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TAX REPORT

MAY 2025 VOLUME 38, ISSUE 4

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EXECUTIVE SUMMARY

PART 1. DISASTER RELIEF

Laurie Stillwell explores both temporary and permanent federal disaster relief provisions, including the recently enacted Federal Disaster Tax Relief Act of 2023, that help individual taxpayers and businesses recover financially from the impact of a disaster. Relief may include the postponement of certain tax-filing and tax-payment deadlines, excludible qualified disaster relief payments, and deductible casualty losses. This month, Part 1 provides an overview with key definitions and covers deductible casualty losses. *[Running time: 1:14:33]*

Learning Objective:

Upon completion of this segment, the user should be able to:

- Identify federal disaster relief provisions.
- Determine the tax effect of a disaster loss.

PART 2. TAX CASES

Renee Rodda, JD, reviews numerous tax cases involving the rich and famous. The facts may vary, but the issues are familiar: estate battles, dying intestate, valuation of image and likeness, right of publicity, deduction of work attire, fraud, deduction of business expenses, self-employment tax, hobby or business, and more. *[Running time: 47:43]*

Learning Objective:

Upon completion of this segment, the user should be able to:

- Apply tax rules to issues such as estate disputes, dying intestate, valuation of image and likeness, right of publicity, deduction of work attire, fraud, business expense deductions, self-employment tax, and distinguishing hobby versus business activities by reviewing celebrity fact patterns.

ABOUT THE SPEAKERS

Laurie Stillwell, CPA, is licensed in New York. Her firm, Laurie A. Stillwell, CPA, P.C., specializes in working with small businesses, professional practices, and their owners. In addition to her practice, Laurie teaches continuing professional education seminars and webinars on ethics, business, and individual income tax issues. She is the author and editor of several continuing professional education texts and handbooks. Prior to forming her firm in two thousand one, Laurie spent more than a decade with local and regional accounting firms and specialized in providing tax and accounting services to closely-held businesses. She began her public accounting career with the international firm of Price Waterhouse, in Boston, Massachusetts.

Renee Rodda, JD, is Senior Vice President of Tax and Accounting for CeriFi, LLC. She is the editor of Spidell's California Taxletter and Spidell's Analysis & Explanation of California Taxes. She has been educating tax professionals for more than 20 years. Renee is also a member of the advisory board for the Franchise Tax Board, the California Department of Tax and Fee Administration, and the Board of Equalization. She is a graduate of Chapman University School of Law with a Tax Law Emphasis.

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EXPERT ANALYSIS AND COMMENTARY

PART 1. DISASTER RELIEF

When Disaster Strikes

Welcome to the first segment of this month's program. In this series, Laurie Stillwell explores both temporary and permanent federal disaster relief provisions, including the recently enacted Federal Disaster Tax Relief Act of 2023, that help individual taxpayers and businesses recover financially from the impact of a disaster, especially when the federal government declares their location to be a major disaster area. Relief may include the postponement of certain tax-filing and tax-payment deadlines for taxpayers who reside or have a business in the disaster area, excludible qualified disaster relief payments, deductible casualty losses, and more. This month, Part 1 provides an overview with key definitions and covers deductible casualty losses. Next month, Part 2 will cover disaster relief payments, involuntary conversions, and postponement of certain tax-filing and tax-payment deadlines for taxpayers who reside or have a business in the disaster area.

Let’s join Laurie.

Ms. Laurie Stillwell

I'm Laurie, and in this course, we will cover some federal tax relief provisions there to assist individuals impacted by disasters. We're going to start with an overview, the unfortunate situation, whether for our individual taxpayers or our business taxpayers, when disaster strikes.

Now, one of the things challenging about being a tax advisor in this area is that tax provisions that impact, again, either personal or business taxpayers in the case of a disaster, fall into one of two broad categories. There are a number of permanent law provisions, and we will certainly cover a number of those here together, but there is also, and we have a recent piece of legislation that added to this list of legislation that provides what I would use the word temporary or very targeted tax relief provisions, essentially impacting taxpayers that are within certain time frames, both of date of declaration of certain disasters, and what is called the incident period, both topics that we will define together further as we move forward.

When we talk key definition at the core of today's chat, we're talking about casualty events. If we were to skip down to the final bullet on your screen, these are sudden, unexpected and unusual. In recent memory, we're talking storms such as wildfires, hurricanes, ice storms, tornadoes, and the like. One of the thing that's been very important for us to remember as tax advisors to personal income tax clients in recent years, is remember that piece of legislation passed back in 2017 called the Tax Cuts and Jobs Act? One of the revenue raisers in that bill, essentially for individuals, limited their ability to take casualty loss deductions for the period that you see on your screen, between 2018 and through December 31st of 2025, to only those personal casualty losses that stem from what are called federally declared disasters.

A federally declared disaster is going to be one that is determined, declared by the president, and this essentially kind of motivates and, and begins the machine at the federal government, and sometimes state and local government, that begins to put in place certain relief provisions, not just tax, but also economic and other forms of support, again, for individual or business taxpayers under what's called the Stafford Act.

When we talk about disaster area, this could actually mean a couple of different things and we will look at that a little bit more closely here as we move forward, but that's generally determined to either be the state, or in many cases, the specific county or counties within a state that is determined to warrant federal assistance. And that is not a one-size-fits-all.

So each disaster could have a very crafted and specific series of federal relief provisions that will apply to it, and as we move through today's conversation, I will also share with you a number of sites on the web, whether it's FEMA, or at the SBA, or certainly IRS resources that you can turn to when you are advising clients.

Let's start with one of those. This is arguably the very first place you start. So, fema.gov/disaster/declarations. This is an evergreen source of disaster declarations, and it also provides for each affected disaster what's called the incident period. That's going to be important, you're going to see as we move forward. The incident period has a very technical definition under the code, but folks, for our purposes, let's suffice to say, that's the period, sometimes a day, sometimes weeks, sometimes even, for example, during the COVID-19 pandemic, months-long period that the disaster is unfolding.

When you go into this website, a couple of things to keep in mind. First of all, you can search, as you can see here, in a number of ways, or at the same page, if you scroll down, there is a reverse chronological order that the disasters are also published in. One last comment before we leave this page. When you are advising a client, it's a good idea before you finalize their tax projections, certainly before you finalize their tax return and their casualties and loss form, the 4684, that you come back into this, and that is because sometimes, for example, there are changes. It is not an infrequent event that a disaster that was not initially declared or deemed to be what's called a major disaster, in hindsight, becomes one somewhere down the road when the true scope of the economic devastation becomes apparent. And you're going to see as we move forward, ladies and gentlemen, why it's important to know whether something has or has not been determined to be a major disaster. More on that in a moment.

The first place we're going to start in terms of federal tax relief for these individuals and businesses, and this is going to be an area where both permanent and temporary tax law do intersect, is talking about casualties. So this is a lot of information here. This is a chart that essentially gives you the high points, I will call it an executive summary, for all of three types, the three types of casualty losses that our clients can incur. And this is where we're going to need to get a little nitpicky. It all comes down to what type of disaster it is, and there are essentially three types. You have a federal casualty loss. That's the first row. You have what's called a disaster loss, and that is the only loss that's individual and business, potentially, in nature. So you can see, gave each one of those a row, and we'll come back and look at some of the key highlights here, and then we have, this is really kind of the temporary set of federal tax law, what are called disaster or qualified disaster losses. That is the most favorable tax treatment available for personal casualty losses, but let's take a look at all three.

When we talk about federal casualty losses, that definition applies just to our 1040 folks. These are going to be individuals that have incurred some type of economic loss and they live in the state in which the disaster has been declared. The outcome here is mixed, depending on the type of taxpayer, in terms of do they itemize, how high a AGI, adjusted gross income, do they have? Because there are two deduction limits that apply. You're going to lose the first $100 of your casualty loss, and then you only garner a deduction for the remaining casualty loss that exceeds 10% of that year's adjusted gross income. A lot of taxpayers lose out right there. Second place they can lose out, unfortunately, is they have to be itemizing taxpayers. In other words, even if they get over the $100 and get over the 10% AGI, they're not going to get a deduction unless they are Schedule A 1040 itemizing deductions. And they also have no flexibility on when to claim that resulting loss. It must be claimed in the year of loss.

Let's go now to disaster losses, whether for individuals or businesses. In both cases, when we talk about the loss event, where did it occur? Here, those taxpayers essentially either need to reside, or their principal place of business, those are two big key components here, are within a county within the state that the federal government has deserved or determined is eligible for assistance. Again, same 10%, $100 limitation for individuals. No such limits apply to businesses. Individuals again, would be required to itemize. Obviously, businesses don't itemize, so no limitation there. And in both cases, now you have some planning flexibility.

Do I want to take the resulting loss, either on a 1040 or an 1120-S for example, in the year of the casualty event? Or would it behoove me to take it in the immediate preceding year? By no means the only two considerations, but two big considerations there are cashflow needs. For example, if you have a taxpayer that has a loss, let's say in March, do they really want to have to wait until the subsequent April, when you do their tax return to get the tax benefit? Or should they claim it on the immediate preceding year's return? Second real implication applies to 1040 taxpayers. If I have two years of adjusted gross income that I'm going to apply that 10% to, which year is going to be a more beneficial outcome for me?

The last type of disaster impacts, or rather loss deduction, impacts only our personal tax clients again. This is what I will call the temporary tax law, and by that there are only specific time frames, specific periods of declaration of the disaster, specific incident periods. And we will define those, including the most recent legislation. So it's only for specific disasters and the individuals impacted by those specific disasters. But if you're over that really big hurdle, now it's all good news from a federal tax relief standpoint. You are going to lose instead of the first $100, you will lose the first $500 of your deduction. So you might be saying, "Well, (laughs) how is that good news?" Admittedly, that's a $400 loss that is now gone, but there's no 10% AGI limit, and now you could be an itemizing taxpayer, add it onto your Schedule A, or if you're a standard deduction taxpayer, which so many of our 1040 folks are these days, tack it on to your standard deduction.

And again, you get that same flexibility. Do I want to claim it on the current year's return, the year that that loss actually transpired? Or do I want to take that on the immediate preceding tax year? A qualified disaster loss. This is the one where Congress comes in and takes what I really think of as a, a patchwork approach to providing temporary federal tax relief. This is all about our 1040 folks. Personal stuff, so we're not talking trade or business, or property held for the production of income.

You can see here this goes back to certain disasters in 2016, the tropical storm and hurricane season of 2017, California wildfires in calendar year 2017, very early 2018, and then again, major disaster occurring in 2018, but before that December date of 2019. More relevant likely for most of our clients are these two last pieces of legislation, one of which, despite the fact that they dated it, named it 2023, the Federal Disaster Tax Relief Act of 2023. This was actually signed into law on December 12th of 2024. That is our most recent incarnation of this type of targeted tax relief. This is going to extend, remember that bottom row that we just looked at on slide 12, where we have, yes, we lose $500, but we have no 10% AGI limit. We don't need to be an itemizing taxpayer. We can tack this personal casualty loss onto our standard deduction, take it this year, the year of the loss, or the immediate preceding year. All of that flexibility.

Under this most recent piece of legislation, that much more advantageous tax outcome is going to apply to individual taxpayers that have economic losses attributable to a major disaster declared between January 1st of 2020, okay, so that kind of picks up that earlier thread from the Taxpayer Certainty and Disaster Tax Relief Act of 2020 that you see referenced just above, and through February 10th of 2025. I'm going to just warn you here, it's going to be really important to look at two dates, the date of declaration, which we just defined. So we essentially have all of 2020, 2021, 2022, 2023, 2024. We'll call it month and a half, February 10th of 2025, but here's where we need to be very careful.

We need to make sure that we are also looking at the incident period. How are you going to know what that is? Remember that fema.gov/disaster citation I shared a bit earlier? That's where you're going to go. Again, there can be gaps. Sometimes the storm happens, and the date of declaration is a trailing date, happens later. Sometimes a date of declaration will actually be presumptive, and the incident period will be, let's say, days thereafter. But the incident period that you're going to determine at that FEMA website also needs to fall under the two pieces of legislation, the 2020 and now the 2024, within the timeframe that that legislation or those two pieces of legislation established.

Because it's the most current law and the one most likely to impact our clients in current tax years, let's go all the way over to the right side, right column. In both cases, these have to be major disasters to get this more beneficial personal casualty loss outcome. So remember how I told you you might want to go back into, in fact, I don't like to use this word, but I'm going to use the word should. We should, as tax advisors and tax practitioners, go back into that fema.gov declaration, double-check, and see if any storm that perhaps wasn't initially designated as major may well have been, dare I use the word upgraded to that, once the true scope of the devastation is known.

Again, let's stick with the most current piece of legislation. In order to have a qualifying disaster for purposes of the qualified disaster personal casualty loss, those advantageous rules, that disaster, major disaster, would need to have been declared by the President between January 1st of 2020, but ending no later than February 10th of 2025. Well, that's what we just said on slide 14, but I also cautioned you on slide 14 that we also need to make sure we're within the right incident period, and here's where it can get a little tricky. The incident period, so the date that that disaster began, needed to begin on or after all the way back to December 28th of 2019.

