Cal CPA

Comprehensive Guide
to Casualty Losses

2025 Los Angeles County Wildfire

Overview

In January 2025, Los Angeles County suffered catastrophic wildfires, resulting in the loss of thousands of homes and businesses, significant environmental damage, and a federal disaster declaration. While the impact has been devastating, individuals and businesses affected by this disaster may be eligible for substantial tax relief and other financial assistance.

This guide summarizes the principal rules governing casualty losses, tax deferral opportunities, and related relief provisions.

What is a casualty loss?

A casualty loss is damage, destruction, or loss of property from a sudden, unexpected, or unusual event—such as a wildfire. To qualify for a tax deduction:

- The event must be identifiable and sudden (not gradual deterioration).
- The loss must generally occur in a federally declared disaster area (which applies here). New Law Change: The OBBBA extends deductible personal casualty losses to include state declared disasters for taxable years beginning after December 31, 2025.
- You must have a financial loss that is not fully reimbursed by insurance or other recovery.
- Losses must reflect physical damage—not general neighborhood value declines.

Examples of qualifying losses include:

- Destruction of your home or personal belongings.
- Loss of business equipment or inventory.
- Damage to landscaping or vehicles.

Tax filing and payment relief

The IRS and California Franchise Tax Board have extended certain deadlines:

Filing and payment deadlines:

Extended to October 15, 2025, for returns, tax payments, and contributions to IRAs and HSAs that were otherwise due between January 7 and October 15, 2025.

Penalty relief:

- Late payroll and excise tax deposit penalties due between January 7 and January 22, 2025, will be waived if deposits were made by January 22, 2025.

Who qualifies:

- Taxpayers residing in Los Angeles County (even if their property was not directly damaged).
- Taxpayers outside the area whose records are located inside the disaster area (must contact the IRS Disaster Hotline at 866-562-5227). This can include taxpayers using L.A. County based CPAs or bookkeepers.

Special provisions for Like-Kind Exchanges (1031) and Opportunity Zone (OZ) Funding:

- The standard 45-day identification and 180-day exchange closing deadlines are postponed under Revenue Procedure 2018-58.
- Since the original due date for filing is extended until October 15th, this extends the OZ funding date for taxpayer who had calendar year 2024 K-1 capital gains until 180 days after October 15th rather than the typical September 10th deadline.

Calculating casualty losses

Individuals—Personal-Use Property

Your deductible casualty loss is calculated as follows:

1. Determine the lesser of:
   - The property's adjusted basis (usually cost + improvements – depreciation), or
   - The decrease in fair market value (FMV) as a result of the disaster.
2. Subtract insurance or other reimbursements.
3. Subtract:
   - A $100 per-event reduction ($500 for personal-use property losses from certain federally declared disasters occurring between January 1, 2020 and July 4, 2025. CA does not conform to this change), and
   - 10% of your Adjusted Gross Income (AGI) (This threshold does not apply to business losses or to personal-use property losses from certain federally declared disasters occurring between January 1, 2020 and July 4, 2025. CA has not yet conformed to the federal change, but a legislative proposal may also eliminate the 10% AGI threshold for CA purposes.)

Example (federally declared disaster occurring between January 1, 2020 and July 4, 2025)

- Adjusted basis: $300,000
- FMV before fire: $900,000
- FMV after fire: $100,000
- Insurance recovery: $200,000
- AGI: $250,000

Calculating casualty losses (cont.)

Calculation:

1. Lesser of $300,000 or $800,000 FMV decline = $300,000
2. Subtract insurance: $300,000 – $200,000 = $100,000
3. Less $500 reduction: Deductible loss = $99,500

Businesses and Income-Producing Property

Key differences:

- No federal 10% AGI floor or $100 ($500) per-event reduction.
- If property is totally destroyed and the FMV before the casualty is less than adjusted basis, the loss equals adjusted basis minus salvage value.
- Business property losses are reported separately for each identifiable asset.

