Tax Implications of Hurricane Damage to Your Boat

by **Scott H. Novak**

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The IRS announced that casualty losses for victims of Hurricane Sandy can be taken on this year's return (2012) or last year's return (2011). You can file an amended return for 2011 to account for the loss. You must live in one of the counties designated a disaster area by FEMA. See IR-2012-83, Nov. 2, 2012.

We are a boating community and we are heartbroken about our local marinas and the boaters whose boats have been lost or severely damaged because of Hurricane Sandy. Where your boat was, on what angle to the wind and how high your jack stands were played a large role in how you faired in the storm. There is a tremendous amount of loss out there. Is there anything that you can do with the portion of the loss not covered by insurance? This article will address the tax deductibility of those losses on your federal income tax return. The rules are a bit complicated, but the income tax form, Form 4684, is relatively painless to work with.

These rules apply to pleasure boats only. The rules are different if your boat was used as a trade or business. The first item to note is that the loss is taken under Miscellaneous Itemized Deductions on your Schedule A. Why does that matter? Because all of the items in this section must exceed 2% of the adjusted gross income (AGI) on your tax return to be deductible. So this is the year to include your tax preparation fees, safe deposit box fee, union dues and any other item that can be deducted on this part of the form.

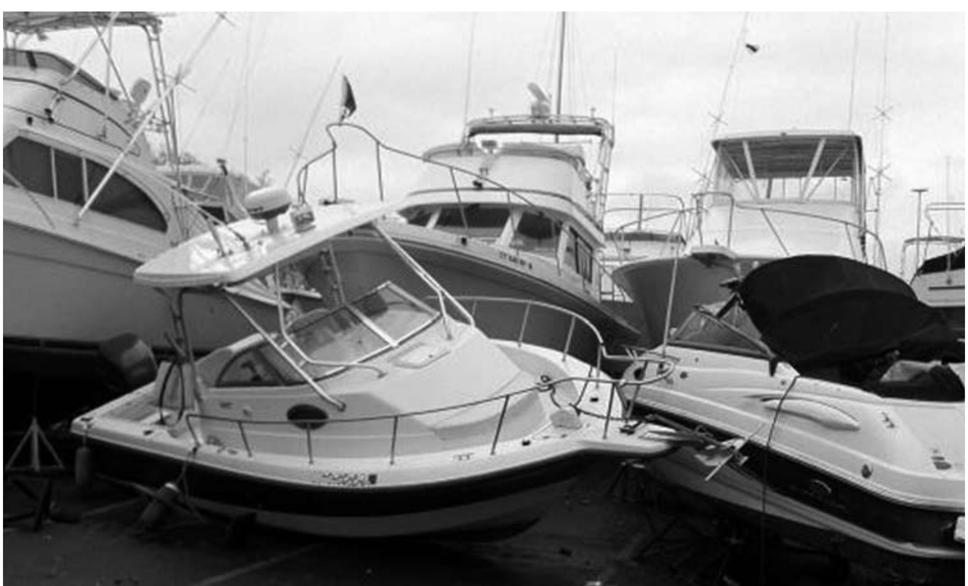
The next rule is that you have to reduce the loss by $100. If your loss is $1,000, you must start with a $900 loss. All of the losses from a single event are added together for the $100 rule. So, if your boat was a total loss, including the equipment and the dinghy, all of those items are added together and the $100 reduction is taken once.

Here's the difficult rule. You must reduce the total of all your casualty or theft losses on personal-use property by 10% of your AGI. Apply this rule after you reduce each loss by $100. If your AGI is $100,000, you can only deduct a loss to the extent that it exceeds $10,000.

Let's apply these rules to see how they work.

Sandy destroyed your boat, which cost $18,500. This was your only casualty or theft loss for the year. Its fair market value (FMV) immediately before the storm was $17,000. You had no insurance, but were able to salvage the

You figure your casualty loss deduction as follows:
1. Adjusted basis (cost in this example) $18,500
2. FMV before storm $17,000
3. FMV after storm $200
4. Decrease in FMV (line 2 – line 3) $16,800
5. Loss (smaller of line 1 or line 4) $16,800
6. Subtract insurance -0-
7. Loss after reimbursement $16,800
8. Subtract $100
9. Loss after $100 rule $16,700
10. Subtract 10% of $70,000 AGI $7,000
11. Casualty loss deduction $ 9,700



engine and sell it for $200. Your AGI for 2012 is $70,000.

"There are instances when someone could have a casualty gain. For example, maybe you bought a damaged boat after the last big storm for $1,000 and spent $5,000 restoring it. It is now worth $25,000 and that is what you have it insured for, with a $500 deductible. If it is destroyed, the insurance company would pay you $24,500. Your "basis" is $6,000. Gain calculation: $24,500 - $6,000 = $18,500. You would have a gain of $18,500 on your income tax return. This gain is reportable as a capital gain on your Schedule D. Fortunately, the 2012 rates are still very low.

However, if you replace the boat with another that costs $24,500, no gain is reportable on your income tax return.

Here is the calculation: cost of the new boat - insurance gain = "basis" in new boat. $24,500 - $18,500 = $6,000. If the new boat is destroyed, the calculation will be: insurance proceeds - $6,000 = gain."

These rules are complicated. This is not tax advice. Make sure your tax preparer has all the information necessary.

If you have a major tax problem, get it solved now. The law office of Scott H. Novak works closely with the IRS, New York and New Jersey on tax settlements for many types of matters. Don't let another year pass with the problem. Put it behind you and sleep better in 2013.