Okay, well, that's probably an easy enough box for our clients to check at this point on the calendar, but here's where we need to be very careful. The incident period needs to begin on or before the date of enactment of the bill, which was December 12th of 2024, and must end no later than January 11th of 2025. So as I mentioned, this is patchwork treatment, and one of the real downsides of that is, for example, if you have a disaster that began, let's say, in the first or second week of January 2025, the incident period did not begin on or before December 12th of 2024. That means those individuals impacted by that disaster cannot use this most favorable set of rules for personal casualty losses. Let's look at the potential difference in the outcome here.

So let's assume we have a taxpayer, an individual taxpayer, that is impacted in April 2025 by a disaster. They don't qualify for the qualified disaster loss rules. We just talked about that, but we are going to compare and contrast with normal rules, what if these more advantageous rules instead applied?

So let's say, for example, we were comparing this with a taxpayer who was impacted by a major disaster in November of 2024. Same numbers in terms of deductible loss, big picture, but the end result, very different. Let's assume both taxpayers have an AGI or an adjusted gross income of $150,000. Their net personal casualty loss from the qualifying federally declared event, net of any personal casualty gains, both cases, $32,500.

Under the normal rule, the first thing you do is lose $100. Under the more advantageous rule, even though there's a give-back here, you're going to lose $500. Where it really starts to get difference in outcome is this next couple of rows, because with the federal casualty loss, in fact, a personal casualty loss that simply isn't a qualified disaster loss, the next thing that's going to happen is you're going to lose casualty loss deduction up to 10% of your AGI. Here, we lose $15,000.

See the differential that we're down to now? For normal loss deductions, we're looking at maybe a loss deduction of 17,400. For qualified disaster loss outcome, $32,000. Also, Schedule A. To the left, the normal rules, you don't get anything. You don't get that $17,400 at all unless you're tacking it on to a Schedule A 1040 on the right-hand side, more beneficial set of rules, yeah, you can claim it on the Schedule A, or you can add it to the standard deduction.

I don't want to get too deep into that, but I did just provide a quick note here. It's a little odd, but I often will get asked by practitioners, "Okay, I'm going to add it to the taxpayer's standard deduction. How do I do that?" Two things. First of all, you're going to complete, as you will in all cases, the Form 4684, casualties and thefts, but for those taxpayers that have qualified disaster loss and you want to add it to their standard deduction, believe it or not, you're actually going to use Schedule A anyway. You're not going to reflect medical expenses, or taxes, or charitable gifts, or mortgage interest, but you're going to go down to the bottom quarter of that form, line 15, line 16, and you'll see in the instructions to the Schedule A 1040 that you actually report that loss there, just the casualty loss, and then that will allow your tax software to tack it on to your standard deduction.

Let's talk here a little bit about the amount deductible, and I'm going to just give you a heads-up that as we move through, we're going to talk really about general rules, but then we will, as part of this discussion, drill down into what the key differences are between how our 1040 folks will determine the amount deductible, we've already kind of taken a, a big picture look at that, and what the differences are for our business taxpayers. In other words, taxpayers with trade or business assets, or assets held for the production of income, so there maybe think rental property.

This is your general rule. You're going to figure the amount of loss, really one of two big picture ways, and we'll get into some more of the semantics, you know, what you might use to determine these various things, IRS safe harbors that have been provided, but this is your big picture. One, you're going to determine the difference in the fair market value. I like to use this term, and I'm sure I will throughout this chat, the fair market value delta. What was the fair market value of whatever this asset or piece of personal property was the moment before the event versus after? Now, of course, if it's completely destroyed, the after is zero, and the fair market value before, that becomes your entire delta.

Number two, and I'm going to say this is going to be easier for our business taxpayers than it's going to be for most of our individuals, but we do the best we can, determine the amount of the adjusted basis. I'm not going to get into that in more detail, folks, but that's this regulation. It's our go-to rules for how we determine cost basis, for determining if we had sold it, or had some other taxable disposition, what would be the adjusted basis of the asset at issue?

Businesses, you're going to go most likely to detailed fixed asset worksheets and schedules. For individuals, that could be pretty difficult if we're talking about something like furniture, but for their home, we're likely to already have, for example, a closing statement where we've capitalized things like, you know, certain commissions or perhaps filing fees and the like. From whichever one, number one or number two is less, you're always going to need to subtract anything that was essentially already compensated to you, whether it's generally in the form of insurance, sometimes it's going to be in the form of grants, other reimbursements, or something actually that we'll touch on a little later, something called no-cost repairs. So, we'll put a pin in that for now, but we'll come back to that a little later.

This is one thing that I get a lot of questions about when I chat with my clients or tax practitioners, "Well, what about insurance?" And it can be a tricky one. We'll have to look at insurance a couple of times together as we move through this conversation. Individuals have a very specific rule that essentially says if you have loss, whether from real property, maybe it's a vehicle, maybe it's personal property, the contents of your home, you know what? Try to get your money back, right? You should file a timely insurance claim. Some folks may say, "You know what? I really don't want to have to do that. Either don't want the hassle or I don't think it's going to be enough money to be worth it." Or, you know, "Maybe I don't want my premiums to go up if my insurance company has to make a claim or pay out a claim." And while that's perfectly understandable, understand that there's no tax write-off for anything that would have been covered had your insurance company received a timely claim and potentially paid. So it's not like, in other words, we can substitute a personal casualty loss instead of doing an insurance claim. The only portion of something that is otherwise covered by insurance that we can go ahead and throw into that casualty loss calculation that we looked at is anything not covered by insurance that might be a deductible. In many cases, unfortunately, it's oftentimes losses in excess of coverage. Please note, folks, and this is going to be the first thing that I will remind you of in terms of determining the difference between treatment, between businesses and personal losses, there's no requirement that businesses need to file an insurance claim.

Again, we're in the general rule component. Let's talk about determining loss or personal casualty gain, and that happens more than I think a lot of individual and business taxpayers may really appreciate, because of those insurance proceeds. For example, you get a nice big insurance check for something with relatively modest cost basis or cost basis after depreciation. If you don't reinvest under what are called the involuntary conversion rules, which we will briefly touch on a little later in our chat, then you could have a casualty gain.

But big picture for our trade or business held for the production of income assets, we're going to start in terms of our analysis with the adjusted basis in the property. Now, that is after tax allowed or allowable depreciation, for example, minus any potential salvage value. Maybe something you can sell for scrap or something that still has some value, albeit much more modest than prior to the casualty event. Minus, of course, any other compensation, generally in the form of insurance, either received or anticipated. If your basis is greater than what you have left plus insurance or other reimbursement, then you're going to have a loss. Think Form 4797. Conversely, if you have some salvage value plus insurance, other reimbursement, and that is greater than your adjusted basis the moment before the casualty, then you have gain. Could be 4797, could be eligible instead for what is called an involuntary conversion, uh, reinvestment. That's Code Section 1033, and we'll touch on that in a bit.

There is an exception. Remember those two big rules, the delta in my fair market value before and after, or if less, basis. For individuals, you're going to move forward with that general rule. Businesses though, there is an exception, and what I like to think about when I get to this part of our conversation is thinking about if a taxpayer sold a business asset for zero, or scrapped a now useless fixed asset.

What we're talking about in this exception is that that trade or business asset, or that asset held for the production of income, is totally obsolete. It's been totally destroyed by the casualty. What if though the fair market value of that particular business asset immediately before the casualty was less than the adjusted basis in that property the moment before the casualty event? The general rule would mess us up here if, let's say, look at our example here.

Let's say the moment before a casualty, a taxpayer had a business asset, our C corporation has a business asset, number 10, and it has an adjusted basis, perhaps we haven't, you know, aggressively depreciated it, of $1,000, but it only has a fair market value of $750. The general rule would say the delta in the fair market value of $750 is less than basis, and therefore that would be our loss. But wait a second. If I sell a business asset or have to scrap a now useless business asset, and it has an undepreciated cost basis of $1,000, I should get that as the loss, and that is the exception. So here, even though the delta in the fair market value before and after the casualty event is only $750, because the asset was completely destroyed, the taxpayer, the business taxpayer, would be entitled to write off the entire $1,000.

Here's another place where we have a difference in how business and individual taxpayers apply these loss rules. This is what I'm going to call the identification standard. What that means is when we talk about trade or business or transactions entered into for profit, think rental property is a very easy go-to-example, we need to do these calculations, casualty loss, casualty gain, on what is called single identifiable property. Well, think about your fixed asset schedule, okay? Let's just use a manufacturing enterprise, and let's assume their manufacturing facility was flooded, and they have 50 pieces of engineering and manufacturing equipment that were waterlogged and damaged. Well, we're not going to do that claim in the aggregate. We're going to take each line of that fixed asset worksheet, each one of those pieces of machinery, and apply the rules that we've discussed and are discussing on a line by line of our fixed asset worksheet basis.

Not so for individuals. When it comes to personal, okay, so real property and improvements, so think maybe our home, our garage, our landscaping, for individuals, we basically package it all together, and under the identification standard, we aggregate all of those items for purposes of calculating. So we don't need to look at that shrub versus, you know, this window, or for those of you in the South, that lanai screen. We put it together and calculate from a real property improvement standpoint one calculation.

If one of the key components to how we determine our capital loss potential is the fair market value delta, we need to know what fair market value is. Easier sometimes said than done. Two ways, big picture, we can go about this. We're going to talk also about some IRS safe harbors that are provided here. But the big picture here is you're going to go at the method evaluation for fair market value delta, one of two ways.

First, appraisal, okay? There's all sorts of rules that we're not going to get into, uh, in terms of timing on the appraisal, obviously the professional credentialing of the appraiser. You know, taxpayers, they might be undergoing something like this, let's say for purposes of, of getting, you know, some type of other relief, loan, loan guarantee, and again, this may be something that, that certain types of assets we may have more luck or more likelihood that an appraisal is going to be relevant.

The other way that we can go at this is by looking at what is called the cost of the repairs. There are some hurdles here. This is laid out in the regs under Code Section 165. Section 165 is a huge code section. It’s titled Losses, and you have to get down into Section 165 to the casualty loss section.

Under the regs, the cost of repairs method is going to be available to substantiate that fair market value delta, as long as you can get over essentially five hurdles. Let's go through A through D, and then we'll cover the fifth. The repairs are necessary to bring this thing back. Think restoration. The amount spent for the repairs is not excessive. Okay, well, you know, that- that's obviously somewhat subjective. It's going to be very facts and circumstances driven. Three, the repairs don't do anything other than fix the damage. So for example, what wouldn't qualify there under letter C? What if you had a taxpayer that had a home with a very modest and perhaps dated kitchen? Well, you know, restoring it, you're not going to go back and attempt to put, you know, linoleum and such, and- and, you know, pre-dated appliances. But you essentially would be looking to restore that, of course, using current appliances and current materials, but you wouldn't be looking to upgrade in terms of, let's say, things like the spacing in the kitchen, uh, and potentially other, you know, accessories and improvements. You want to bring it back, you want to restore, you cannot improve. D, or number four, the value of the property after the repairs does not, as a result of the repairs, exceed the value of the property immediately before the casualty. Again, if we can think restoration rather than improvement or enhancement. The last component is you actually have to do this for the general cost of repairs methodology to be available for determining that fair market value delta. You actually have to do it.

Couple of things here for our individual taxpayers, because these are areas that even if their home largely escaped damage, and the contents of their home escaped damage, oftentimes they will, at a minimum, have loss from landscaping and/or vehicles. Very, very common for our individual taxpayers.

Landscaping, so this is IRS, actually out of their publication that I'll share with you in just a bit here. The cost of restoring landscape certainly can support that decrease, that fair market value delta. So, we may want to keep records as applicable for the cost of removing those destroyed or damaged trees or shrubs, minus any applicable salvage value, the cost of pruning or other measures to try to save or at least, uh- uh, deal with those damaged trees or shrubs, and of course, the cost of replanting.

Vehicles. You're going to see when we get just ahead in our chat, we're going to talk about some IRS safe harbors that attempt to simplify for individual taxpayers the level of documentation and work they need to do to determine their personal casualty loss. But you're going to see that vehicles, not going to qualify for the safe harbor. So when it comes to a car, chances are super good we haven't had our vehicle appraised recently. So what we're going to be able to do, and document, document, document, is turn to things like, for example, the Kelley Blue Book. Try to get as close as you can to the year, the model, the make, and the like, package, for example, the trim package. Make an accounting whether it's for or against for the age of the vehicle, perhaps the mileage on the vehicle, and the condition of the vehicle immediately before the casualty event. Document those. That should be enough to support the personal casualty loss deduction.

When we talk about the amount deductible, remember, couple of things here. We looked at this in the chart early on in our conversation. For individuals, not businesses, they will lose the first $100, or for those qualified disaster losses, the first $500. Now, keep in mind what we're saying here is that is per casualty event. Not unlikely that we have losses that can span tax years. The point of this slide is to reinforce the fact that there is one $100, and one, as applicable, $500, per casualty.