When to claim the loss

You have flexibility in the timing of your deduction:

- **Default:** Claim in the year the loss occurred (2025).
- **Election:** Claim on your 2024 return, allowing you to obtain a faster refund.

Note: You must file this election by the due date (including extensions) of your 2024 or 2025 return. Note that a taxpayer may change this election in the future. See Treas. Reg. Section 1.165-11(g) and Rev. Proc. 2016-53.

Treatment of insurance proceeds and casualty gains

If insurance or other reimbursements exceed your adjusted basis, you have a casualty gain, which is generally taxable. However, you have options to defer or exclude this gain:

Section 121—Principal Residence Exclusion

- Up to $250,000 (single) or $500,000 (married filing jointly) of gain can be excluded if ownership and use tests are met.
- Even if you did not meet the two-year ownership and use requirement, you may qualify for a prorated exclusion due to unforeseen circumstances.

Section 1033—Involuntary Conversion Deferral

- Gain can be deferred if you reinvest the insurance proceeds in similar property:
  - Two years (generally).
  - Three years (if business/investment property is condemned, requisitioned, seized, or sold under threat/imminence thereof).
  - Four years (principal residence or its contents).
  - Replacement periods generally begin on the last day of the tax year in which the taxpayer incurs a casualty gain – so the replacement periods are actually 11 months longer than reflected above in the case of CA wildfire victims.

You must notify the IRS of your replacement or intention not to replace property.

If only part of proceeds is reinvested, partial gain recognition applies.

Example of Section 1033 Deferral

- Insurance proceeds: $1,000,000
- Adjusted basis: $350,000
- Realized gain: $650,000

Treatment of insurance proceeds and casualty gains (cont.)

If you buy a new residence for $400,000 within four years, $400,000 of proceeds are reinvested:

- Gain recognized: $650,000 – $400,000 = $250,000
- This remaining gain may be eligible for the Section 121 exclusion.

Section 1033 can also apply to the subsequent sale of land

- In Revenue Ruling 96-32 the IRS confirmed that when a principal residence is involuntarily converted, for §1033 purposes, there is no need to apportion basis between the dwelling and the land. The taxpayer may apply the aggregate basis of the residence (land and improvements) against both the insurance proceeds and the later land sale to compute deferred gain under §1033.
- In PLR-111360-07 the IRS concluded that the subsequent sale of an entire apartment complex, including land and remaining improvements, qualified for deferral under section 1033 because it was not economically feasible for the taxpayer to restore the property to its intended business use. Masser V. Commissioner was relied upon in multiple instances to determine if and when business properties consisted of a single economic unit for purposes of deferring a subsequent gain from a sale under section 1033.

Scheduled vs Unscheduled Assets

- Scheduled assets are items that are specifically listed in your insurance policy, such as jewelry or artwork, often with a stated value or detailed description. Unscheduled assets, on the other hand, are general household contents (like furniture, clothing, and appliances) that are not individually listed but are covered under the blanket personal property coverage of your policy.
- No gain will be recognized on insurance proceeds received for personal property that was part of your principal residence if the property was not scheduled property.
- If you receive insurance proceeds for scheduled property and the proceeds exceed your basis, you may need to reinvest the proceeds in similar property to avoid recognizing gain.

State of California rules

California generally conforms to federal casualty loss rules, with key differences:

- Loss must be tied to a federally or state-declared disaster.
- You may claim on your 2025 return or by amending your 2024 return using Schedule X.
- Documentation must include:
  - FEMA disaster declaration name
  - Proof of property loss and basis
  - Insurance and reimbursement records

California Net Operating Loss (NOL):

- Unused losses can generate an NOL carryforward for up to 20 years.
- Disaster loss carryovers are not affected by the NOL suspension rules.
  - Net Operating Loss

California and Los Angeles County Property Tax Relief:

- Temporary Reduction in Assess Value
  - If your property suffered at least $10,000 in damage, you may apply for a temporary reduction in assessed value, which lowers your property taxes until repairs are completed.
  - Some taxes may be refunded if already paid.
- If your property was substantially damaged or destroyed, you may transfer its base year value to a comparable replacement property within the same county (Proposition 50), to another county (Proposition 171), or under Proposition 19, which allows wildfire victims to transfer the taxable value of their original primary residence to a replacement within two years.
- To learn more or apply: LA County Disaster Relief

Sales and Use Tax Relief:

- The CDTFA extended filing deadlines and penalty waivers for affected businesses.

