The following are general guidelines, in question/answer format, for individuals and businesses within the federally declared disaster area that suffered casualty losses to property due to flooding in the spring and summer of 2011. It is not intended to be a complete list. More specific questions should be directed to a Brady, Martz & Associates, P.C. professional.

Q: Which counties have been designated as federally declared disaster areas?

Q: What is a casualty loss?
A: A casualty loss is a loss due to damage, destruction or loss of property resulting from an identifiable event that is sudden, unexpected or unusual in nature. There must be actual physical damage to the property that is the immediate and direct result of the casualty.

Q: Can I deduct a casualty loss resulting from the flooding?
A: Yes, losses to business property, income-producing property or personal use property (including your home) due to actual physical damage, destruction, or loss of property generally are deductible.

Q: Are the costs of protecting my property against a casualty, part of the casualty loss?
A: The answer will depend upon the nature of the property. If the property is personal use property, the costs of protecting the property (i.e. constructing dikes) are neither part of the casualty loss, nor are they deductible. If the costs are related to business or income producing property, the costs will be deductible as an ordinary and necessary business expense.

Q: Does the casualty loss include damaged trees and other landscaping damaged by the disaster?
A: Yes, if the actual damage is caused by the disaster and not the activity related to protecting the property (i.e. constructing dikes). However, trees and other landscaping are considered part of the entire property and are not valued separately (see “How do I determine the amount of the losses to deduct” below).
Q: Does the casualty loss include losses related to home furnishings, vehicles and other personal property?

A: Yes, the casualty loss will include all property, personal and real estate damaged in the casualty.

Q: Are expenses incident to the casualty (i.e., temporary housing, meals, transportation, etc.) deductible?

A: Generally, no. Those types of expenses are considered personal unless related to a business transaction.

Q: How do I determine the amount of losses to deduct?

**Personal Use Property**

A: A personal casualty loss is determined by taking the smaller of:

- The adjusted basis of the property before the loss (reduced by any insurance reimbursement) or

- The decline in fair market value of the property due to physical damage as measured immediately before and after the casualty (reduced by any insurance reimbursement).

- Reduce by:
  - $100 and
  - 10% of your Adjusted Gross Income (AGI) for the year.

<table>
<thead>
<tr>
<th>Example:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted Basis in the Property</td>
</tr>
<tr>
<td>Decrease in the Fair Market Value (FMV) of the Property due to Casualty</td>
</tr>
<tr>
<td>Insurance Proceeds</td>
</tr>
<tr>
<td>Adjusted Gross Income</td>
</tr>
</tbody>
</table>

| Smaller of Adjusted Basis or Decrease in FMV | $ 20,000 |
| Reduced by:                                  |
| Insurance Proceeds                          | $(7,500) |
| Flat Dollar Adjustment                      | $( 100) |
| AGI % ($50,000 AGI x 10%)                   | $( 5,000) |
| Casualty Loss                               | $  7,400 |

**Business property & income-producing property:**
A: A business or income-producing property casualty loss is determined by taking the smaller of:

- The adjusted basis of the property before the loss (reduced by any insurance reimbursement) or
- The decline in fair market value of the property as measured immediately before and after the casualty (reduced by any insurance reimbursement).

**Example:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted Basis in the Property</td>
<td>$100,000</td>
</tr>
<tr>
<td>Decrease in the Fair Market Value (FMV)</td>
<td>$  20,000</td>
</tr>
<tr>
<td>Smaller of Adjusted Basis or Decrease in FMV</td>
<td>$ 20,000</td>
</tr>
<tr>
<td>Insurance Proceeds</td>
<td>$(7,500)</td>
</tr>
</tbody>
</table>

Casualty Loss $12,500

Q: Is the total decline in fair market value of the property part of the casualty loss?

A: In general, only the decline in fair market value due to the actual physical damage to the property that resulted from the casualty is included in the casualty loss.

The decline in fair market value for purposes of determining the casualty loss does not include a decline in value due to psychological resistance to inundated properties. In other words, the casualty loss will not include a temporary general market decline that may occur at the same time as the casualty due to buyer's hesitation to purchase a home which may flood in the future.