So for example, let's say that we had a federal casualty event, and it happened, it began in 2024. We had a loss of $40 in 2024, a loss in 2025 of $250. And let's assume this is a federal disaster loss, so the $100 applies. You only have one $100. You'll lose the $40 from 2024, and the first $60 of the loss in calendar year 2025, per casualty event.

Keep in mind, for our individuals that have personal casualty losses, otherwise allowable, that are not qualified disaster losses, remember, the 10% limitation does not apply to those qualified disaster losses, then you are going to apply that after the $100. And you're either going to look at your AGI in the current year, or for the disasters where we discussed where you can look at the immediate preceding year, apply the 10% AGI limit.

So for example, let's assume in September you have a taxpayer whose home is damaged by a tropical storm that's a federally declared disaster. Let's assume that's September 2025. That is not, under today's law, eligible to be a qualified disaster loss. Let's assume that the loss after insurance, because of course we need to net out insurance and other reimbursements, is $2,000, and the AGI for the year at issue is $29,500. We're going to start with $1,900, and this is unfortunately the hurdle that so many of our clients at the 1040 level never get over for the "normal" casualty loss calculation—10% of their AGI is $2,950, they get nothing.

There is a special rule in the event where personal casualty losses exceed personal casualty or rather, excuse me, personal casualty gains exceed personal casualty losses. As I mentioned, it can happen more than we may think because we tend to have the situation where taxpayers receive insurance checks for things, assets that have very modest, or for businesses, maybe even no adjusted cost basis after things like depreciation deductions historically. In the event where personal casualty gains for the tax year at issue exceed those losses, those are treated as capital gains, long-term, short-term. So think Form 8949 feeding to 1040 Schedule D.

Let's look at a quick example. Let's assume that Jonathan has an AGI of $140,000, and this is a federal disaster loss, so we're going to use the normal rules. After applying the $100 per casualty limit, he has $10,000 of non-federal casualty losses. For example, his garage had a fire due to faulty electrical wiring, had nothing to do with the federal disaster. $40,000 in federal disaster losses. Jonathan had a tough year. There was a flood, damaged his home and the contents. And $30,000 of personal casualty gains, again, oftentimes driven by insurance reimbursements. That $30,000 is first going to get netted against the non-federal casualty losses. That's taxpayer advantageous because we can't get a deduction on the Schedule A 1040 for that anyway, with the resulting $20,000 casualty gain going to offset the $40,000 of federally declared related personal casualty losses. We've already taken care of the $100. We need to get over 10% of his AGI, which means the loss is going to be deductible only $6,000. You can see the normal rule, not so great for our individual taxpayers.

Just a quick reminder, four important key differences between doing a casualty loss calculation, let's say, for a 1065 partnership taxpayer versus a 1040. One, businesses don't have the $100 or the $500 threshold. They also, of course, don't have the 10% AGI limitation. Two, we talked about the identification rules for businesses. They're going to go line by line on their fixed assets. They can't lump everything together and calculate at the aggregated level. Three, remember that exception rule. The delta of the fair market value is not going to be determinative if the moment before the casualty, the fair market value of that affected asset was less than its adjusted basis and the asset was entirely destroyed. Remember the example that we moved through with business asset number 10 just a bit earlier. Four, and then again, just perhaps for the time frame 2018 through 2025, individuals can get no personal casualty loss unless it is attributable to a federally declared disaster. Still within the amount deductible, what I want to move to is a conversation about a set of safe harbor rules.

This was provided a handful more or so years ago in the form of Revenue Procedure 2018-8. Businesses cannot use this. This is a set of safe harbor rules only for individuals. There is, provided in the revenue procedure, a set of safe harbor rules both for residential real property, so we're talking personal residences here, we're not talking trade or business or held for the production of income, and their belongings. If there is more than one property, you can choose to not use the safe harbor at all, to use it on the multiple properties, or to use it on my principal residence, but not my personal second home.

Let's start with the rules about personal use residential real property. This is a, any time we have safe harbors, or at least the majority of the time when we have safe harbors, we typically see a degree of simplification, and that's wonderful. Unfortunately, when it comes to these personal use residential real property safe harbor rules, there are, while a lot of taxpayers positively impacted because they can choose to use this, you're going to see there's going to be a significant number of 1040 taxpayers that will be excluded from being able to treat their personal residence as qualifying here, and we'll talk about who's in, who's covered, and who's not as we move through this.

First thing to keep in mind is this set of safe harbors, we're talking about personal use residential real property. Doesn't have to be your primary, okay? Could be your second personal home that doesn't have any type of rental property or any type of trade or business. Could be buildings, could be things like outbuildings, sheds, garages, ornamental trees and shrubberies, single family residence, or what the safe harbor includes, or what they call single unit within a contiguous group of attached units. So think townhouse or duplex. That's who's in.

Now we have to talk about who's not in, who cannot use this safe harbor. Of course, if you can't use the safe harbor, what are you back to? The general rule, which is fair market value delta. Think appraisal, think cost of repairs that you actually make, or if less, the adjusted basis in that asset. Of course, always taking insurance and other reimbursement into account.

Here's what's excluded. Rental property, any property containing a home office used in a trade or business or in a transaction entered into for profit. You know, I've been a CPA for better than 30 years, talked with a lot of folks over the years about home offices, and to be frank, this isn't something that I typically think of right on the tip of my tongue, but this is certainly a consideration for taxpayers in determining should they convert a portion of their, in many cases, primary residence, to a home office. Going to pop them out of eligibility here. It also does not include condominiums or cooperative units. It does not include trailers or mobile homes. That's a big swath of individual taxpayers that will not be eligible to use this set of safe harbor rules.

I'm going to tell you that we're going to cover the five components of the safe harbor for personal residential property between this and the upcoming slide. You're going to see that they're different in terms of how large a loss can be deducted and what types of action steps a taxpayer will need to do and implement to be able to utilize one of the safe harbors. There's five of them. Again, this is for residential personal use property.

We will start with what's called the estimated repair cost safe harbor method. So here, again, simplification theoretically. The taxpayer will determine that fair market value delta by using the lesser of two itemized cost estimates. Not by your brother-in-law, but by two licensed contractors. Again, think restoration, not improvement. And yes, this is simpler. However, it's also limiting. You cannot claim a residential property-based loss in excess of $20,000 using this safe harbor approach.

Even more modest is the de minimis safe harbor method. Here, we're basically going to give it our best guess, okay? "I think it's going to cost about $3,700. Document," I always tell my clients, "to restore this property." Again, restoration, not improvement, and yeah, that sounds very nice. That sounds very simple. However, it's also very modest. That is only available for casualty losses for individuals related to that personal real property of no more than $5,000.

The next three methodologies are going to be more complicated. Still simplification. Nobody's getting appraisals before and after. However, these also have no monetary caps.

The insurance safe harbor method. This is going to be one I think a lot of our 1040 clients are going to be able to use, assuming, of course, that their property is covered, whether by flood and/or homeowner's insurance. Determine the decrease in fair market value, so that's your fair market value delta, by using the estimated loss...... per the underwriting process. And again, that can be your primary homeowner's insurance or flood insurance, or a combination of the two.

The contractor safe harbor method: now here, we're not just using estimates, okay? Now here, we've committed. Here we have signed, binding contracts with a licensed contractor not to improve, but to restore the property.

Last but not least, disaster loan appraisal... that's a mouthful... safe harbor method. So I mentioned this a little earlier. Sometime taxpayers may be able to utilize appraisals that they've secured for purposes of getting federal money, federal loan, perhaps a federal guarantee of a loan from another financial institution. Again here, if we have an appraisal prepared similarly, we may be able to rely on that for purposes of documenting the fair market value increase/decrease after the casualty.

I am going to say, we're going to cover this because it's part of Revenue Procedure 2018-8, and there will likely be, dare I say, more organized 1040 clients that didn't have all their records damaged by the casualty event that might be good candidates for this. I don't know that I would use the word simplification though here, uh, under Revenue Procedure 2018-8. This is no longer... we now shifted.

We've left the personal residential real property behind us. Now what I would like to talk about are the stuff, the stuff inside our home, the stuff inside our garage. This is personal belongings. These are items of tangible personal property not owned by businesses. Again, this is personal, just for individuals, not used in any way, shape, or form in a trade or business, nor in an activity held for the production of income.

Here's where we're going to exclude, though. Does not include a boat, a plane, a mobile home, a trailer. See a lot of things with two or four wheels here. Automobiles, motorcycles, motor homes, recreational vehicles, SUVs, off-road vehicles, vans, or trucks. So none of that stuff. Remember how I mentioned maybe KelleyBook or like types of maybe online resources for things like boats or planes? Antiques, jewelry, collections, let's say maybe a coin collection, um, jewelry. I think I might have mentioned that. I got jewelry on the brain here. Other assets that are either expected to maintain or increase in value, also not candidates for this.

The first thing that we will start with is... and this is very simplistic, very straightforward for our clients, but also very limiting because the amount of loss for our real personal property or rather our personal belongings cannot be more than $5,000. So I mean, that- that's a pretty modest amount when you think about a taxpayer impacted by flooding, impacted by a tornado, impacted by a wildfire. Very modest. But if you have clients with modest economic losses, they can under the safe harbor, what's called the de minimis safe harbor method, they don't need to get appraisals. They don't need to have insurance. They don't need to have contractors do binding estimates and contracts. They need to just document a good faith estimate of the loss of value in their personal belongings.

This is the one that I just cannot get myself to extend the word simplification to. The other safe harbor for personal belongings under this revenue procedure is what is called the replacement cost safe harbor method. So essentially, you're either in or you're out. What I mean by that is you're going to either apply this to all impacted personal belongings that are not otherwise excluded, or you're not going to use it at all. So this is an all or nothing. All of your personal belongings impacted or destroyed by that casualty event, everything's in or everything's out.

There are exclusions, and these are going to sound familiar. You cannot use the replacement cost safe harbor method for, again, transportation assets, boats, planes, mobile homes, trailers, vehicles. Cannot use it for automobiles, motorcycles, motor homes, RVs, SUVs, ... And again, you cannot use it for items like antiques that are expected to, if not hold, maybe even appreciate in value over time.

Here's where this concept of simplification gets a little murky, because to use this safe harbor, what you're essentially doing is... I think of this as a reverse time value of money calculation. Here's what I mean by that. You're going to determine the current cost when you go to that furniture store to replace that sofa. What is that cost? And then I need to reduce that 10% for every year that I owned the sofa that was just destroyed in that flood. That is the reverse time value of money, and theoretically gets us to the pre-disaster fair market value. Remember, what we're doing, big picture, delta in the fair market value versus adjusted basis in that asset, which one of those is less after you consider insurance or other reimbursement. If you've owned this thing for nine or more years, well you can't keep dropping by 10% every year, so you simply use 10%.

Let's look at an example, and here's why I say maybe our most organized clients who were fortunate to not have their records destroyed in the casualty event, they're going to need to start pulling those records out to be able to use this replacement safe harbor.

Let's look at Juan. His personal belongings included a couch destroyed by a hurricane in a federally declared disaster. Juan purchased the couch four years ago, okay? That he can probably figure out, but he purchased it for $700. We're going to need to know that, right? Delta in the fair market value, adjusted basis, whichever one is less. That's the part that's going to be tricky, especially for our 1040 folks. We're going to do and document the best we can to come up with that number. Let's assume when Juan goes to his local furniture store, the cost to replace that couch is $1,000 and no insurance company is writing him a check for that. Okay, I had $1,000. I've owned the old now destroyed couch for four years at 10% each, so 10% reduction for each one of those four years of ownership means that my pre-casualty event cost, or rather fair market value of this couch just before the casualty event, is assumed to be $600. So now it's completely waterlogged and destroyed. I had to have it carted away. Its fair market value is zero. So when we look at that, that means our fair market value delta, $600 minus $0, so that's $600.The adjusted basis was $700. Of course, no depreciation allowance would be applicable. Which one's less? The delta in the fair market value of $600, the adjusted basis of $700? Obviously, the $600 in under the safe harbor, that would be Juan's applicable deduction.

You know, I, I always try to acknowledge the things that are going to be easier for our clients to put their hands on. Again, assuming that they're fortunate enough to not have to try to recreate and reconstruct records in the wake of a fire. This is going to be one that I think can be a little tricky. So again, we're going to communicate with our clients, and we're going to ask them to document, and then we get a copy of their documentation, and perhaps we add to it our own. How did we come up with this? This is no cost repairs. When we are calculating our casualty loss, we already said you need to reduce it for insurance or other actual monetary compensation. But you are also to reduce it for what are called no-cost repairs. That is, for example, the repair and the rebuilding of your personal residence, this is just an example, uh, by volunteers. And the place that my mind always goes is in the wake of Hurricane Katrina and large corps of volunteers moving through various neighborhoods, um, outside, um, or inside rather the affected areas and helping folks, uh, rebuild and at least make their homes livable. So we are... when we use that safe harbor method, we need to reduce any applicable otherwise to-be-claimed casualty loss by the cost of those no-cost repairs, and I always think of this, same thing with insurance, we can't double-dip. So here, we didn't get an insurance check, or at least we got repairs someone helped us do out of the goodness of their heart, in addition to an insurance check. We can't also take a related casualty loss.