Special rules for retirement distributions

Individuals impacted by a federally declared disaster may:

- Withdraw up to $22,000 from retirement accounts without the 10% early withdrawal penalty.
- Spread the income over three years or repay within three years to avoid taxation.

Other nontaxable relief

The following are not taxable income if received for disaster-related expenses:

- Qualified disaster relief payments from employers, nonprofits, or government agencies (IRC §139).
- Certain wildfire relief payments under the Federal Disaster Tax Relief Act.
- Qualified excess living expense reimbursements from insurers (to the extent they exceed pre-disaster costs).
- Crowdfunding donations (generally treated as gifts).

Documentation requirements

Proper documentation is essential. Collect and maintain:

- Photographs and videos of damage before cleanup.
- Appraisals showing FMV before and after the casualty.
- Insurance claims and correspondence.
- Receipts for repairs, cleanup, temporary housing, and meals.
- Records of any FEMA or SBA relief.

Common pitfalls:

- Discarding damaged property before photographing.
- Failing to file insurance claims in a timely manner.
- Underestimating insurance reimbursements (which can create unplanned taxable income).

Forms and elections

Federal:

- Form 4684—Casualties and Thefts
- Schedule A (Form 1040) – Itemized Deductions
- Form 4797—Business property gain/loss
- Form 8949 / Schedule D – Capital gains

California:

- Form 4684 (California conforms to the federal form)
- Schedule CA (Form 540)—Adjustments to federal income
- FTB 3805V—Net Operating Loss and Disaster Loss computation

Next steps and recommendations

1. Assess Your Situation:

- Confirm insurance coverage and potential reimbursements.
- Estimate the potential deductible loss.

2. Decide When to Claim:

- Evaluate whether claiming the loss in 2024 or 2025 will provide the greatest tax benefit. A separate election can be made for federal and California purposes.

3. Consider Gain Deferral or Exclusion:

- If insurance proceeds exceed basis, assess eligibility for Section 121 or 1033 relief.

4. Document Everything:

- Retain all supporting records.

5. Consult a Qualified Tax Professional:

- Given the complexity of these rules, professional guidance is strongly recommended.

Frequently asked questions

Q: *Can I deduct the loss of landscaping or trees?*

A: Yes, if the loss was sudden and not fully reimbursed. The deduction is generally based on the decrease in property value attributable to the landscaping, which often requires a qualified appraisal.

Q: *What if I received more insurance than my property's basis?*

A: The excess is a casualty gain. It's generally taxable unless you reinvest it and qualify for deferral under §1033.

Q: *What if I have both a casualty gain and a loss?*

A: Gains and losses must be netted. If losses exceed gains, apply standard personal loss limitations. If gains exceed losses, the net gain is taxable.

Q: *If I claim the loss on my 2024 tax return, do I still have to report insurance proceeds received later?*

A: Yes, if you claim a loss in 2024 and later receive additional reimbursements, you must include those amounts in your income in the year they are received (to the extent they exceed the remaining basis). This is sometimes called a "tax benefit rule" adjustment.

Additional resources

- IRS Publication 547, Casualties, Disasters, and Thefts
- FTB Publication 1034, Disaster Loss – How to Claim a State Tax Deduction
- IRS Disaster Assistance
- FTB Disaster Relief
- FEMA Assistance
- IRS Disaster Hotline: (866) 562-5227

This guide is for informational purposes only and should not be relied upon as legal or tax advice. Each taxpayer's circumstances are unique. We strongly recommend consulting a tax professional to ensure proper treatment and compliance.

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