

October 31, 2007

TAX RELIEF FOR FIRE VICTIMS¹

Dear Friends and Colleagues,

We are all deeply saddened by the recent fires, and our hearts go out to the thousands of victims who suffered indescribable losses. In the aftermath of this tragedy, those affected by the fires and their advisors should be aware of tax relief and other forms of assistance made available by the federal and state governments to assist with the rebuilding process. The purpose of this letter is to provide a general description of the tax relief that is available as a result of the recent fires. Those affected by the fires are encouraged to consult with their accountant or tax advisor to evaluate the extent of relief that may be available, which will depend on each individual situation.

I. FEDERAL TAX RELIEF

On October 25, 2007, President Bush declared Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara and Ventura counties as major disasters as a result of fires. From a tax perspective, the President's declaration means that affected taxpayers are eligible for tax relief (in addition to other federal assistance) under the Disaster Relief and Emergency Act. As used herein, "affected taxpayers" include individuals and businesses located in the disaster area, those whose books, records, or tax professionals' offices are located in the disaster area, and relief workers. A complete list of "affected taxpayers" can be found in Treas. Reg. Section 301.7508A-1(d)(1).

A. Casualty Loss Deduction

When your property is lost or damaged due to a fire that is sudden, unexpected, or unusual, it is considered a casualty loss. The damage to your property that is not repaid by insurance or other reimbursements usually qualifies as a casualty loss deduction for tax purposes. To determine the amount deductible, you first compare the property's decline in fair market value with the property's adjusted tax basis to determine which is the lesser amount. For instance, if the property's value prior to the fire exceeded its adjusted tax basis (i.e., appreciated property), and the property was rendered worthless by the fire, the adjusted tax basis would be

¹ This letter was prepared by Jon P. Schimmer and DeEtte L. Loeffler of the Tax Group of Procopio, Cory, Hargreaves & Savitch, LLP, as a courtesy for the victims of the recent disasters and their advisors. It is not intended to be specific tax advice as individual situations may vary. We recommend consulting with your accountant or other tax advisor to evaluate the extent of benefits that may be available to you, depending on your situation.

the lesser amount. From the lesser amount, you subtract \$100, and then subtract ten percent (10%) of your adjusted gross income, to arrive at the amount deductible. For details, see IRS Publication 547, "Casualties, Disasters and Thefts", available at <http://www.irs.gov/pub/irs-pdf/p547.pdf>. A casualty loss becomes a disaster loss if the loss is sustained in an area the President of the United States designates as a disaster area, and the loss is sustained because of the declared disaster. A special relief provision permits affected taxpayers to elect to deduct disaster losses either in the tax year of occurrence (2007 for calendar year taxpayers) or the immediately preceding year (2006). See Exhibit A for a sample election to claim the loss in the preceding year. Claiming the loss on an amended 2006 return will result in an earlier refund, but waiting to claim the loss on this year's return could result in greater tax savings due to the adjusted gross income limitation discussed above. For example, if your 2006 adjusted gross income greatly exceeds your 2007 adjusted gross income, taking the loss on your 2007 return may provide more benefit.

Affected taxpayers should write "California Wildfires" in red ink at the top of the return so that the IRS will expedite processing of the return (and refund). Form 4684 must also be filed with the return and can be filled out on-line at <http://www.irs.gov/pub/irs-pdf/f4684.pdf>. Instructions for the form are located at <http://www.irs.gov/pub/irs-pdf/i4684.pdf>. Form 1040X, "Amended Federal Income Tax Return," can be filled in on-line at <http://www.irs.gov/pub/irs-pdf/f1040x.pdf>. Instructions to Form 1040X are found at <http://www.irs.gov/pub/irs-pdf/i1040x.pdf>. For additional information, see Publication 547, "Casualties, Disasters and Thefts" (copy at <http://www.irs.gov/pub/irs-pdf/p547.pdf>), Publication 584, "Casualty, Disaster, and Theft Loss Workbook" (copy at <http://www.irs.gov/pub/irs-pdf/p584.pdf>), and Publication 584B, "Business Casualty, Disaster and Theft Loss Workbook" (copy at <http://www.irs.gov/pub/irs-pdf/p584b.pdf>). For instruction on self-prepared amended tax returns using Quicken software, see http://turbotax.intuit.com/tax_help/tax_return_turbotax/article.

Affected taxpayers receiving insurance proceeds must also consider the tax rules which treat the involuntary conversion of a principal residence (e.g., destroyed by fire) as a sale of the residence. The insurance proceeds are treated as the amount realized from the sale. If eligibility requirements are satisfied, the taxpayer may elect to exclude up to \$250,000 (\$500,000 for joint returns) of the gain from the deemed sale of the residence.

