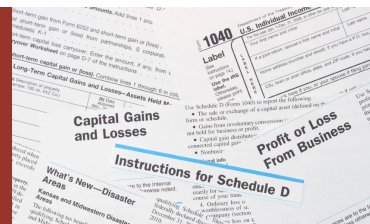




Federal and State Tax Alert

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The Federal and State Tax Treatment of Disaster Relief Payments and Casualty Losses

By Christopher R. Grissom and Virginia T. McKibbens

Many Alabamians are struggling to cope with the devastating effects of the recent storms and flooding. Recognizing the need to alleviate some of the burden associated with the recovery, President Obama designated a number of Alabama counties federally declared disaster areas. As a result of this declaration, individuals living in these counties may qualify for an exclusion from gross income for payments received to reimburse certain disaster-related expenses. The purpose of this exclusion is to ensure that storm victims are not hit with an additional tax burden in connection with their loss.

Section 139 of the Internal Revenue Code provides an exclusion from gross income for amounts received by an individual that are qualified disaster relief payments. A qualified disaster relief payment includes a payment, from *any* source, to or for the benefit of an individual to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster, including medical, dental, and transportation expenses.

Excluded payments also include payments, from *any* source, made to reimburse or pay expenses incurred for the repair or rehabilitation of a personal residence or repair or replacement of its contents to the extent that the need for such repair, rehabilitation, or replacement is attributable to a qualified disaster. The term "personal residence" includes rented residences.

Qualified payments from the individual's employer are eligible for the Section 139 exclusion and are not subject to self-employment or employment taxes. Payments from federal, state, and local governments to promote the general welfare in connection with a qualified disaster are also excluded under Section 139. Note that payments in the nature of income replacement are generally *not* excluded from income and unemployment assistance payments made under the Disaster Relief and Emergency Assistance Act constitute taxable unemployment compensation.

The Section 139 exclusion only applies to the extent an expense is not compensated by insurance or otherwise.

A taxpayer may claim a casualty loss to the extent his or her damage exceeds his or her qualified disaster relief payment and is not covered by insurance. Federal tax law allows taxpayers affected by the recent storms to claim a disaster-related casualty loss on this year's 2011 tax return or on an amended return for last year. Affected taxpayers claiming a casualty loss deduction on last year's tax return are directed to use the Disaster Designation "Alabama/Severe Storms, Tornadoes, Straight-line Winds, and Flooding" to expedite the refund process. For specific details on calculating casualty losses, please see www.irs.gov/businesses/small/article/0,,id=147162,00.html.

The following Alabama counties qualify for assistance:

Autauga, Bibb, Blount, Calhoun, Chambers, Cherokee, Chilton, Choctaw, Clarke, Colbert, Coosa, Cullman, DeKalb, Elmore, Escambia, 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.

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The Alabama Department of Revenue reports that Alabama will follow the IRS treatment of qualified disaster relief payments under Section 139 except for the taxation of unemployment compensation. Alabama does not tax unemployment compensation so these payments received due to the disaster are not taxable under Alabama's income tax laws. For more details, please see www.irs.gov/businesses/small/article/0,,id=147166,00.html.

The Alabama Department of Revenue issued an Information Release on June 17, 2011 explaining that taxpayers may claim a casualty loss only in the year the loss occurs. Unlike the treatment of disaster-related casualty losses under federal law, taxpayers may not amend their 2010 Alabama tax return to claim a casualty loss from the storms occurring in 2011. For more details, please see www.revenue.alabama.gov/prdocs/ICTAX%20Casualty%20Losses%202011.pdf.

Workers who come into Alabama to help with cleanup or construction for the disaster will be taxed on wages or contract amounts earned in Alabama. At this time, there is no provision to exempt the income earned while working on this effort in Alabama.

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