

Independently Owned & Operated by

TaxRUS Corp

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Dear Tax Client:

Hurricane Charley sure made a mess of our beautiful Southwest Florida. As your tax preparation service we are here to assist those of you who need help with this disaster when it comes to your tax return.

You may qualify for a "casualty loss" and be entitled to file either an amended tax return for 2003 or claim the loss on this year's return that we will hopefully prepare for you in early 2005.

The enclosed newsletter is an excellent way for you to start understanding the tax law associated with this type of loss and allow you to start the necessary paperwork documenting your losses.

You **MUST** establish your "value" in the items lost or destroyed. We have software that may help. Please make a detailed list and we can help you to make a valuation on your loss. Good luck.

Call us for our new convenient location to assist you with your casualty loss before tax season begins or remember that we will back inside the Super Wal-Mart on Del Prado starting in early January.

Insurance Proceeds in a Disaster Area

A taxpayer whose principal residence (or its contents) is damaged in a disaster can qualify for special tax treatment regarding certain insurance proceeds received as a result of the casualty. To qualify, the locale of the residence must be in a Presidential-declared disaster area. The rules stipulate that no gain is recognized on the receipt of insurance proceeds for personal property that was part of the residence contents, if such property was not scheduled under the insurance policy (scheduled property are items such as jewelry covered by a rider under the insurance policy).

Other insurance proceeds received for the residence or its contents may be treated as a common pool of funds. If those funds are used to purchase property similar to the property lost, a taxpayer will need to recognize the gain only to the extent that the pool is more than the cost of the replacement property. The replacement period for the damaged or lost property in a disaster area is four years after the close of the first taxable year in which any part of the gain on the involuntary conversion is realized.

These rules are extended to renters as well. Renters who receive insurance proceeds related to disaster damage to their property in a rented principal residence also qualify for the disaster loss relief.

Determining the Loss

Frequently, taxpayers will rely on the cost of repairs, rather than a competent appraisal, to measure the amount of a casualty loss. This requires the repairs to actually be made in order to measure the loss, because a taxpayer can't use the estimated cost of repairs when no repairs are made. Therefore, if a taxpayer does not intend to make the repairs or plans on doing some or all of the repairs himself, the taxpayer should get a competent appraisal of the property showing the decline in the value of the property as a result of the casualty.

However, where a taxpayer employs a competent appraiser to determine the property's decrease in fair market value resulting from the casualty, the appraiser is allowed to base his estimate on the estimated costs of repairing the damaged property, even though the repairs to the property are not made.

Reimbursement for Living Expenses

An exclusion from gross income is allowed for insurance proceeds received for the temporary increase in living expenses due to a casualty loss of a principal home. The exclusion amount is limited to the increased "actual" reasonable and necessary living expenses as compared to the "normal" living expenses that would be incurred by the taxpayer to maintain his/her customary living standard during the loss period. Living expenses include temporary housing, utilities, meals, transportation and miscellaneous items like laundry, etc. For this purpose, mortgage interest is not considered a living expense.

Disaster Losses Offer Special Options

Disaster losses are casualty losses that occur in a geographical area declared a disaster region designated by the President of the United States. Normally, casualty losses must be taken in the year in which they occur. However, if the casualty occurs in a designated disaster region, such as the Tropical Storm Bonnie and Hurricane Charley disaster area, the losses can be taken on the return of either:

- The year of the loss, or
- The year prior to the loss.

Example: A taxpayer in the Bonnie/Charley disaster area can claim their casualty loss either on their 2004 return or on their 2003 return. If the 2003 return has already been filed, as most have, it can be amended by filing a Form 1040X by April 15, 2005.



When to take the loss depends upon a number of factors and should be carefully analyzed to determine which year is the most beneficial for the taxpayer. Some of the factors to consider include;

- The tax brackets for each year - From purely a tax standpoint, each year should be carefully examined as to which will provide the greatest overall tax benefit without wasting other tax benefits.

- The need for immediate cash - The primary purpose of the special rates allowing the casualty loss to be claimed on the prior year's return is to provide taxpayer access to a tax refund without the need to wait - often many months - to file their return for the year of the loss. For example, taxpayers in the designated 25 Florida counties can amend their 2003 returns right away and expect refunds in just a few weeks, as opposed to waiting until 2005 when they can file their 2004 returns.

- Self-Employment Tax - Self-employed taxpayers will also need to consider whether to take a business casualty loss that affects inventory in the current or prior year, since the loss can offset self-employment tax as well as income taxes.

* Whether the loss will be used up - If the casualty loss is not fully used up in the year it is first deducted, it can create what is called a net operating loss (NOL). An NOL can be taken back to prior years or carried forward to future years and used as a deduction on the carryback or carryforward returns. If this turns out to be the case, care should be taken to analyze the benefit from the potential loss carryback versus carrying the loss forward.

Generally, a taxpayer may carry their net operating loss back 2 years and forward 20 years until it is used up. NOLs resulting from casualties may, by election, be carried back 3 years.

Home Destroyed is Still Treated as a Home

A taxpayer may be able to continue treating their home as a qualified home even after it is destroyed in a fire, storm, tornado, earthquake, or other casualty. This means the taxpayer can continue to deduct the mortgage interest subject to the normal limits for home mortgage interest. To continue treating a destroyed home as a qualified home, the taxpayer must do one of the following within a reasonable period of time after the home is destroyed: **1)** Rebuild the destroyed home and move into it, or **2)** Sell the land on which the home was located.

This rule applies whether the home is the main home or a second home that the taxpayer treats as a qualified home. Also, it applies whether or not the home is in a Federal disaster area.

It is possible to incur a gain from a casualty event. Assume an individual purchased a home for \$50,000 some years back and the home was destroyed by the hurricane. The insurance company decides the home is a total loss and pays the single homeowner \$200,000 for the loss. The taxpayer is left with the \$200,000 settlement and a lot worth \$40,000. The taxpayer may use his \$250,000 home gain exclusion to offset the gain from the casualty.