This is just a quick example looking at some of the outcomes, and this actually comes right out of an IRS publication that I'll share with you in a little bit. There is a workbook both for individual casualty losses and a workbook, which this is an excerpt from, for business casualty losses. You might find them helpful. And when we get to the very end of our chat and we look at some resources that are available, I'm going to make sure that you know where those resources can be found. But this is just... we're not going to go through each line, but I thought you might find this helpful for reference purposes.

So remember, when we talk about potential outcomes here, trade or business assets, they can't use any of those safe harbors we just talked about. That was all 1040 personal. So businesses need to use that general rule with the one exception about an asset fully, totally destroyed who the moment before the casualty had a fair market value less than the adjusted basis. But assuming that doesn't apply, what we're using for business taxpayers is after insurance, whichever one is less, the reduction in the fair market value, the adjusted basis would mean net, right, cost basis original net of any allowed or allowable depreciation that's applicable, adjusted cost basis.

So for example, if you were to look at... let's just pick the, the, the chair. We have a chair on our fixed asset schedule with cost basis of $695. We receive, let's assume, an insurance reimbursement of $375. Well, we don't have a casualty gain because we didn't get reimbursement in excess of cost basis, so we can move past that. Let's assume it wasn't completely destroyed. That chair had a fair market value of $500 before the event, $200 after, which means a decrease of $300. Well, now, which one is less, the adjusted basis minus the insurance or the fair market value delta? Answer, fair market value delta of $300. That is that business's Form 4684 casualty loss deduction. And again, remember, businesses, they don't have a $100 or a $500 floor that they lose, nor do businesses have a 10% AGI limit.

Let's talk a little bit about insurance, and I'm going to use the word consternation here because this is really challenging for individual taxpayers especially, not that businesses always get prompt satisfactory insurance outcomes. But typically, a business coverage is a little bit more straightforward. Individuals, perhaps far less so.

When we have a casualty loss, whether we're talking individuals or businesses, that loss deduction needs to be reduced, see this word, by expected, anticipated, or certainly received insurance or other reimbursements. I already mentioned it's not at all unusual that taxpayers may receive insurance proceeds in excess of the adjusted basis of the asset or assets that were impacted by the event. If they do not reinvest, that's what is typically called the involuntary conversion set of rules, which we will briefly touch on, they could have a resulting casualty gain.

Now let's talk about those expectations. Sometimes we're really lucky as tax planners and advisors and preparers, and our client knows what their casualty loss was. They know because they have the check from their insurance company by the time we do their tax return. I will just... a logistics comment, we may want to put those folks, be very conservative when we do their extensions in terms of the allowable casualty loss anticipated based on expected insurance proceeds. But those are good taxpayers to consider doing an extension because we give time for that insurance check to come in.

Let's look at, we didn't get it exactly right. We thought we were going to get $100,000. We got something more. We got something less. If insurance is expected, we think we're going to get $100,000, but it hasn't been received yet. What happens if it's less than what was expected? We thought we were going to get $100,000. We did a casualty loss calculation for, let's say, the 2024 calendar year using 100,000, but it turns out in 2025 or 2026, our client only gets $90,000. You do not go back and amend that earlier return, not for this issue. You instead will claim that additional, in my verbal example, $10,000 resulting loss in the year it's determined that you cannot reasonably expect any further reimbursement. So we've already taken care of, as applicable, the $100 or the $500. If it is a 10% AGI limit loss, then you will have to apply the 10% AGI limit in the year that you take what we will call that trailing loss. The trailing loss specifically because the insurance was less than anticipated when we did the original casualty loss calculation.

Let's go in the other direction. What if we thought we were going to get $100,000 and then we got $110,000? Okay, well, now we've overstated our earlier years' casualty loss. So one of two things is going to happen. Maybe you have, start with scenario one, a high income taxpayer. And you know what? They didn't get any benefit from that earlier year's overstated casualty loss, because of the 10% AGI limit. Well then, they never got a tax benefit from the earlier year's casualty loss, nothing to be done.

Well, what if they did get some or all of that casualty loss as a benefit in that earlier year, and now it's turned out, since you got more insurance money, that that loss, that deduction was overstated? Again, you do not go back and amend that earlier year's return. Instead, what you will do is pick up that later amount in income, but again, and hopefully that was the compare and contrast between those two scenarios, only to the extent that that earlier year's casualty loss would have provided benefit.

The regs say if you're unsure, you know what? Don't, don't file the claim until you know. That's what we have to follow, of course, because regulations are authoritative. They're really up there in terms of substantial authority, just below the law of the code itself. That can be difficult though, when we are looking to garner a casualty loss deduction, especially for our 1040 folks, because of course there's cash flow and tax savings associated with that.

Let's now talk a little bit about the year of deduction. Remember that table that we talked about that kind of kicked it off, this whole conversation of casualty losses? You had the three different types, individuals three different types, one type for businesses. And as we moved down that chart, remember there were two types of losses, including those qualified federal disaster losses, that you have an, a choice. You can claim them in the year that is sustained. That's your go-to general rule. What year did you have the economic loss, which is almost always... I don't like to use the words always and never, but almost always going to be the year of the event itself. That's going to be the year what they say evidenced by closed and completed transactions, fixed by identifiable events. The tornado hit in 2025. That's going to be your general rule, the taxable year in which the loss is sustained.

But for those two types of losses, disaster losses, that's individuals or businesses, or the ones that the legislation gives us here and there and there, what are called qualified disaster losses for individuals only, you have a choice now. You can either claim it in the year that the loss is actually suffered, or you have the opportunity to do an election to take the loss instead in the immediate preceding tax year. There are likely many different components of making that decision.

The two for me that always leap to mind are first cash flow, both for individuals and businesses, because again, if a casualty loss event transpires, let's say in the first quarter of a calendar year, and you won't be doing the affected taxpayer, you won't be doing my tax return for a year from now, then that's going to take me a long time to actually get tax relief from the casualty event I suffered yesterday. But if I have one of these two types of losses, I can go on my immediate preceding tax return. You're going to amend it for me very quickly, near immediate tax relief, cash flow.

The other issue, I think that is something for our individual taxpayers that we're going to want to keep in mind here, is also AGI. Not for qualified disasters, but for these, our individuals have that 10% AGI floor. Course, if our AGI is pretty consistent from one year to the next, that's less of an issue. But if we have taxpayers, let's say, where last year's

AGI was much higher, where last year's AGI was much lower, that's obviously going to have an impact on the casualty loss personal calculation, and that would be a key thing we need to look at as well.

It's an election, which means it needs to be done timely, on a timely filed return, including extensions. If the return has been filed, this one, you can actually amend it. There's a very specific provision just for this one election. The election needs to be made within six months after the due date of the tax return for the disaster year. How are you going to do it? You do it right on Form 4684. That's your casualties and theft form. You can revoke it, uh, attaching a revocation statement, and you can see the instructions for the 4684 for more instructions there, for the immediate preceding year. But now you have a pretty tight window. That revocation would need to be done on or before 90 days after the due date for the preceding tax year.

Let's talk a little bit here about reporting the deduction. Left-hand side, personal use property, could be real, could be tangible, but it's personal. Same on the right side, personal use. We're not talking any trade or business stuff here. That's going to be, uh, what we'll cover on the upcoming slides. Personal casualty loss, gain, they both need to go on the 4684. When you have a casualty event, whether it's a net casualty loss, net casualty gain, you are using that 4684, period.

Schedule A, if applicable, the loss goes there. And I mentioned this a little earlier, but I'm going to remind you. Most instances, individuals with a personal casualty loss will need to itemize. However, for qualified disaster losses only, that's where that legislation comes in, we do not need to itemize. We can tack it on to our standard deduction. But the reporting for those standard deduction taxpayers, it's a little odd. You're still going to use the Schedule A. You're not going to complete it for all the normal stuff. You're not going to put mortgage interest or charitable gifts on it, but you're going to get down to the bottom lines, I believe 15 and 16, and you're going to report the casualty loss to be added to your standard deduction there, and then your tax software, both for regular and AMT purposes, will take that amount and add it for regular purposes, for example, 1040 bottom page one. If you have personal use and you have a net casualty gain, think schedule D, right? Long term, short term, that's going to be driven by the holding period of the affected asset or assets.

Now let's talk about business and income producing property. We'll start with short term. Property held one year or less. Okay, so this could be individuals, or it could be our 1120s, 1120-Ss, 1065s. This is assets used in a trade or business or held in an activity held for the production of income. Again, can't get away from having to do the Form 4684. Individuals report losses from income producing property on Schedule A, so think rental property, for example. Gains from business, gains from income producing property are going to be combined with losses from business property with the net gain or loss.... on that Form 4797.

Well, now let's talk about business and income-producing property that has a long-term holding period, specifically assets or property held more than one year. We're still going to use that Form 4684 across the board. Individuals, again, will report losses from income-producing property on Schedule A. If losses from business and income-producing property exceed, are more than, gain from those types of property, we're going to combine the losses from the business property with total gains from business and income-producing assets, and whatever the net loss/gain is, report it on the Form 4797. General rule also is if losses from the business and the income-producing property are less than or potentially equal to gains from those types of properties, again, net 4797.

The last thing I want to note here is in the event that you have trade or business, or assets held for the production of income property that generates a casualty gain, if that affected asset... And remember, for businesses, we're looking fixed asset schedule line by line. If that trade or business asset, for example, creates casualty gain, if that asset has been subject, allowed, or allowable to a depreciation allowance, the taxpayer, in addition to experiencing the realized or recognized gain, could be forced to the extent of that gain to treat it as ordinary 1245 recapture or unrecaptured 1250 gain, which is subject to that special capital gains rate of 25%, just like if they sold the property in an otherwise taxable transaction.

Federal Tax Relief

When Disaster Strikes – An Overview

1 When Disaster Strikes – Federal Tax Relief

CERIFY CPEdge

When Disaster Strikes – An Overview

- Tax policy is one of several policy tools that can be used for disaster relief. At various points in time, Congress has passed legislation to provide tax relief and to support recovery following disaster incidents.
- **Permanent** tax relief provisions may take effect following qualifying disaster events.
- **Temporary** tax relief provisions are designed to respond to specific disaster events.

2 When Disaster Strikes – Federal Tax Relief

CERIFY CPEdge

When Disaster Strikes – An Overview

- **Key definitions.**
  - *Casualty loss.* For losses of property not connected with a trade or business, or a transaction entered into for profit, losses arising from fire, storm, shipwreck, or other casualty, or from theft.
    - However, for personal losses that would otherwise be deductible in a tax year beginning after December 31, 2017, and before January 1, 2026, an individual can deduct a personal casualty loss only to the extent it is **attributable** to a *Federally declared disaster.*
    - A *casualty* is a loss arising from something sudden, unexpected, or unusual, and not from progressive deterioration due to a steadily operating cause, even if the damage was not discovered until it was complete. In addition, another prerequisite to a casualty loss deduction—physical damage to property—must also be met.

3 When Disaster Strikes – Federal Tax Relief

When Disaster Strikes – An Overview

- **Key definitions.**
  - *Federally declared disaster* means any disaster determined by the President of the United States to warrant assistance by the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act).
    - The Stafford Act constitutes the statutory authority for most federal disaster response activities—especially as they pertain to FEMA and FEMA programs—and established the presidential disaster declaration process.
  - *Disaster area* means the area determined to warrant the federal assistance.

