

# Tornado Legal Guidance



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In light of the recent tornados that destroyed so much of Alabama, we are providing this newsletter to our clients. The newsletter covers—

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## Special Tax Rules for Federally Declared Disaster Areas

The President has declared the following counties federal disaster areas: **Autauga, Bibb, Blount, Calhoun, Chambers, Cherokee, Chilton, Choctaw, Clarke, Colbert, Coosa, Cullman, DeKalb, Elmore, Etowah, Fayette, Franklin, Greene, Hale, Jackson, Jefferson, Lamar, Lauderdale, Lawrence, Limestone, Madison, Marengo, Marion, Marshall, Monroe, Morgan, Perry, Pickens, Shelby, St. Clair, Sumter, Talladega, Tallapoosa, Tuscaloosa, Walker, Washington and Winston.** This list is updated through May 9, 2011.

Taxpayers who reside or have a business in these counties may qualify for tax relief. We summarize some of these forms of relief below.

### Impact of a Presidentially Declared Disaster Area

#### ...on your personal residence or residence that you rent.

No gain is recognized on insurance reimbursements for “non-scheduled” personal property regardless of whether you replace the items. The majority of the contents of your home, therefore, need not be replaced to avoid recognizing income from the insurance proceeds. Property is “scheduled” only if specifically listed in the insurance policy.

A different rule applies with respect to your home and scheduled property. Insurance proceeds for your residence and scheduled property are treated as if they compensate you for the loss of a single item of property. In turn, any replacement property similar or related in service or use to your residence or its contents is a qualified replacement for that single item of property.

This means, for example, that insurance

proceeds received for the loss of valuable artwork or furniture can be used as part of the down payment on a new house. Also, you have four years instead of the usual two years to replace the property.

If you don’t replace the property within four years, you are treated as though you sold the property for the insurance proceeds and have to pay taxes on the gain.

Finally, if you are required by the State or any State or local agency to demolish or



relocate your residence because it has been rendered unsafe and the loss is not fully insured, you may be able to claim a deduction for the uninsured portion of the loss.

#### ...on business and investment property.

Normally, property destroyed by tornado must be replaced by property similar or related in service or use. You could not replace a bowling alley with a restaurant or a dry cleaner.

However, in a federally declared disaster area, any property you buy with the insurance proceeds from the federally declared disaster and hold for productive use in a trade or

## Special Tax Rules for Federally Declared Disaster Areas

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business will qualify as replacement property. Rather than rebuild or buy hard assets, you may also buy stock controlling a corporation that owns the replacement property.

Unlike your personal residence, this replacement property must be bought within two years after the end of the tax year of the loss to qualify for tax free treatment. These rules apply with equal force to a physical structure as well as the contents, such as fixtures and inventory.

### ...on filing returns, paying taxes, and meeting deadlines.

The IRS is authorized to extend certain deadlines impacting an affected taxpayer for up to 90 days. Broadly speaking, an "affected taxpayer" is an individual (and spouse) or business whose primary residence or place of business is located in the disaster area, any individual, business, estate, or trust whose necessary tax records were located in the disaster area, and any relief worker affiliated with a recognized government or charitable organization who is assisting in the disaster area.

Affected taxpayers are granted additional time to file certain returns, pay many taxes, make contributions to retirement plans, file petitions with the Tax Court, and file for a credit or refund. Unfortunately, the government is also granted additional time to assess and collect taxes.

If you had to complete any of these actions between April 15 and June 30 (either because of an original due date or an extension), the IRS has granted you an additional 90 days. Under certain circumstances, interest and penalties may also be reduced or eliminated entirely.

You have not been granted extra time to file your tax return even if you have received an extension unless the due date falls between April 15 and June 30. For example, if you received an extension to file your tax return until October 15, the due date does not fall between April 15 and June 30 and you do not receive another 90 days.

### ...on 1031 like-kind exchanges.

If the 45-day period to identify replacement property or the 180-day period to exchange property subject to a deferred like-kind exchange falls on or after the date of a presidentially declared disaster, you have an extra 120 days, or if later, until the last day of the general disaster extension period (not yet announced by the IRS) to complete the transaction.

The extension only applies where the relinquished property was transferred on or before the disaster date, ownership was transferred to the exchange accommodation party, and the taxpayer (transferor) is an "affected taxpayer." The extension also applies if the 45-day identification period ran before the disaster date but the property was substantially damaged by the disaster.

In order to take advantage of the extension, you must meet all the criteria.

## Casualty Losses

If you experience an uninsured casualty loss, you will normally qualify for a casualty loss deduction equal to the loss in value of the property. The loss in value may not be the same as the cost of repair. For example, the loss of trees may not affect the market value of a property even though they may be extremely costly to remove and to replace.

Many expenses incurred in connection with a casualty loss are not deductible, such as temporary living arrangements, expenses to prevent casualty losses, and appraisals. However, the cost of cleanup and debris removal may be deductible as well as amounts expended to recover lost property or reduce the amount of loss already suffered.