Depending on the circumstances, however, affected taxpayers may want to forego the election to exclude gain because special rules apply where a taxpayer's principal residence (or any of its contents) is involuntarily converted as a result of a Presidentially declared disaster. Under these rules, no gain is recognized by reason of the receipt of insurance proceeds for personal property that was part of the contents of the residence and that was not scheduled property for purposes of such insurance. Further, all other insurance proceeds received on account of damage to the residence or its contents are treated as a common pool of funds. If this pool of funds is used to purchase any property similar or related in service or use to the converted residence (or its contents), the taxpayer may elect to recognize gain only to the extent that the amount of the pool of funds exceeds the cost of the replacement property. The replacement property must be acquired within four years after the close of the first taxable year in which any part of gain upon the conversion is realized.

B. Extensions to File or Pay Taxes

On October 29, 2007, the IRS announced that deadlines for affected taxpayers to file returns, pay taxes and perform other time-sensitive acts falling on or after Oct. 21, 2007, and on or before Jan. 31, 2008, have been postponed to Jan. 31, 2008.

In addition, the IRS will waive the failure to deposit penalty for employment and excise deposits due on or after Oct. 21, 2007, and on or before Nov. 5, 2007, as long as the deposits are made by Nov. 5, 2007.

If any affected taxpayer receives a penalty notice from the IRS, the taxpayer should call the number on the notice to have the IRS abate any interest and any late filing or late payment penalties that would otherwise apply during the period from Oct. 21, 2007, to Jan. 31, 2008 — Oct. 21, 2007, to Nov. 5, 2007, for failure to deposit penalties. No penalty or interest will be abated for taxpayers that do not have a filing, payment or deposit due date, including an extended filing or payment due date, during this period.

IRS computer systems now automatically identify taxpayers located in the covered disaster area and apply automatic filing and payment relief. Taxpayers within the covered disaster area therefore do not need to self-identify by writing on their returns or using the disaster designation in their tax software.

Affected taxpayers who reside or have a business located outside the covered disaster area, but who are entitled to relief because of the location of their records, are required to call the IRS disaster hotline at 1-866-562-5227 to self-identify for disaster relief.

The IRS gives affected taxpayers until Jan. 31, 2008, to file most tax returns (including individual, corporate, and estate and trust income tax returns; partnership returns, S corporation returns, and trust returns; estate, gift, and generation-skipping transfer tax returns; and employment and certain excise tax returns), or to make tax payments, including estimated tax payments, that have either an original or extended due date falling on or after Oct. 21, 2007, and on or before Jan. 31, 2008. For original filing due dates falling during this period, the relief is provided under section 6081 and if additional time to file is needed beyond Jan. 31, 2008, an affected taxpayer may file the appropriate extension request to obtain the remainder of the 6-month period provided by section 6081. For extended filing due dates falling during this period where the full six-month extension period has been used, relief is provided under section 7508A. In such a case, no additional time to file is available after Jan. 31, 2008.

The IRS also gives affected taxpayers until Jan. 31, 2008, to perform other time-sensitive actions described in Treas. Reg. Section 01.7508A-1(c)(1) and Rev. Proc. 2007-56, 2007-34 I.R.B. 388 (August 20, 2007), that are due to be performed on or after Oct. 21, 2007, and on or before Jan. 31, 2008. This relief also includes the filing of Form 5500 series returns, in the manner described in section 8 of Rev. Proc. 2007-56. The relief described in section 17 of Rev. Proc. 2007-56, pertaining to like-kind exchanges of property, also applies to certain taxpayers who are not otherwise affected taxpayers and may include acts required to be performed before

or after the period above. A copy of Rev. Proc. 2007-56 can be obtained at http://www.irs.gov/irb/2007-34_IRB/ar13.html.

The postponement of time to file and pay does not apply to information returns in the W-2, 1098, 1099 or 5498 series, or to Forms 1042-S or 8027. Penalties for failure to timely file information returns can be waived under existing procedures for reasonable cause. Likewise, the postponement does not apply to employment and excise tax deposits. The IRS, however, will abate penalties for failure to make timely employment and excise deposits, due on or after Oct. 21, 2007, and on or before Nov. 5, 2007, provided the taxpayer made these deposits by Nov. 5, 2007.

C. Other Relief

The IRS will waive the usual fees and expedite requests for copies of previously filed tax returns for affected taxpayers who need them to apply for benefits or to file amended returns claiming casualty losses. Such taxpayers should write “California Wildfires” in red ink at the top of Form 4506, “Request for Copy of Tax Return,” or Form 4506-T, “Request for Transcript of Tax Return,” as appropriate, and submit it to the IRS.