4 When Disaster Strikes – Federal Tax Relief


When Disaster Strikes – An Overview
www.fema.gov/disaster/declarations
Disasters and Other Declarations
Declaration Date
Year (Start)
2019
Year (End)
2025
TIP: Modify the start and end year(s) to broaden search.
Declaration Type
- Any -
Incident Type
- Any -
State/Tribe
Choose some options
Search and Filter Disasters
5
When Disaster Strikes – Federal Tax Relief
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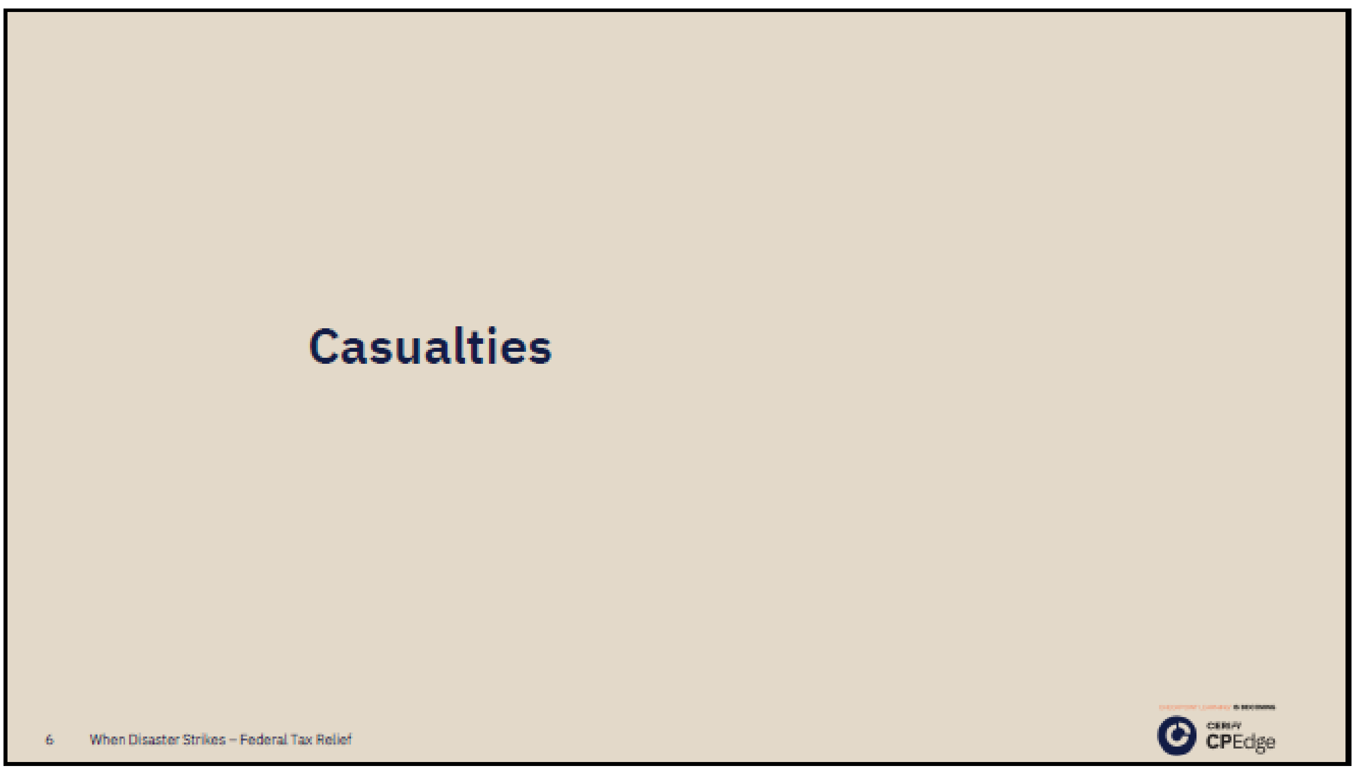
Casualties
6
When Disaster Strikes – Federal Tax Relief
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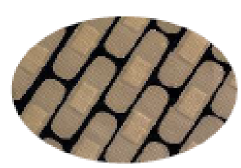
Casualties

	Personal-Use Property	Business (or Income) Property	Loss Event Occurred	Deduction Limits Apply	Required to Itemize Deductions	When Deductible
Federal casualty loss	Y	N	State-declaration	$100/ 10% AGI floor	Y	Year of loss
Disaster loss —Individuals	Y	N/A	County eligible for assistance	$100/ 10% AGI floor	Y	Year of loss OR elect prior tax year
Disaster loss —Businesses	N/A	Y	County eligible for assistance	No limit	N/A	Year of loss OR elect prior tax year
Qualified disaster loss	Y	N	**Specific disasters only**	$500/ no AGI floor	No; may add to standard deduction	Year of loss -OR- Elect prior tax year

Casualties

- A *qualified disaster loss* includes an individual's casualty loss of personal-use property that attributable to—
  - A major disaster declared under §401 of the Stafford Act in 2016.
  - Hurricane and/or Tropical Storm Harvey (2017).
  - Hurricanes Irma or Maria (2017).
  - California wildfires in 2017 and January 2018.
  - A major disaster declared under §401 of the Stafford Act and that occurred in 2018 and before December 21, 2019, and continued no later than January 19, 2020 (except those attributable to the CA wildfires in January 2018 that received prior relief).



Casualties

- The *Taxpayer Certainty and Disaster Tax Relief Act of 2020* (TCDTRA) expanded the definition of *qualified disaster loss* to included losses attributable to a **major** disaster and dated between January 1, 2020, and February 25, 2021.
- The *Federal Disaster Tax Relief Act of 2023* (FDTRA) extended the definition of *qualified disaster loss* to include losses attributable to a **major** disaster declared by the President during the period between January 1, 2020, and February 10, 2025. Note – the date of enactment of this legislation is December 12, 2024.
- However, additional rules pertain to the incident period of the disaster.

9 When Disaster Strikes – Federal Tax Relief

CPEdge

Casualties

	TCDTRA (2020)	FDTRA (2024)
Applies to major disasters	Yes	Yes
Date of declaration – period beginning	January 1, 2020	January 1, 2020
Date of declaration – period ending	February 25, 2021	February 10, 2025
Incident period beginning on or after	December 28, 2019	December 28, 2019
Incident period beginning on or before	December 27, 2020	December 12, 2024
Incident period ending no later than	January 26, 2021	January 11, 2025

10 When Disaster Strikes – Federal Tax Relief

CPEdge

Casualties

	Federal Casualty Loss Outcome	Qualified Disaster Loss Outcome
Adjusted gross income	$150,000	$150,000
Net personal casualty loss (net of casualty gains)	$32,500	$32,500
$100 loss floor	($100)	NA
$500 loss floor	NA	($500)
10% AGI floor	($15,000)	NA
Allowable casualty losses (Form 4684)	$17,400	$32,000
Deduct loss on Form 1040, Schedule A	Yes, as applicable	Yes, as applicable
Add loss to standard deduction	No	Yes, as applicable**

Note:
** See instructions to Form 4684 (Casualties and Thefts); a taxpayer's increased standard deduction reporting requires Form 4684 and Form 1040, Schedule A.

11 When Disaster Strikes – Federal Tax Relief

Amount Deductible

General rule.

- Figure the amount of loss using the following steps:
  1. Determine the amount which is equal to the fair market value (FMV) of the property immediately before the casualty reduced by the FMV of the property immediately after the casualty;
  2. Determine the amount of the adjusted basis (see Reg. 1.1011-1) for determining the loss from the sale or other disposition of the property involved before the casualty; and
  3. From the lesser of the amount determined in item 1 or 2, subtract any insurance or other reimbursement received, or expected to be received.

12 When Disaster Strikes – Federal Tax Relief

Amount Deductible

Impact of insurance.

- If an individual taxpayer's property is covered by insurance, they should file a timely insurance claim for reimbursement of their loss [see IRC Sec. 165(h)(4)(E)].
- If the individual taxpayer doesn't file an insurance claim, they can't deduct the full unrecovered amount as a casualty or theft loss; only the part of the loss that isn't covered by the insurance policy is deductible.
- The portion of the loss usually not covered by insurance (for example, a deductible) is not subject to this rule.
  - An insurance claim does not have to be filed for business-use property losses.

13 When Disaster Strikes – Federal Tax Relief

Amount Deductible

BUSINESS and INCOME-PRODUCING PROPERTY
Adjusted basis in the property (net of cost recovery deductions, as applicable)
MINUS any salvage value
MINUS any insurance or other reimbursement received (or anticipated)
Basis > (Salvage + Insurance) = LOSS on business or income-producing property
(Salvage + Insurance) > Basis = GAIN on business or income-producing property

14 When Disaster Strikes – Federal Tax Relief

Amount Deductible

Exception.

- However, if property used in a trade or business or held for the production of income is totally destroyed by casualty, and if the fair market value of the property immediately before the casualty is **less** than the adjusted basis of such property, the amount of the **adjusted basis** of such property shall be treated as the amount of the loss for purposes of IRC Sec. 165(a).
- For example, business asset #10 has an adjusted basis of $1,000 and FMV of $750 immediately before the casualty event. Asset #10 is totally destroyed in the casualty event. The realized loss is $1,000.

Amount Deductible

Identification.

- A loss incurred in a trade or business or in any transaction entered into for profit shall be determined by reference to the **single, identifiable** property damaged or destroyed (i.e., no aggregation of property).
- However, in determining a casualty loss involving real property and improvements not used in a trade or business or in any transaction entered into for profit, the improvements (such as buildings and ornamental trees and shrubbery) to the property damaged or destroyed shall be considered an integral part of the property and no separate basis need be apportioned to such improvements (i.e., **aggregation** of property for computing loss).

Amount Deductible

of valuation.

- In determining the amount of loss deductible, the FMV of the property immediately before and immediately after the casualty shall generally be ascertained by competent appraisal. This appraisal must recognize the effects of any general market decline affecting undamaged as well as damaged property which may occur simultaneously with the casualty.
- Taxpayers may be able to use an appraisal obtained for another purpose, such as getting a federal loan (or federal loan guarantee).

17 When Disaster Strikes – Federal Tax Relief

CERIFY CPEdge

Amount Deductible

of valuation.

- Alternatively, the cost of repairs to the property damaged is acceptable as evidence of the loss of value if the taxpayer shows that—
  a) the repairs are necessary to restore the property to its condition immediately before the casualty,
  b) the amount spent for such repairs is not excessive,
  c) the repairs do not care for more than the damage suffered, and
  d) the value of the property after the repairs does not as a result of the repairs exceed the value of the property immediately before the casualty [Reg. 1.165-7(a)(2)].
- Note that here the taxpayer must actually make the repairs; estimates of the costs of repair are not adequate.

18 When Disaster Strikes – Federal Tax Relief

CERIFY CPEdge

Amount Deductible

of valuation.

- **Landscaping**. The cost of restoring landscaping to its original condition after a casualty may support the decrease in FMV. A taxpayer may be able to measure his loss by what he spends on the following:
  - Removing destroyed or damaged trees and shrubs, minus any salvage value received.
  - Pruning and other measures taken to preserve damaged trees and shrubs.
  - Replanting necessary to restore the property to its approximate value before the casualty.
- **Vehicles**. Books issued by various automobile organizations that list the manufacturer, and the model of the taxpayer's car may be useful in figuring the FMV of the affected vehicle. A taxpayer may use the retail value for the car listed in the book and modify it by such factors as mileage and the condition of his car to determine its value.

Amount Deductible

Deduction limit.

- The $100 (or as applicable, $500) limitation applies separately to each casualty and applies to the **entire loss** sustained from each casualty.
- For example, if as a result of a specific federal casualty event, a taxpayer sustains in 2024 a loss of $40 and in 2025 a loss of $250, no deduction is allowable for the loss sustained in 2024 and the loss sustained in 2025 must be reduced by $60 ($100 – $40) [Reg. 1.165-7(b)(4)(ii)].

Amount Deductible

Deduction limit—10% rule.

- In cases of a Federal casualty losses or personal disaster losses, individuals must reduce their total federal casualty losses by 10% of their adjusted gross income.
  - Apply this rule after each loss is reduced by $100.
  - Remember: This 10% limitation does not apply to qualified disaster losses.

Example. In September, your house was damaged by a tropical storm that was a federally declared disaster. Your loss after insurance reimbursement was $2,000. Your adjusted gross income for the year the loss was sustained is $29,500. Figure your casualty loss as follows.

1. Loss after insurance	$2,000
2. Subtract $100	100
3. Loss after $100 rule	$1,900
4. Subtract 10% of $29,500 AGI	$2,950
5. **Casualty loss deduction**	**$ -0-**

You don't have a casualty loss deduction because your loss ($1,900) is less than 10% of your adjusted gross income ($2,950).

Amount Deductible

- A special rule applies where personal casualty gains <u>exceed</u> personal casualty losses [IRC Sec. 165(h)(2)(B)].
  - The term *personal casualty gain* means the recognized gain from any involuntary conversion of property not connected with a trade or business (or a transaction entered into for profit) arising from fire, storm, shipwreck, or other casualty, or from theft.
  - The term *personal casualty loss* means **any** loss described in IRC Sec. 165(c)(3).
- If the personal casualty gains for any taxable year <u>exceed</u> the personal casualty losses for such taxable year, all gains are treated as gains from sales or exchanges of capital assets.

Example #1: Amount Deductible

- Johnathon has AGI of $140,000. After applying the $100-per-casualty limit, he has $10,000 of nonfederal casualty losses, $40,000 in federal disaster losses, and $30,000 of personal casualty gains for the tax year.
- The $30,000 of personal casualty gains are netted with the $10,000 of nonfederal casualty losses first, resulting in net $20,000 personal casualty gains.
- Next, the $40,000 in federal disaster losses is reduced by the $20,000 personal casualty gains.
- The federal disaster loss is deductible to the extent it exceeds 10% of his AGI, or $6,000 [$20,000 net federal disaster losses – 14,000 ($140,000 x 10%)].

Amount Deductible

Reminder.

- Four important differences exist between business and personal casualty losses:
  1. No percentage of AGI or $100 (or $500) per casualty threshold applies to limit the amount deductible for business casualty losses.
  2. For real property, a business casualty loss or involuntary conversion gain is calculated **separately** for each identifiable piece of property [Reg. 1.165-7(b)(2)].
  3. If business property is totally destroyed in a casualty and the fair market value of the property is less than its adjusted basis immediately before the casualty, the loss is calculated **solely** by considering the adjusted basis and the insurance proceeds. The decrease in FMV is not considered [Reg. 1.165-7(b)(1)(ii)].
  4. For tax years beginning after December 31, 2017, and before January 1, 2026, personal casualty losses of an individual are deductible only to the extent they are attributable to a federally declared disaster [IRC Sec. 165(h)(5)]. No such limitation exists for business casualty losses.