Casualty losses to personal property are reported on Schedule A of your Form 1040. For property owned by a sole proprietorship, casualty losses are reported on Schedule C.

You are entitled to claim the loss on either your 2010 or 2011 tax return.

You should be aware that you may encounter Alternative Minimum Tax issues because casualty losses are disallowed in computing your AMT liability.

You may not deduct a casualty loss that is covered by insurance unless you file an insurance claim for reimbursement. Any reimbursement you receive will reduce the loss you may claim. If you don't file a claim, you may deduct only the part of the loss that wasn't covered by insurance.

Because you'll have to substantiate the fair market value of your property before and after the casualty, consider obtaining an appraisal. Before you do, however, talk to us. An appraisal obtained by an attorney in the scope of representing his client is privileged material and is not required to be disclosed to anyone, including insurance companies. For obvious reasons, this could be important in filing and substantiating your claim.

## Theft Losses

Theft losses are reported in the same manner as casualty losses on your Form 1040. Generally, you can only deduct a theft loss in the year you discovered your property was stolen. But because this is a federally declared disaster area, you are entitled to claim the loss on either your 2010 or 2011 tax return. The same tax considerations that apply to a casualty loss apply to a theft loss.

Again, you may not deduct a theft loss that is covered by

*"If you experience an uninsured casualty loss, you will normally qualify for a casualty loss deduction..."*

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insurance unless you file an insurance claim for reimbursement. Any reimbursement you receive will reduce the loss you may claim. If you don't file a claim, you may deduct only the part of the loss that wasn't covered by insurance.

Please contact Jay Guin (205-633-0205) or Tommy Ikard (205-633-0213) to discuss your options.

## Tax Rules and Opportunities for Churches and Other Non-Profits

### Churches can reduce sales and use taxes in the rebuilding effort

Churches that sustained damage can save a tremendous amount of money when they rebuild their facilities by establishing a United Appeal Fund (Fund). A Fund allows churches to buy construction materials sales tax free. The savings typically exceed 5% of your construction budget.

Once the Fund is established, your church can buy relief supplies, Sunday school materials, and other items free of sales tax.

To realize the full benefit, great care must be taken at the outset to properly establish the Fund before construction begins.



This is a technique pioneered by our firm, and so we have over 20 years of experience in assisting churches to establish United

Appeal Funds and have helped many churches save untold sums in needless sales taxes.

Please call Jay Guin (205-633-0205) or Tommy Ikard (205-633-0213) to discuss the benefits of a United Appeal Fund.

### Deducting your expenses incurred while volunteering

You are allowed to deduct the expenses incurred while volunteering for approved governmental or recognized charitable organizations. So long as your activity is performed through one of these groups, expenses like chainsaw cutting chains, your mileage (although at a reduced rate), donated meals, travel costs, etc. are deductible. Expenses must be unreimbursed, directly connected with your charitable work, incurred because of your charitable work, and not personal, living, or family expenses.

### Deducting your charitable contributions

#### ...of money and property (not inventory).

If your donation totals more than \$250, you must obtain an "acknowledgment" (i.e. a receipt) from the charitable

organization. Most charities and churches are well aware of the requirements for claiming a deduction. But to ensure you can claim the deduction, the IRS requires that the acknowledgement meet the following:

1. It must be written.
2. It must include:
  - a. The amount of cash you contributed,
  - b. Whether the qualified organization gave you any goods or services as a result of your contribution (other than certain token items and membership benefits),
  - c. A description and estimate of the value those goods or services received (other than intangible religious benefits), and
  - d. A statement that the only benefit you received was an intangible religious benefit, if that was the case. The acknowledgment does not need to describe or estimate the value of an intangible religious benefit. An intangible religious benefit is a benefit that is not sold. An example is admission to a religious ceremony.
3. You must get it on or before the earlier of:
  - a. The date you file your return for the year you make the contribution, or
  - b. The due date, including extensions, for filing the return.

If the acknowledgment does not show the date of the contribution, you must also have a bank record or receipt that does show the date of the contribution. If the acknowledgment does show the date of the contribution and meets the other requirements, you do not need any other records.

These requirements don't apply to any gift under \$250. In figuring whether your contribution is \$250 or more, do not combine separate contributions. For example, if you gave your church \$25 each week, your weekly payments do not have to be combined. Each payment is a separate contribution.

The deduction for donations of new property, such as bottled water, is generally the cost. For used property, such as used clothing, the deduction is the lesser of cost or fair market value on the date of donation.

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## Tax Rules and Opportunities for Churches and Other Non-Profits

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### ...of inventory.

Donations of inventory are generally limited to cost, but larger deductions are often available where the inventory is used for the charitable purpose of the charity it's given to. For example, if Panera Bread has food left over at the end of the month, it would typically receive the same deduction for throwing the food away as it would by giving it to a local food pantry and it would avoid any documentation requirements. But a special rule applies to allow for a larger deduction of inventory to a charity than would otherwise be available.

### ...of a vehicle.

If you plan on giving a vehicle to charity to assist in the recovery process, your deduction equals the book value of the car. If you donate a car to charity and they sell the car, your donation may be limited to the actual amount the charity realized from the sale.

