GROWERTALKS

Features

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Diving Into Loss Deductions

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Losses suffered by those in the greenhouse business come in many shapes and forms. There are those losses that result from natural disasters, losses caused by dishonest employees and/or customers, financial losses from bad business decisions, or those resulting from a poor economy. Although insurance may help defray some of the costs associated with restoring and replacing damaged property, several of the IRS's regulations provide added relief.

As the threat of severe winter storms replaces last summer's natural disasters and the West Coast's fires, many growers are discovering that the legislation passed in December 2017, the Tax Cuts and Jobs Act (TCJA), eliminated, with a few exceptions, the casualty loss tax deduction as an itemized deduction on personal income tax returns. Fortunately, the tax deduction for business-related losses continues to provide some relief.

That's right, the deduction for an individual's personal casualty losses not connected with: 1) a trade or business; or 2) a transaction entered into for profit has been eliminated. While losses to business property remain tax deductible, between now and 2025, a personal casualty loss may only be claimed to the extent of personal casualty gains or where the property loss was attributable to a "qualified disaster loss," i.e., a "federally declared disaster."

Business casualty & theft loss deductions

Casualty losses are caused by fire, floods, earthquakes, hurricanes, tornadoes, terrorism or some other sudden unexpected or unusual event. Losses from natural disasters are often treated separately from robbery, cyber fraud, embezzlement or theft losses.

In order to qualify as a tax-deductible casualty loss, the damage or complete destruction of property must be due to an event that is either:

- Sudden or fast moving
- Unexpected and not caused intentionally
- Unusual

In fact, for any loss to be allowed as deductible, it must be evidenced by a closed and completed transaction and fixed by an identifiable event. Tax-deductible also means there must be some external force involved in order for a loss to be a casualty loss.

No-no for crops

Losses of plants, produce and crops raised for sale are generally not deductible by a business reporting income on a cash basis. If the cost of raising these items has already been deducted as expenses, their basis or book value is equal to zero.

For plants with a pre-productive period of more than two years, a tax deduction is possible if there's a basis in the plants. A tax basis exists if the expenses associated with these plants have already been capitalized under the uniform capitalization rules.

If income is reported on an accrual basis, casualty or theft losses are deductible only if the items were included in inventory at the beginning of the tax year. The deduction is taken by omitting the item from inventory at the close of the tax year since there's no separate casualty or theft loss deduction.

Lost income

A loss of future income isn't tax deductible. However, if a storm or other casualty destroyed a standing crop and the insurance proceeds are used to acquire another standing crop, the purchase will qualify as replacement property. Of course, the costs of planting and raising a new crop qualify as replacement costs for the destroyed crop for those using the cash method of accounting. Here, the costs of bringing the new crop to the same level of maturity as the destroyed crop will qualify as replacement costs, at least to the extent incurred during the replacement period.

Naturally, a casualty loss deduction can be claimed, or claimed only to the extent that the loss isn't covered by insurance or otherwise reimbursed. If the loss is fully covered, no tax deduction is available. The IRS measures the amount of damage to property using a very conservative yardstick. A grower or retailer must use the lesser of:

• The property's adjusted tax basis immediately before the loss; or

• The property's decline in fair market value as a result of the casualty.

Theft losses

Although lost profits aren't tax deductible, Uncle Sam—in the form of our tax rules—stands ready to help every commercial growing business cope with theft and fraud losses. Under our tax rules, theft is defined as the taking and removing of money or property with the intent to deprive the owner of its use.

Unlike casualty losses, theft losses are generally deductible in the year that property was discovered stolen unless there's a reasonable prospect of recovery. Naturally, no deduction is available until the tax year in which it can be determined with reasonable certainty whether or not reimbursement will be received.

Disaster business losses

While casualty losses must usually be deducted in the year in which the loss event occurred, to help cushion losses suffered by growers, retailers and others, the tax laws allow deductions for disaster losses in an area subsequently determined by the President of the United States to warrant federal assistance. For those, the business or individual has the option of:

• Deducting the loss on the tax return for the year in which the loss occurred; or

• Choosing to deduct the loss on the tax return for the preceding tax year.

In other words, the growing business or individual taxpayer has the option of deciding whether the loss would be most beneficial if used to offset the current year's tax bill or better used to reduce the tax bill for the previous year—generating a refund of previously paid taxes.

In order to accomplish this, an amended tax return for the preceding year can be filed, figuring the loss and the change in taxes exactly as if the loss actually occurred in that preceding year.

The proof is in the records

The success or failure of a casualty loss standing up under the scrutiny of the IRS is usually determined by the quality and reliability of your records. Many a deduction has been denied where there was a reasonable prospect of recovery.

Although the rules allow three years from the time an original return is filed until an amended return containing the claimed loss must be filed, bottom-line, the tax rules for casualty losses require proof, including:

• That the taxpayer owned the property

• The amount of the basis or book value of the property

• The pre-disaster value of the asset

• The reduction in value caused by the disaster

• The lack or insufficiency of reimbursement to cover the costs

If records are missing, new IRS guidelines for reconstructing important records can help. For example, past bank or credit card statements, along with suppliers' invoices, are invaluable for determining what was paid for many assets. The Kelley Blue Book or Edmunds can be used to help determine the current fair market value of lost or damaged business vehicles.

Unfortunately, while the tax laws allow you to deduct many types of losses, when those losses combined with your operation's other deductions exceed its income and a so-called "net operating" loss (NOL) results, special rules come into play. The TCJA generally limits the amount of NOLs that can be utilized to only 80% of taxable income without the NOL. Even worse, the NOL carryback that formerly produced a refund of taxes paid in earlier years, is no longer. NOLs can now only be carried forward.

More options

A grower-retailer incurring a casualty loss of business property often prefers to claim the loss as an ordinary and necessary business expense under the tax law's Section 162(a), Trade or Business Expenses. If property used in a trade or business suffers a casualty, you may claim the cost of repairs and maintenance as ordinary and necessary expenses. Naturally, if the expenditures result in an improvement or betterment of the property, the expenditure should be capitalized.

If the casualty is claimed under the tax law's Section 165, Losses, you won't be able to claim amounts for loss reimbursement claims from insurance companies or claims against individuals or entities who may be responsible for the loss. To the extent there's a reasonable prospect of recovery, no portion of the loss where reimbursement is on the horizon may be claimed until it can be ascertained with reasonable certainty whether or not such reimbursement will be received.

Complexity and goodwill

Obviously, the tax laws governing business casualty losses are extremely complex. One such complexity involves the fair market value of many businesses, which often includes a significant amount representing goodwill. A loss could be based on the permanent impairment of goodwill resulting from the casualty.

The rules have changed, but casualty losses suffered as a result of storms, fire, flooding—or the more common theft, burglary, embezzlement or cyber fraud—continue to be complex and often confusing. To achieve a full recovery, and to avoid running afoul of the ever-vigilant IRS, professional assistance is strongly recommended. **GT**

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