Amount Deductible

- The IRS has provided safe harbors for individuals determining their casualty losses for personal-use residential real property and personal belongings (Rev. Proc. 2018-8).
- If more than one property is owned, the election of a safe harbor is made separately for each property.
- If an individual owns two or more parcels of personal-use residential real property, the use of a safe harbor for one parcel does not require the individual to use the same safe harbor , or any safe harbor , for any other parcel.

25 When Disaster Strikes – Federal Tax Relief

CPEdge

Amount Deductible

- Rev. Proc. 2018-8 provides optional safe harbors for casualty losses on **personal-use residential real property** due to a Federally declared disaster.
  - Personal-use residential real property is real property, including improvements (such as buildings and ornamental trees and shrubbery), that is owned by the individual who suffered a casualty loss and that contains at least one personal residence.
  - A personal residence is a single-family residence, or a single unit within a contiguous group of attached residential units (for example, a townhouse or duplex), owned by the individual who suffered a casualty loss, and includes any structures attached to the residence or single unit.

26 When Disaster Strikes – Federal Tax Relief

CPEdge

Amount Deductible

- However, personal-use residential real property does not include any property used as rental property or any property containing a home office used in a trade or business or transaction entered into for profit.
- It also does not include any condo or co-op if the taxpayer does not own the structural components (e.g., foundation, walls, roof) or owns only a fractional interest in all the structural components (as opposed to specific components).
- Trailers and mobile homes are also excluded.

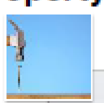
27 When Disaster Strikes – Federal Tax Relief

Amount Deductible

Personal-use residential real property.

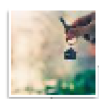
Estimated repair cost safe harbor

- Determine the decrease in FMV using lesser of two itemized cost estimates (prepared by licensed contractors).
- Do not include improvements or additions that increase FMV.
- Available for casualty losses of $20,000 or less.



***De minimis* safe harbor**

- Determine the decrease in FMV by estimating cost to restore property.
- Do not include improvements or additions that increase FMV.
- Available for casualty losses of $5,000 or less.



Insurance safe harbor

- Determine the decrease in FMV by using the estimated loss as determined in reports prepared by the individual's homeowners' or flood insurance company (estimated loss).

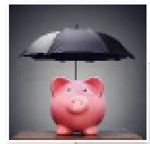
28 When Disaster Strikes – Federal Tax Relief

Amount Deductible

Personal-use residential real property.

Contractor safe harbor

- Determine the decrease in FMV using signed, binding contract with licensed contractor to restore property.
- Do not include improvements or additions that increase FMV.



Disaster loan appraisal safe harbor

- Determine the decrease in FMV by using an appraisal prepared for the purpose of obtaining a loan of Federal funds or a loan guarantee from the Federal Government setting forth the estimated loss the individual sustained as a result of the damage to or destruction of the individual's personal-use residential real property from a Federally declared disaster.

29 When Disaster Strikes – Federal Tax Relief

Amount Deductible

- Rev. Proc. 2018-8 also provides optional safe harbors for casualty losses on **personal belongings** due to a Federally declared disaster.
  - A personal belonging is an item of tangible personal property that is owned by the individual who suffered a casualty loss and that is not used in a trade or business or in a transaction entered into for profit.
  - For this purpose, personal belongings do not include a boat, aircraft, mobile home, trailer, automobile, motorcycle, motor home, recreational vehicle, sport utility vehicle, off-road vehicle, van or truck.
  - Antiques and other assets that maintain or increase their value over time are also excluded.

30 When Disaster Strikes – Federal Tax Relief

Amount Deductible

- Rev. Proc. 2018-8 also provides optional safe harbors for casualty losses on **personal belongings** due to a Federally declared disaster.
  - Under the *de minimis safe harbor* , an individual may make a good faith estimate of the decrease in the fair market value of the individual's personal belongings.

    An individual using the *de minimis safe harbor* must maintain records describing the personal belongings affected and detailing the ology used for estimating the loss.

    The *de minimis safe harbor* is available for casualty losses of $5,000 or less, prior to application of the limitations under IRC Sec. 165(h).

31 When Disaster Strikes – Federal Tax Relief

CERIFY CPEdge

Amount Deductible

- Rev. Proc. 2018-8 also provides optional safe harbors for casualty losses on **personal belongings** due to a Federally declared disaster.
  - Alternatively, an individual may use the *replacement cost safe harbor* to determine the fair market value of the individual's personal belongings located in a disaster area immediately before a Federally declared disaster in order to compute the amount of a casualty loss.

    If an individual chooses to use the *replacement cost safe harbor* for a Federally declared disaster, the individual must apply that to all qualifying personal belongings for which a loss is claimed under IRC Sec. 165 for that Federally declared disaster.

    An individual may not use this for Federally declared disasters for a boat, aircraft, mobile home, trailer, vehicle, or an antique or other asset that maintains or increases its value over time. For purposes of this revenue procedure, a vehicle is an automobile, motorcycle, motor home, recreational vehicle, sport utility vehicle, off-road vehicle, van, or truck.

32 When Disaster Strikes – Federal Tax Relief

CERIFY CPEdge

Amount Deductible

- To use the *replacement cost safe harbor* , an individual must first determine the current cost to replace the personal belonging with a new one and reduce that amount by 10% for each year the individual owned the personal belonging. This is the pre-disaster FMV of the belonging.
- If the personal belonging was owned by the individual for nine or more years, the pre-disaster fair market value is 10% of the current replacement cost under this safe harbor .

33 When Disaster Strikes – Federal Tax Relief

CPEdge

Example #2: Amount Deductible

- Juan's personal belongings included a couch destroyed by a hurricane in a Federally declared disaster area.
- Juan purchased the couch for $700 four years prior to the hurricane. The cost to replace the couch with a new couch is $1,000. The couch is not insured.
- Using the replacement cost safe harbor for Federally declared disaster areas, Juan computes the FMV of the couch immediately before the hurricane by multiplying the current replacement cost of the couch, $1,000, by 60%, or $1,000 × 60% = $600.
- Juan then determines the decrease in the fair market value of the couch by subtracting $0, the fair market value of the couch immediately after the hurricane, from $600, the fair market value of the couch immediately before the hurricane, or $600 – 0 = $600.
- Juan compares the basis of $700 with the decrease in fair market value of $600. Since the decrease in fair market value is less than the basis, the amount of his casualty loss is $600.

34 When Disaster Strikes – Federal Tax Relief

CPEdge

Amount Deductible

No-cost repairs.

- Reimbursements to individuals may include the value of repairs to (or rebuilding of) the individual's personal-use residential real property provided by another party at no cost to the individual (known as *no-cost repairs*), such as the repair or rebuilding of an individual's personal residence by volunteers.
- No-cost repairs include repairs made for a *de minimis* or token cost, donation, or gratuity.
- An individual who uses any safe harbor provided in Rev. Proc. 2018-8 to determine the decrease in the fair market value of or the amount of loss to the individual's personal-use residential real property or personal belongings must reduce the loss by the value of any no-cost repairs.

35 When Disaster Strikes – Federal Tax Relief

Example #3: Amount Deductible

Schedule 1. **Office Furniture and Fixtures**

(1) Item	(2) Cost or other basis	(3) Insurance or other reimbursement	(4) Gain from casualty or theft [1]	(5) Fair market value before casualty	(6) Fair market value after casualty	(7) Column (5) minus column (6)	(8) Smaller of column (2) or column (7) [2]	(9) Casualty/Theft Loss (column (8) minus column (3)) [3]
Example								
Bookcase	*250.00*	*50.00*	*.00*	*150.00*	*.00*	*150.00*	*250.00*	*200.00*
Chair	*695.00*	*375.00*	*.00*	*500.00*	*200.00*	*300.00*	*300.00*	*-0-*
Desk	*425.00*	*480.00*	*55.00*					

[1] If column (3) is greater than column (2), enter the difference here and skip columns (5) through (9) for that item.

[2] If the property was completely destroyed or stolen, enter in column (8) the amount from column (2).

[3] If zero or less, enter -0-.

36 When Disaster Strikes – Federal Tax Relief

Effect of Insurance Proceeds

- Once the amount of the casualty loss is determined, it must be reduced by expected insurance or other reimbursements.
  - Note that the existence of insurance coverage may create an involuntary conversion gain rather than a loss.
  - Such a gain occurs when total reimbursements exceed the adjusted basis of the property (see IRC Sec. 1033 for more information regarding involuntary conversions and gain deferral rules).

37 When Disaster Strikes – Federal Tax Relief

CPEdge

Effect of Insurance Proceeds

- If an insurance reimbursement is expected but has not been received when the return is filed, the taxpayer must consider the expected reimbursement in determining the amount of loss [Regs. 1.165-1(c)(4) and (d)(2)(ii)].
  - If the eventual reimbursement turns out to be less than expected, a loss can be claimed in the year it is determined the taxpayer cannot reasonably expect any further reimbursement.

    The original return is not amended [Reg. 1.165-1(d)(2)(ii)].

    The additional loss is treated as if sustained in the year of settlement and is included with any other casualty losses for that year. However, the $100 per-casualty limit ($500 for a qualified disaster loss) applies separately to each casualty and applies to the entire loss sustained from such casualty or incident [Reg. 1.165-7(b)(4)(ii)].

38 When Disaster Strikes – Federal Tax Relief

CPEdge

Effect of Insurance Proceeds

- If an insurance reimbursement is expected but has not been received when the return is filed, the taxpayer must consider the expected reimbursement in determining the amount of loss [Regs. 1.165-1(c)(4) and (d)(2)(ii)].
  - If the taxpayer later receives a larger reimbursement than expected, the additional amount is included in income in the year it is received to the extent a tax benefit was obtained from the prior-year deduction [Reg. 1.165-1(d)(2)(iii)].

39 When Disaster Strikes – Federal Tax Relief

Effect of Insurance Proceeds

- If uncertainty exists about the amount of the reimbursement, that part of the loss should not be deducted until it is reasonably certain no reimbursement will be received [Reg. 1.165-1(d)(2)(i)].

40 When Disaster Strikes – Federal Tax Relief

Year of Deduction

- Generally, a loss shall be allowed as a deduction under IRC Sec. 165(a) only for the taxable year in which the loss is sustained.
- For this purpose, a loss shall be treated as sustained during the taxable year in which the loss occurs as evidenced by closed and completed transactions and as fixed by identifiable events occurring in such taxable year.

41 When Disaster Strikes – Federal Tax Relief

CPEdge

Year of Deduction

- However, if the casualty loss is a *disaster loss* or *qualified disaster loss*, the taxpayer may elect to deduct the loss on the return for the immediately preceding year [IRC Sec. 165(i); Reg. 1.165-1].
  - If that return has been filed, it may be amended for a refund of taxes already paid.
  - The election must be made within six months after the due date of the tax return for the disaster year, using Form 4684.
  - The election may be revoked by the filing of an amended return, including a revocation statement, for the preceding tax year. The revocation must be done on or before 90 days after the due date for making the original election.

42 When Disaster Strikes – Federal Tax Relief

CPEdge

Reporting the Deduction

	Personal-Use Property Loss	Personal–Use Property Gain
Form 4684	Y	Y
Schedule A**	Y, if applicable	N
Schedule D	N	Y

Note:
** For *qualified disaster losses*, see instructions to Form 4684, *Casualties and Thefts* – a taxpayer's increased standard deduction reporting requires Form 4684 and Form 1040, Schedule A.

43 When Disaster Strikes – Federal Tax Relief

Reporting the Deduction

Business and income-producing property—property held *1 year or less.*

- Use Form 4684 (Casualties and Thefts) to report gains and losses.
- Individuals report losses from income-producing property on Schedule A (Form 1040).
- Gains from business and income-producing property are combined with losses from business property and the net gain or loss is reported on Form 4797.

44 When Disaster Strikes – Federal Tax Relief

Reporting the Deduction

Business and income-producing property—property held *more than 1 year*.

- Use Form 4684 (Casualties and Thefts) to report gains and losses.
- Individuals report losses from income-producing property on Schedule A (Form 1040).
- If losses from business and income-producing property are **more** than gains from these types of property, combine the losses from business property with total gains from business and income-producing property. Report the net gain or loss as an ordinary gain or loss on Form 4797.
- Generally, if losses from business and income-producing property are **less** than or equal to gains from these types of property, report the net amount on Form 4797.
- Depreciable property. If the damaged property was depreciable property held more than one year, the taxpayer may have to treat all or part of the gain as ordinary income to the extent of depreciation allowed or allowable.

45 When Disaster Strikes – Federal Tax Relief

CERIFY CPEdge

GROUP STUDY MATERIALS

A. Discussion Questions

1. What is the difference between permanent and temporary tax relief provisions for disasters?
2. Which act extended "qualified disaster losses" through 2025?
3. What is the cost-of-repairs method?
4. Which items are excluded from the definition of "personal belongings" under the de minimis safe harbor method?
5. For the replacement cost safe harbor method, how is the pre-disaster FMV of a personal item determined?
6. How are personal casualty gains treated under IRC Sec. 165?

