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Business Advisor

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Annual Fall Sale and surcharges for tax returns

From October 16 through December 15, 2013, my annual fall sale offers a 20% discount on all services except IRS (or other government) audit assistance. So, save on year-end tax planning, getting your computerized accounting up and running before the new year, business consulting, and personal financial planning. Call today to set up your appointment. To take advantage of the discount, you need to pay your invoice within 10 days of billing. (Note: This is *not* the same as the prepayment plan for 2013 tax return preparation, which you will learn about in December.)

Those of you filing your tax returns between now and the December 2, 2013 deadline due to the floods need to have the bulk of your material to me by November 4 to avoid surcharges for late submission of tax materials and gain the full benefit of the fall sale. The 25% surcharge applies to information received after November 4 but before November 11. November 12 through 18 it goes to 50%; then 100% after that. I already have Thanksgiving week booked with continuing education seminars Monday and Tuesday, skiing Wednesday, and Dinner Thursday. I want to have your returns completed by Sunday, November 23, though I'll hold off on electronic filing (assuming we can do that) until December 2 if you desire.

Tax Aspects of the Flood Disaster

The tax treatment of a disaster like the recent Colorado floods turns out to be a lot less favorable than one might think. First I'll address losses of personal use items, like your residence.

Complete destruction: When your home is completely destroyed your loss for tax purposes starts with the smaller of the basis of the home or the decrease in the fair market value of the property. Only the residence portion of the property is considered, not the land portion (though loss of landscaping can be included). If you bought the home a number of years ago, your basis might be only a small percentage of the value immediately before the flood; but that is all that counts.

Because this is a personal loss, not a business loss, the first \$100 is not counted. Then another 10% of your income is not counted. The result is that the available loss can be pretty low.

Here's a quick example:

- Cost of home 10 years ago: \$100,000
- Cost of land 10 years ago: \$100,000
- Value of home today: \$300,000
- Value of land today: \$300,000
- Your 2013 adjusted gross income: \$150,000

The usable loss is: \$100,000 less \$100 less \$15,000 = \$84,900. This is an itemized deduction. Note: you can elect to take the loss on your 2012 return. So if 2012 had less income, the usable loss would be greater.

Of course, the cost to rebuild would be \$300,000 or more, not \$100,000. And if you didn't have flood insurance, you get no help from insurance. If the mortgage on the property is a high percentage of the current value, you might not be able to borrow the rebuilding funds. I believe you should seriously consider whether walking away from the property and the mortgage makes sense, in spite of the cost to your credit rating.

What happens if you did have flood insurance? In that case, you might even have a gain from the casualty. In the above example, if flood insurance paid \$150,000 you would have a \$50,000 capital gain, unless you rebuild the home or buy a replacement residence by 12/31/2017.

Partial destruction: This is even less likely to result in a usable tax deduction, but the cost analysis is less clear than with total destruction. You might be able to borrow the funds to rebuild, recognizing that you will be saddled with the additional debt for many years to come.

Business disaster losses: As with personal losses, the allowable loss is the adjusted basis of the property. For equipment, the loss may well be zero, if it is fully depreciated. Unlike personal losses, though, a business loss is reported on the front of the business tax return, and there are no reductions to the usable loss.

Other sources of recovery funds

Register with FEMA: Be sure to register with FEMA. You may be entitled to quick funding to cover short-term needs, like temporary housing, and removal of flood debris and damage. They will assess the problem and have a check issued in fairly short order.

Obtain a Disaster Loan. The Small Business Administration provides these low-interest, long-term loans for physical and economic damage caused by a declared disaster. They are available not only to businesses, but also to individuals.

- For individuals the limits are \$200,000 for your principal residence, \$40,000 for personal property, with a rate of not over 4% if you cannot get credit and 8% if you can. The term is up to 30 years.
- For businesses (including rental property), you can get loans of up to \$2,000,000 on similar terms for physical damage, and a similar amount for economic losses (even if you had no flood damage).

IRS Circular 230 requires that certain steps be taken by a tax advisor before his or her written tax advice may be relied upon to avoid IRS penalties. Accordingly, this newsletter is not intended by me to be used, and cannot be used, by any taxpayer for the purpose of avoiding tax penalties that may be imposed. Further, any written statement in this newsletter relating to a federal tax transaction or matter may not be used by any person to support the promotion or marketing of, or to recommend, any federal tax transaction or matter addressed herein.

Promote justice, equity, and compassion for everyone.