Affected taxpayers who are contacted by the IRS on a collection or examination matter should explain how the disaster impacts them so that the IRS can provide appropriate consideration to their case.

Taxpayers may download forms and publications from the IRS website at <http://www.irs.gov/formspubs/index.html> or may order them by calling 1-800-TAX-FORM (1-800-829-3676). The IRS toll-free number for general tax questions is 1-800-829-1040.

For further information, see “Tax Relief in Disaster Situations,” available at <http://www.irs.gov/newsroom/article/0,,id=108362,00.html>.

II. OTHER FEDERAL ASSISTANCE

Following the major disaster declaration by President Bush, the Federal Emergency Management Agency (FEMA) announced that federal disaster funds will be available for people besieged by the wildfires. In particular, residents of the seven disaster counties who suffered fire losses may be eligible for aid that can include grants to help pay for temporary housing, home repairs and other serious disaster-related expenses. Low-interest loans from the U.S. Small Business Administration also will be available to cover residential and business losses not fully compensated by insurance. Federal funding also is available to state and eligible local governments and certain private nonprofit organizations on a cost-sharing basis for debris removal and emergency protective measures.

FEMA also publishes a pamphlet, “Help After a Disaster,” that can be obtained at http://www.fema.gov/pdf/assistance/process/help_after_disaster_english.pdf.

To begin the disaster application process, affected residents and business owners in the designated counties should call FEMA at 1-800-621-3362, or 1-800-462-7585 for the hearing impaired. The toll-free numbers will be available starting Tuesday, October 28, from 8 a.m. to 6 p.m. seven days a week until further notice. For additional information and new developments, go to <http://www.fema.gov>.

III. CALIFORNIA TAX RELIEF

On October 26, 2007, Governor Arnold Schwarzenegger declared a State of Emergency for the counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara and Ventura. He directed the Franchise Tax Board and the Board of Equalization to “consider using their administrative powers where appropriate to provide those individuals and/or businesses impacted by the wildfires extensions for filing, audits, billing, notices, assessments and relief from subsequent penalties.” Individuals or businesses who have experienced damage or loss as a result of the fires may be eligible for state tax relief.

A. Property Taxes

Reduced Assessment. You may be eligible for immediate relief based on the loss in value caused by the fires. This relief gives taxpayers an immediate reduction in taxes, including possible refunds of taxes already paid.

Deferral of Unpaid Taxes. Owners of real property and manufactured homes may be able to defer, without penalty or interest, payment of the next property tax installment due. For unpaid taxes following the October 2007 fires, the next property tax installment due date is December 10. Applications for deferral should be filed with the county assessor along with, or in addition to, the applications for reduced assessments.

Other Relief. Under certain conditions, taxpayers may be eligible to have the taxable values of their properties in their pre-damaged conditions transferred to comparable replacement properties. In this way, a taxpayer whose home has been damaged or destroyed can acquire or build a new home without incurring increased property taxes that would otherwise occur under Proposition 13. For assistance, please contact your county assessor’s office for applications and further information about each type of property tax relief.

- Los Angeles: 888-807-2111, <http://www.lacountyassessor.com>
- Orange: 714-834-2727, <http://www.ocgov.com/assessor/>
- Riverside: 800-746-1544, <http://riverside.asrclkrec.com>
- San Bernardino: 877-855-7654, <http://www.sbcounty.gov/assessor/>
- San Diego: 858-505-6262, <http://www.sdarcc.com/arcc/>
- Santa Barbara: 805-568-2550, <http://www.sbcvote.com/carehome.aspx>
- Ventura: 805-654-2181, <http://assessor.countyofventura.org/news/Ranch-fire.html>

B. Sales Tax or Other Taxes Administered by the Board of Equalization

Interest and Penalty Relief. Relief from interest and penalties may be provided for those persons who are unable to file their returns and pay taxes and fees due in a timely manner. You must include with your return a statement signed under penalty of perjury stating the cause for the late filing or payment. For your convenience you may use Form BOE-27, "Penalty and Interest Relief for Disaster Victims," which is available on the Board of Equalization website at <http://www.boe.ca.gov/pdf/boe27.pdf>.

This relief may be provided in the following programs: sales and use taxes, use fuel tax, alcoholic beverage taxes, cigarette and tobacco products taxes, gasoline tax, timber yield tax, energy resources and emergency telephone surcharges, and hazardous waste fees, as well as many other programs and administration fees associated with such programs.