B. Suggested Answers to Discussion Questions

1. Permanent provisions are part of standing tax law and generally apply to qualifying disaster events under existing statutes. These often include rules under IRC §165 for casualty losses.

   Temporary provisions, on the other hand, are enacted in response to specific disaster events. They provide enhanced or more favorable treatment (e.g., broader deduction eligibility, AGI floor waivers, or standard deduction treatment) but apply only to certain disasters declared during defined periods.

2. The Federal Disaster Tax Relief Act of 2023 (FDTRA) extended the availability of qualified disaster loss treatment through 2025.

   Prior to FDTRA, the Taxpayer Certainty and Disaster Tax Relief Act of 2020 (TCDTRA) applied to disasters declared between January 1, 2020, and February 25, 2021. Individuals with losses from major federally declared disasters during that period were eligible for more favorable qualified disaster loss treatment. However, disasters declared after February 25, 2021, were not covered, and taxpayers affected by those events were subject to the more restrictive general casualty loss rules.

   The FDTRA, enacted on December 12, 2024, extended qualified disaster loss treatment to include major disasters declared by the President between January 1, 2020, and February 10, 2025. This preserved the more favorable provisions for individuals affected by those disasters, including:

   - The ability to add the loss to the standard deduction (no need to itemize)
   - A $500 per-casualty floor (instead of the usual $100)
   - Elimination of the 10% AGI floor
   - The option to claim the loss in either the disaster year or the prior tax year

   In addition, FDTRA introduced a new technical requirement: to qualify, the incident period of the disaster (i.e., the timeframe during which the disaster occurred) must begin on or after December 28, 2019, and end no later than January 11, 2025.

3. The cost-of-repairs method is one of the accepted approaches for determining the decrease in fair market value (FMV) of property damaged in a casualty event, as allowed under Treasury Regulation §1.165-7(a)(2)(ii).

   This method may also be used in certain safe harbor situations outlined in Rev. Proc. 2018-8, which provides optional safe harbors for individuals with casualty losses related to personal-use residential real property or personal belongings due to a federally declared disaster.

   To use the cost-of-repairs method, the taxpayer must show that:

   - The repairs are necessary to restore the property to its condition immediately before the casualty;
   - The amount spent for repairs is not excessive;
   - The repairs do not improve the property beyond its pre-casualty condition;
   - The post-repair value does not exceed the pre-casualty value as a result of the repairs; and
   - The repairs must actually be made — estimates alone are not sufficient.

   The cost-of-repairs method applies to:

- General casualty loss claims under IRC §165 (for both business and personal-use property).
- Safe harbor valuation of personal-use residential real property under Rev. Proc. 2018-8, specifically the:
  - Estimated repair cost safe harbor (using two licensed contractor estimates, for losses ≤ $20,000), and
  - Contractor safe harbor (based on a signed, binding contract for restoration).

4. Under Rev. Proc. 2018-8, the following are excluded from the definition of "personal belongings" for the de minimis safe harbor:
   - Boats, aircraft, mobile homes, trailers
   - Automobiles, motorcycles, motor homes, RVs, SUVs, off-road vehicles, vans, trucks
   - Antiques and other assets that maintain or increase in value over time.
5. The pre-disaster FMV is calculated by:
   1. Finding the current cost to replace the item with a new one.
   2. Reducing that amount by 10% for each year of ownership.
      - If the item was owned nine or more years, the pre-disaster FMV is 10% of the replacement cost.
6. If personal casualty gains exceed personal casualty losses in a tax year, the entire amount of gains is treated as capital gain and reported as if it were from the sale or exchange of a capital asset. These gains are typically from insurance or other reimbursements that exceed the adjusted basis of the property

PART 2. TAX CASES

Lessons from the Rich and Famous

In the second segment of this month's program, Renee Rodda reviews numerous tax cases involving the rich and famous. The facts may vary, but the issues are familiar: estate battles, dying intestate, valuation of image and likeness, right of publicity, deduction of work attire, fraud, deduction of business expenses, self-employment tax, hobby or business, and more.

Let's join Renee.

Ms. Renee Rodda

This is sort of a fun topic. One of the things we found in going through these celebrity tax cases is they really just give us some celebrity fact patterns that remind us about tax rules or considerations that have been around for a long time. And so, I think they're, they're fun and they're entertaining, but they also give you some tools to use to have conversations with your clients.

So, I think we're always looking for ways to make this tedious information a little more entertaining. And I think tying them to some, sometimes frightening celebrity fact patterns makes them that much more entertaining. So, we'll walk through this sort of collection of different cases. The only theme being that they are all related to some sort of celebrity, some a little minor celebrities, some major celebrity, but definitely items that we've found in the news.

One of the things that we hear quite a bit about are legal disputes over the estates of celebrities, and I think for me, what I find interesting about this is how often we hear about them going on years and years after celebrity deaths. Tupac Shakur's estate has been one that's given us lots of information over the years. It's more than 30 years after he passed away, and we are still seeing battles over his estate.

Years ago, we saw cases over whether the executor of his estate was embezzling from the estate. Now we have cases involving who gets rights to his NFTs, which is a Non Fungible Token based on his album art. And NFTs are a whole other conversation. We could talk about what they are and how they get sold, but in this case, if you take a look on Page 1 of the material, there was an NFT that was created and sold at auction, along with the original physical painting for $212,000.

Now, the estate has argued that they get the rights to that NFT and the income related to it because they owned the rights to the underlying art. The artist argued that if he owns the rights to the art, not the estate. This is something I think we'll see battled out in the courts, and I think it'll have a larger ramification than it does just for purposes of Tupac's estate. It's really going to be a bigger issue over these NFTs and who really owns the rights to the arts. And after they're transferred where that income belongs, which I think will then result in questions over the taxability of the income.

So, I think it's an interesting case. It's one we'll keep our eye on and one you'll probably hear an update from us on. Maybe not next year, because these cases can sometimes take quite a while, but we'll keep an eye on it for sure.

In some cases, we see situations where celebrities have no will. In other cases, they have too many wills. Prince is a celebrity who had no will. And the fact that he did not have a will meant that his estate was probated. Anyone who doesn't have a will, their estate goes through probate.

The larger the estate, the more public the estate, the more complicated the probate because what happens in probate is that the assets go into the probate. There's sort of a notification period where heirs or creditors have the right to come forward, and then those assets are distributed based on who the beneficiaries of the estate are at the end once we've determined how much is left.

Prince's estate was interesting because we had all sorts of people who came forward and said that they were siblings, children, all sorts of other family members, but the other problem with Prince's estate was there was a discrepancy over the value of the asset.

So, the estate said that the assets were valued at $82.3 million. The IRS said the assets were valued at $163.2 million. They ended up settling on $156.4 million. So, we ended up much closer to the IRS's valuation than we did to the estate's valuation. And I think that's something that we see commonly with celebrities where we have a value that's related to future earnings of the estate and the question of what is the death of that individual due to those future earnings? What does it mean for those assets over their lifetime?

And I think, you know, Prince obviously was a very well-known celebrity, and so, I think there was no question that his, his likeness, his royalties, all of those things had long standing value, but the question was, "How do we really determine that value?"

I think it's much harder in an area where we don't have sort of a regular commodity market; right? It's a little different. You're going to have one expert say it's worth this much, another says it's worth this much. In this case, the estate took the more conservative position. The IRS was a bit more aggressive. It looks like the IRS was closer to where that number should have been. That's why they settled on that $156 million number, but definitely a common issue we see with the estates of celebrities, even if there is a, will or trust in place.

When Aretha Franklin died, there was originally no will, and then all of a sudden four different wills popped up. Now, Aretha Franklin's estate was valued at about $80 million. and there were three handwritten wills that were signed, and then one will from a law firm that was unsigned.

Now Aretha lived in Michigan. Michigan doesn't require a witness, but they will recognize intent even if not all of the formalities are followed. So, her eldest son had special needs and the written wills disinherited him. But the law firm will had established a trust and then the kids ended up fighting over the wills. Recently, the jury found that the will that was found in her couch cushions was the valid will. They confirmed that based on the fact that there was a signature with a smiley face in the "A" that showed it was her signature, and they also found based on other facts and circumstances that it showed her intent.

So, you know, this is a good example of your clients who change their mind from time to time, and they say, "Well, I want to revoke my prior will and I want to create a new will," or the same thing with a trust. It's most often done through a trust, but we can see it done through wills as well.

It is smart to designate that, "I am revoking the will that was drafted on this date, and I am drafting this new will today." So, it is very clear that your intent is this later document is the one that should stand, not that prior document. I think a lot of people assume, "Well, the date is later, and so it's clear that this is what I want." You always want to spell it out and make it crystal clear, because when you're no longer there to explain what you wanted, you don't want anyone to have any question about what your wishes were.

We tend to rely on trusts to avoid probate issues and expenses, but I will tell you that sometimes probate is cheaper. Now, probably not for big estates like Aretha Franklin or Prince, but I always like to use my own family as an example here. My grandfather did not have a large estate. He lived to be 97 years old, and he lived a great life.

He was wonderful. We were able to make sure that he always lived in his house. I had one uncle who had moved in with him to make sure that we always had somebody there. And between the family members, we sort of shared duties to help make sure that he could always be at his house, and he always had everything that he needed.

My grandfather had an estate planning attorney who lived across the street from him. His estate was very well spelled out. He had drafted his trust. He said exactly what he wanted. Everything was to go to his three children, and they were to split it evenly. There had never been any large disputes between the children during their lifetime. There was one sibling who was not as close as the other two, but I don't think anybody foresaw there being any problems with my grandfather's estate.

My grandfather passed away, and to say that the wheels came off the bus would be an understatement. And to be clear, my grandfather owned a nice house in a middle-class neighborhood. At the time of his death, I think the house was probably worth about $400,000. He had maybe $100,000 left in the bank. And so we weren't talking about a significant amount of assets to be fighting over. I'm not saying that $500,000 isn't a lot of money, but we weren't talking about millions of dollars.

And one of the siblings became incredibly difficult during the administration of the estate. He argued that his brother had had the right to live there rent free for years, even though he was helping to take care of his father, and that he owed him rent for all of that time that he had lived there.

Then the one sibling wanted, my mom wanted to make sure that her brother who had moved in to take care of her dad got to continue living in the home. So, she was trying to negotiate so that they could sell to him. It was messy. It was ugly, and the administration of the estate went on for so long that the one sibling who had been living in the home taking care of the grandfather also subsequently passed away.

So, now we were left administering the estate for the two remaining siblings and the two children of the sibling who had passed away. It took about six years to administer the estate. Looking back, I would tell my grandfather, "Have it probated. Let it go through probate. The court will administer this quickly. It will not be messy. We'll get it done and it won't be a problem," but I never would have guessed that that would be that issue.

I think anytime you have a situation where you think there's possible litigation between the family members, probate might not be a bad idea. I also think if you have an asset, for example, I always like to use the situation where maybe we have a family member who's been a little bit of a slumlord and maybe we have an asset where there may be some lawsuits after their death. I like the idea of leaving that asset out of the trust and having it probated because that expedites those claims. Any claimants have to come forward during the probate claim period, and the probate court is going to hear those cases much faster than if they go through a civil court. So, probate isn't always a bad thing, but that's just my two cents on the topic for today.

On Page 3, there's a discussion of bad instruction. So Frank Zappa, again, didn't clearly spell out what he wanted to happen, and so there were no instructions about his music rights. His widow formed a trust to manage the intellectual property, and at her death, controlling interest went to two of the four children, not Dweezil, but Dweezil was still touring and using the Zappa name, which the trust owned.

So, this became, again, an issue between the siblings. And this is a great example of how litigation can be expensive. So, Dweezil paid a licensing fee until his brother sent him a cease and desist telling him he couldn't use it at all. They kept touring with a different name and then the trust sued them. They ended up having to sell the family home and the recording studio to Lady Gaga for $5.25 million to pay the legal fees. There is now a settlement. They've all negotiated. I'm sure they're not friendly, but they've come up with a settlement. It didn't have to get to that situation.

So, I think it's a good reminder that we often think about those assets that are very clear; right? I own a business, I own a property, but if there are things like royalties or other IP that may exist after death, you want to be very clear about what you want to happen with those things after you're gone. Not an issue for all clients, but it is a good reminder about how important it is to spell out all those details to avoid messy litigation where the only ones who win are the attorneys.

I have some other interesting cases where we have individuals who died with no will, celebrities. Abe Lincoln died without a will. I find that one to be very interesting because he was a lawyer. Although I will tell you that we lawyers can often be the worst about taking care of our own affairs. I was reminded of this a couple of years ago, I guess more than a couple of years ago now.

I have a trust. It's been spelled out for years. I own a piece of real estate. I thought I had changed my title to the real estate to put it into my trust. I went to sell the house. My mother, who's a realtor, pulled up the title to the property and realized I had never put it in my trust.

So, that was just a mistake on my part. I did exactly what I tell all of you and your clients not to do. I forgot to take that last step. So, my trust was just an expensive piece of paper; right? So, I always find those things interesting.