Q: How does one prove the amount of the casualty loss?

A: In substantiating the amount of the casualty loss, the taxpayer must establish: (1) the adjusted basis of the properties involved; (2) the decline in value of the property as a result of the casualty; and (3) the amount of any reimbursement.

Generally, the question of decline in value is the most difficult to prove. It may be best to obtain an appraisal from a qualified appraiser that (1) appraises the property immediately before the casualty; (2) appraises the property immediately after the casualty; and (3) separately identifies the decline in value due to the physical damage and the general market decline.

Where property is partially destroyed, the cost of repairs and clean up may, in certain cases, be used to measure the decline in FMV, if you meet the following requirements:

- The repairs are actually made.
- The repairs are necessary to bring the property back to its pre-casualty condition.
- The amounts spent for repairs are not excessive.
- The repairs cover the damage caused by the casualty only.
- The value of the property after the repairs is not, due to the repairs, more than the value of the property before the casualty.

**Q:** Are the cost of the appraisal deductible?

A: Yes, however, the cost of the appraisal for personal-use property is an itemized deduction, subject to the 2% floor on miscellaneous itemized deductions.

**Q:** Are clean-up costs expensed/deductible?

A: No. For businesses the clean-up costs would be capitalized. For personal use property the clean-up costs may be used to measure the decline in FMV (see above).

**Q:** If insurance proceeds are received, are the proceeds taxable? What about FEMA payments?

A: Generally, no. Insurance proceeds and FEMA or other related payments are applied against the casualty to reduce the loss. If insurance proceeds or other payments exceed the basis in the property the excess may be taxable.

**Q:** What if I don’t use the insurance proceeds to make repairs or replace the property, are the proceeds taxable?

A: Generally, no. The proceeds reduce the adjusted basis in the property. However, if the proceeds exceed the adjusted basis, the excess is taxable.

**Q:** What if I receive the insurance proceeds in one year, but don’t make the repairs or replacement until the next year, are the insurance proceeds taxable?

A: Generally, no. You have 2 years to make the necessary repairs or replacement. No income is recognized if the amount of repairs or replacement and adjusted basis exceeds the insurance proceeds, certain elections may be required. For homeowners in federally declared disaster areas a replacement period of 4 years is allowed.

**Q:** When should the loss be claimed?

A: If you resided in a federally declared disaster area, you have the option of deducting the loss on either the current year’s return or the prior year’s return. Certain restrictions do apply.

**Q:** If the taxpayer’s income tax return for the year immediately preceding the disaster has already been filed, can the election still be made to deduct the loss in the preceding year?

A: Yes. As long as the applicable time periods are met, the taxpayer can amend the income tax return for the preceding year and reflect the disaster loss.
Q: Where do I report the loss from personal use property?
   A: A taxpayer is allowed a deduction for casualty losses in federally declared
disaster locations as an itemized deduction:

   Personal Use Property:  Form 4684 - Casualties and Thefts
   Schedule A - Itemized Deductions

Q: Can an NOL be created due to losses attributable to federally declared disasters?
   A: Yes. Generally, the normal two-year carryback period may apply. However,
   qualified small businesses are eligible for a three-year carryback period.

Q: Can an individual's casualty loss create an NOL?
   A: Yes. Losses of property arising from fire, storm, shipwreck, or other casualty, or
   from theft can create an eligible loss for NOL purposes. The eligible loss may be
carried back three-years.

Q: Is damage due to mold a deductible casualty loss?
   A: Not typically, if the mold damage is due to insufficient or inadequate repairs the costs
to repair are not deductible.

As discussed above, there are numerous rules and requirements related to taking a deduction for
losses suffered as a result of a casualty. After discussing your particular facts and circumstances,
we can more accurately and reliably inform you of the tax implications of the casualty.

The IRS requires us to advise you that, unless specifically indicated otherwise, any tax advice
contained in this communication (including any attachments) was not intended or written to be
used, and cannot be used, for the purpose of (1) avoiding tax-related penalties imposed by the
Internal Revenue Code, or (2) promoting, marketing, or recommending to another party any tax-
related matter addressed herein.