Extension for Filing Tax Returns. Special relief in the form of a one-month extension of time to file excise tax returns and pay taxes or fees is available to any taxpayer or fee payer who works or resides in the covered counties and who, as a result of the recent wildfires, cannot meet tax filing and payment deadlines. In seeking an extension, include with your tax return a statement in writing signed under penalty of perjury, stating the cause for the late filing. For your convenience, you may use Form BOE-468, "Request for Extension of Time in Which to File a Tax Return," which can be accessed on the Board of Equalization website at <http://www.boe.ca.gov/pdf/boe468.pdf>. You may request an extension for most programs administered by the Board of Equalization (see preceding paragraph).

Estimated Tax Payments and Installment Payments. You may be able to estimate the tax amount due based on the best information available. You may also qualify to make installment payments. Contact one of the telephone numbers below to discuss this option.

Deferred Audits. If you are scheduled for a Board of Equalization audit, call the Board office you have been working with to request a postponement or to discuss other remedies.

Lost Records. If you cannot locate records you have filed with the Board of Equalization, call the Information Center for assistance: 800-400-7115.

For Disaster Assistance, Call a Board Office. As noted above, call your county assessor if you have questions regarding property taxes. Call one of the numbers below for questions about other taxes and fees administered by the Board of Equalization.

San Diego: 619-525-4526
Ventura: 805-677-2700
Norwalk: 562-466-1694
West Covina: 626-480-7200
San Marcos: 760-510-5850

Riverside: 909-680-6400
Culver City: 310-342-1000
Van Nuys: 818-904-2300
Chula Vista: 619-409-7440
Santa Ana: 714-558-4059

C. Income Taxes

Casualty Loss. Affected taxpayers may also qualify for a State disaster loss deduction. The loss may be claimed on an amended tax return for the year preceding the year of loss. To expedite the refund, write “Southern California Wildfires 2007” in red ink at the top of the return. California Form 540X, “2006 Amended Individual Income Tax Return,” can be filled in on-line at http://www.ftb.ca.gov/forms/06_forms/06_540x.pdf?refresh=14741. For additional information, see Franchise Tax Board Publication 1034, “Disaster Losses,” which is available at <http://www.ftb.ca.gov/forms/misc/1034.pdf>. Affected taxpayers needing copies of lost or damaged State returns should complete FTB Form 3516, “Request for Copy of Tax Return,” which is available at http://www.ftb.ca.gov/forms/03_forms/3516.pdf. The request is free for affected taxpayers who write “Southern California Wildfires 2007” in red at the top of Form 3516.

For the latest updates pertaining to tax matters surrounding the wildfires, check the FTB website at www.ftb.ca.gov. Taxpayers with questions about their accounts can also call the FTB toll free at 800-852-5711 Monday through Friday from 7 a.m. to 6 p.m.

For California purposes, affected taxpayers whose losses exceed their income may qualify for one hundred percent (100%) carryover of any excess disaster loss to future taxable years if the Legislature enacts legislation adding the Southern California Wildfires to the list of eligible disasters identified in California Revenue and Taxation Code Sections 17207 and 24347.5. If included by legislation, which is expected, the disaster loss deduction and carryover rules are not suspended for the 2006 and 2007 tax years as are other net operating losses.

Miscellaneous. The Franchise Tax Board announced that due to the wildfires, all tax billings, notices, audit correspondence, and proposed assessments bound for taxpayers in the affected counties will be temporarily suspended. In 2003, the suspension was for two weeks.

D. Insurance

A discussion of insurance is beyond the scope of this article. However, helpful information regarding insurance and insurance claims is attached to this memo.

On behalf of those of us here at Procopio Cory, we express great sympathy for those in our community who suffered losses. We are also grateful for all the wonderful volunteers tirelessly assisting the victims in putting their lives back together. We hope this letter provides the victims and their advisors some guidance in identifying tax relief and other assistance that may be available to ease the burdens of rebuilding.

PROCOPIO, CORY, HARGREAVES
& SAVITCH, LLP

JPS/DLL

EXHIBIT A

**SAMPLE ELECTION TO DEDUCT
DISASTER LOSS IN PRECEDING TAX YEAR**

Election to Deduct Disaster Loss in the Preceding Tax Year

Name: [name]

SSN#: [SSN]

Tax Year: [tax year]

Taxpayer elects under Code Section 165(i) and Reg. Section 1.165-11 to deduct the disaster loss that occurred on [date] in the taxable year ending [end of taxable year], the year preceding the year that the loss occurred.

[Describe the loss, the disaster and its date(s), the city, town, county, and state in which the damaged or destroyed property was located, and the amount of the deduction being claimed.]

Date: [date]

[Signature]