### ...of your time and labor.

You cannot deduct the value of your time and labor.

*Please call Jay Guin (205-633-0205) or Tommy Ikard (205-633-0213) to discuss these issues.*

## Federally Subsidized Loans for Those in Disaster Areas

### FEMA Assistance

Government assistance is typically available to an underinsured or uninsured individual or business who suffered a loss within a presidentially declared disaster area. There are many forms of assistance available, including low-interest disaster loans, that can be accessed by registering online at [www.disasterassistance.gov](http://www.disasterassistance.gov) or by calling (800) 621-FEMA (3362). FEMA assistance is normally not taxable to an individual unless used to replace income of some form.



### Small Business Association (SBA) Assistance

Disaster loans are provided to individuals, businesses, and nonprofit organizations to repair or replace damaged property. These loans come in two forms.

1) **Physical Disaster Loans** of up to \$2 million are available to businesses of all sizes and private, nonprofit organizations. These loans may be used to repair or replace damaged real estate, equipment, inventory, and fixtures. These loans will only cover uninsured or under-insured losses.

A loan may be increased by as much as 20% of the disaster damage to real estate or leasehold improvements to protect the property against future disasters of the same type. Thus, a business suffering a \$1,000,000 loss with \$700,000 of insurance proceeds may borrow \$300,000 for the under-insured loss and another \$200,000 to upgrade the structure to prevent future disaster losses.

2) **Economic Injury Disaster Loans** of up to \$2 million are available to small businesses, small agricultural cooperatives, and certain private, nonprofit organizations of all sizes suffering substantial economic injury. These loans are available to pay operating expenses the business would have paid if the disaster had not occurred.

In other words, these loans aren't available for disaster clean up and repair but could be used by a landlord to pay property taxes and insurance premiums while a leased building is not receiving rent due to damage from the tornado.

The interest rate on both these loans will not exceed 4% if you do not have credit available elsewhere. Repayment can be up to 30 years, depending on the business's ability to repay the loan. For businesses and nonprofit organizations with credit available elsewhere, the interest rate will not exceed 8%. SBA determines whether the applicant has credit available elsewhere.



If you need support from the SBA, you should begin the process by applying online at [www.disasterloan.sba.gov](http://www.disasterloan.sba.gov). All support begins with this step. For more information, visit [www.sba.gov](http://www.sba.gov).

*Please contact Jay Guin (205-633-0205), Marland Hayes (205-633-0209), Brooke Nixon (205-633-236), or Tommy Ikard (205-633-0213) to discuss your options.*

## Legal Issues Affecting Leased Property Damaged by Casualty

### Commercial Leases

Some commercial leases require the landlord to rebuild in the event of a casualty loss. Some may provide complex rules with formal notices being required to establish whether the landlord must rebuild and whether the tenant must return to the

leased space after repairs have been made. Still others leave the topic unaddressed.

Because most commercial leases are long-term leases, the tenant may be required to reoccupy the building once repaired

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or reconstructed and resume paying rent.

Even a total destruction does not necessarily terminate the lease. It's critical that your lease be carefully reviewed to be certain you do not unintentionally lose a valuable tenant or location. Don't decide to remodel or not to rebuild without having your lease reviewed to be certain your plans won't breach the lease.

### Residential Leases

If your residence was destroyed by the tornado or rendered unlivable, you may cancel your lease by vacating the residence and giving your landlord 14 days notice that you intend to terminate the lease. The lease terminates as of the day you vacate the residence. You may also be entitled to recover your security deposit.

If you don't give timely notice, and if the landlord rebuilds within the term of the lease, he technically will have the right to require you to pay rent after the unit is again habitable.

*Please contact Jay Guin (205-633-0205), DW Wilson (205-633-0216), Bert Guy (205-633-0206), Marland Hayes (205-633-0209), Brooke Nixon (205-633-236), or Tommy Ikard (205-633-0213) to discuss your options.*



## Insurance Issues Arising from Casualty Loss

### Cash value vs. Replacement cost

Many insurance policies will only pay replacement cost coverage if you rebuild. Otherwise, the insurance company will pay "cash value," that is, fair market value immediately before the casualty.

You'll need an appraisal to negotiate either the cash value or replacement value, and if you choose not to rebuild, may need to negotiate with the insurer to receive a fair settlement.

Because you'll have to substantiate the fair market value of

your property before and after the casualty, consider obtaining an appraisal. Before you do, however, talk to us. An appraisal obtained by an attorney in the scope of representing his client is privileged material and is not required to be disclosed to anyone, including insurance companies. For obvious reasons, this could be important in filing and substantiating your claim.

### Business Interruption Insurance

Proceeds received under a business interruption policy are taxed as ordinary income. A lost profits analysis is required to substantiate your claim.

It is important that you read your policy closely to understand the coverage you are entitled to.

### Renter's Insurance

The renter will generally be required to provide a list of items that were damaged, their cost, and their replacement cost. As always, read your policy to determine the coverage you are entitled to.

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