds between IRAs without owing any current tax, if the rollover is competed within 60 days of receipt. You might decide to do this for investment reasons.

Caveat: You are only allowed one such rollover a year. Under the Tax Court's interpretation in a recent case, this rule applies to all your IRAs, not just one specific separate IRA.

However, the once-a-year limit does not apply to trustee-to-trustee transfers made between IRAs. Consult with your tax advisor for more details.

Facts and Figures
Timely points of particular interest

New Vehicle Limits—The IRS has announced the depreciation limits for vehicles placed in service in 2021. For instance, the maximum first-year deduction for a passenger car, including "bonus depreciation," is $18,200 (up from $18,100 for cars placed in service in 2020). Deductions are then based on the percentage attributable to business use. Note: Comparable rules apply to deductions for leased vehicles used for business driving.

Higher Power—In a groundbreaking step, the IRS has launched a new feature that can allow taxpayers to digitally authorize their tax practitioners to represent them before the IRS with a power of attorney. Similarly, taxpayers may allow representatives to access their tax accounts. Once an authorization request is submitted by a tax professional, it will appear in the taxpayer's online account for review, approval or rejection and electronic signature.