Anne Heche passed away recently. She does not have a will and her situation is even messier because her estate is being sued for $2 million after the accident that she died in. So, that's going to be something that goes on for years and years. A will wouldn't necessarily fix that problem, but I always find it interesting.

Anna Nicole Smith, after fighting over her billionaire husband's estate, never updated her will after her son's death. Sonny Bono, his death brought out an alleged love child. Stieg Larsson, his estate went to his father and his girlfriend of 32 years got nothing because he didn't properly spell out what he wanted.

Jimi Hendrix, his dad -- he did not have anything. His dad inherited the property and then disinherited Jimmy's brother and left everything to an adopted child. Probably not what Jimmy would have wanted, but again, who knows, but because he didn't spell out what he wanted. What he actually wanted, becomes irrelevant at the end.

Heath Ledger never updated his will after his daughter was born. It all went to his parents who thankfully passed it on to his daughter. Now, this is an area where it is important to remind people that you can always disclaim an inheritance. If an inheritance doesn't go to the place where it is supposed to, you can always disclaim it if that's going to send the inheritance to the right place. If the disclaimer doesn't send the inheritance to the right place, it requires a gift, which can potentially create a lifetime gifting issue depending on the size of the estate of the individual who received the inheritance that probably shouldn't have gone to them.

I was speaking with a gentleman recently. He had been married for decades. He got divorced. And after the divorce, he and his spouse went through their whole settlement agreement. They negotiated everything. They went through the divorce. They finalized everything, and this is a reminder of having to take that one last step. As part of the divorce agreement, she got her brokerage account and he got his. She never updated the beneficiary designation on her brokerage account. About six months after the divorce was settled she passed away and he was the named beneficiary of her brokerage account, even though in the divorce settlement, the brokerage account went to her.

Now, it's possible that her heirs could have tried to sue him and get it back. I don't know what would have happened in that case, but they got lucky because we're talking about a brokerage account of almost a million dollars, and he did the right thing, and he just disclaimed it so that it would go to her beneficiaries. But that doesn't always happen. It's an option and it's always something that I like to remind people is an option, but it doesn't always work out that way.

John Denver had no estate plan or pension beneficiary, which resulted in millions of lost taxes and tax-free compounding, which was unfortunate. Howard Hughes cost hundreds of millions of dollars in estate taxes. If he had left it to medical research, like he said he had wanted to, it would have saved money and it would have advanced research, but he never actually put that plan into play.

I think it's interesting. I like to use these cases. I think they're a great tool to educate your clients, to help them understand that estate plans accomplish a whole lot of goals. And I think some people think, "Well, I don't have a big estate, so I don't need an estate plan." And, yes, an estate plan, first and foremost, can be used to save taxes, but estate plans can also be used to avoid legal fees. They can keep assets private. And they can just avoid your assets going somewhere where you don't want them. And I think, you know, really anyone who has assets is not too young to have some sort of an estate plan. And it's certainly something that they should consider. It's better to consider it earlier rather than later.

Now, we touched on this a little bit at the beginning of the discussion, but especially with celebrities, one of the things that's difficult is valuing assets. I think valuing assets is always something that's tricky when we talk about an estate, whether it's your clients who have a small business or whether it's clients that have intellectual property. Michael Jackson's estate is a great, great example of this.

Michael Jackson left his image and likeness and his copyrights and music catalogs to his estate. The estate valued the image at $2,105. The IRS said it was valued at $434 million. Now, I think Michael Jackson is a really good example because certainly he was not without controversy during his lifetime.

So, the estate's argument was, look, with all the turmoil during his lifetime, it had really lessened the value of his image. We placed the value at $2,100. I don't think that any one of us would have gone with that $2,100 argument. I think there's sometimes a point where you go too far and you really hurt yourself by undervaluing something.

Like I said, the IRS said $434 million. The estate pointed to debts of $450 million and child abuse allegations, but the IRS said, "Look, you're going to have ability to monetize his image." Now, the tax court settled at $4.1 million. Looking back, we know really it could have been a much larger number, but hindsight can be tricky. It can help you or it can hurt you.

I think when you're talking about valuations you want to make sure that you're not automatically just going for the lowest valuation. You're going for a more realistic valuation. So, you don't get to the point where the IRS says, "Well, wait a minute, this is just a ridiculous number. We're going to bring in our own value," which is going to be much higher. And then you're going to be stuck fighting it out; right. So, we really want to look for that realistic valuation.

With celebrities. You have an interesting discussion of the right of publicity, and how do you value the right of publicity? It varies from state-to-state, and that can create significant differences. I think the landmark case involves the Flowers in the Attic author. The IR of the estate did not list her name as an asset. The IRS prevailed in court that it was an asset of the estate. And so, I think, you know, that's one of the things that you have to keep in mind that potentially there is a value-to-assets that you don't consider and the IRS may come after them.

I think with your non-celebrity clients, that is less likely to be an issue. But for those of you who have celebrity clients, I think it's interesting to learn lessons from some of these cases that we've seen over the years. Robin Williams is an excellent example of that. He filed a deed stating that his image can't be used in film or publicity for 25 years after his death. And then he passed his right of publicity to a charity.

So, he essentially took the value of that asset and dropped it and then passed it on to a charity. So, at some point, the charity will benefit from that, but it took a lot of that unknown out of the estate and didn't create a situation where this unknown asset that has a future value was going to create a tax liability for his heirs. Because what happens when we have a taxable estate is, let's say that for Robin Williams, the IRS had said that that future publicity was worth $20 million to the estate. Maybe it was, and maybe the estate would get the $20 million or the $200 million or whatever the number might be, but the problem is they have to pay a tax liability on it today.

So, this was a really interesting, smart estate tax planning tool because what you see in estates where you have a very high value, but not a lot of liquidity, you have to come up with a plan for the heirs to be able to pay the tax so they don't lose all of the other assets; right.

If the biggest value in Robin Williams' estate was his right of publicity after his death, there wasn't current liquidity in that. And so, his heirs would have been stuck in a situation where they had to sell other assets to pay the tax, or we would have had to have significant life insurance with huge premiums to pay the tax on that asset.

So, this planning tool was really very smart because it made sure that the assets remaining in the estate could be valued without having this unknown variable. And I think to me, shows how valuation can be an issue and how you can plan to make sure the assets that don't have liquidity maybe don't force your heirs to sell their other assets. So, I really thought that this was a very interesting planning tool.

Starting on Page 6, we switch gears and we move to the discussion of deducting work attire. I am sure that all of you have had the conversation with your clients about the fact that standard work attire is not deductible; right? Your clients want to argue that I had to buy this for work and so I should be able to take a deduction for it. It doesn't work that way.

To be able to deduct attire for work, you have to show that it is required or essential to your work, it is not suitable for general personal wear, and it is not worn for general personal wear. And these are really some very fun, very interesting cases to go through because it really shows sort of what you would have to show to demonstrate that it's not something that you wear in the normal course of your life.

Abba wore very glittering suits to ensure that they weren't suitable for street use. So, somewhere along the line, ABBA got good advice from their tax counsel who told them that, "Look, whatever you're wearing on stage, if it's just some sort of a suit, that's not necessarily going to be something that you couldn't wear on stage." So, they started wearing very glittery suits to show that, "Look, these are not suitable for use outside of us being on stage. They're deductible expense of our tour or stage performances. "

Lady Gaga wore a dress made of meat at one point. It was found to be deductible and oddly enough, it has been dried and preserved so that it will be around, I don't know how long a dried meat dress is going to stay, I guess, depending on how they preserve it, how long that will last, but it was a deductible expense.

I also think it's interesting to talk about sort of what some of these amounts cost or what some of these outfits costs. Some of them are very expensive, right, but, the meat dress was definitely an interesting one.

There's a case involving a TV anchor. Now she argued, "Look, I wear normal clothes, but I keep them at work and I never wear them for personal purposes." I think, again, this is a good example of where she probably went a little bit too far because she also included bedding, robes, workout clothes, and at the end of the day, all of those expenses definitely raised some red flags, and it was found that, "Look, just not wearing something outside of work doesn't mean that it isn't suitable to be worn outside of work."

So, whereas Lady Gaga could show, "Look, a meat dress, really isn't suitable for anything other than an event where I'm trying to get some attention." And Abba was able to show, "Look, wearing glittered suits, even though we only wear them for our performances, also, we couldn't wear them on the street as normal clothing. So, they are truly expenses of our work." This TV anchor, she, it's hard to argue that something that's a normal suit can't be worn outside of work just because you don't wear it outside of work.

There is another case involving an exotic dancer named Chesty Love. And I get a number of questions from practitioners about clients who maybe have some sort of cosmetic surgery that they argue is necessary for the line of work that they are in, whether it is a facelift or some other sort of enhancement. In this case, Chesty Love had very large implants, and she argued that she should get a deduction for her implants because they were required for her work.

She argued, "I am an exotic dancer. These make me more successful as an exotic dancer." I think a lot of people are well aware of this story. She was on talk shows, she did a number of, she was, did a number of interviews related to this. And she looked, argued, "Look, these are not suitable for personal wear." She even showed that they were so heavy that they caused her problems and damages, and that she couldn't just take them off; right? So, they were surgical enhancements. They would have to be surgically removed, and so she was successful.

I do not think that this is a situation where you could argue that any sort of enhancement in this area is going to be deductible if we have someone who is an exotic dancer, for example. I think you're really going to have to show that it went so far that it was not suitable for personal wear as we saw in the Chesty Love case. I don't think that's the normal outcome.

On Page 8, there is a good reminder to these celebrities that probably they should be smarter about what they're putting on their social media. I think there is a great case involving, an American celebrity, it doesn't necessarily mean it's someone that all of us are going to recognize. There is a performer by the name of Nuke Bizzle. Nuke promoted his pandemic unemployment scam on YouTube. And I will also say that we saw through the pandemic, be it unemployment scams or PPP loan scams, so many frauds being caught because of social media. But in this case, Nuke Bizzle promoted his scam on YouTube. He scammed the EDD to the tune of $1.2 million. And then he wrote a song called You Gotta Sell Cocaine, I Just File a Claim. And he is currently facing up to 22 years in prison because of this fraudulent activity.

And, you know, I wish that I could say that it would be easy to help these taxpayers. I don't know that you would want or non-taxpayers, fraudsters, I don't know that you even want to help them, but I do think it's a good reminder to tell your clients that what they put on social media is more public than they think.

Even if it's not necessarily public, there are people who can see it. They often take images of it. We talk about this in our divorce course as well. People will have arguments about when the date of separation actually occurred. One spouse will say it's this date. Another spouse will say it's another date. They'll look to all sorts of sources to argue who is right and who is wrong, and often you will see social media posts come up.

We have heard of the Franchise Tax Board using social media to audit taxpayers, whether it's for residency issues about where they're truly spending their time or maybe some gains that they've publicized that they didn't report on their income. So, you definitely want to watch out for those social media claims because you can get yourself into trouble.

There was also one on Facebook. There was a woman who posted, “I'm Rashia, the Queen of IRS Tax Fraud.” She used medical records to file fake returns, and then she was convicted of taking $3 million in fraudulent refunds. It looks like it could be up to $20 million. She threw a $30,000 birthday party for her daughter, and she bought her boyfriend a chrome plated Camaro. I mean, who doesn't want a chrome plated Camaro? I'm not sure where you even find a chrome plated Camaro, but Rashia, the Queen of IRS tax fraud was able to do that. So, you know, certainly something worth taking a look at.

One thing I will point out for those of you who don't know Kathryn Zdan, she does our podcasts, our weekly Federal and California podcasts. She does an amazing job. She also writes a number of our tax tribune articles, if you've never seen them. Kathryn is wonderful at taking these fun cases and finding sort of the tax rules or reminders in all of them, and I also, Kathryn and I are similar in the fact that we can easily go down a rabbit hole where we like to search out the facts about some of these individuals or also look for them on Facebook or other social media.

So, you'll notice that we do include links to the articles on these individuals. So, if you want to look up some more information, we have some links for you there where you can go ahead and find some interesting information on these cases. But be careful, it is a rabbit hole you can definitely go down.

And it wouldn't be any good celebrity tax course without talking about celebrity tax fraud. I think Al Capone is the most famous criminal who was caught because of tax fraud, but Heidi Fleiss, also. I think probably most of you remember Heidi Fleiss being in the news, but probably a lot of people are not aware that Heidi Fleiss was never convicted of pandering. She was, however, convicted of money laundering and tax evasion, and she took her dad along right down -- took her dad down right along with her.

I remember these cases because I remember her little black book and all of the celebrities that came out as part of the Heidi Fleiss case. So, it was pretty well publicized, but I do think it's interesting that in some cases they're not actually convicted of any sort of crime, but the money laundering and the tax evasion is what got her into trouble.

Richard Hatch is another one he got in trouble for tax fraud. For those of you who don't remember Richard Hatch, he was the first survivor, and he won a million dollars on the show. It's on the bottom of Page 9 and onto Page 10. I don't know how many of you remember Survivor, but it was quite a phenomenon when it first came on. It was very well publicized. So, I think there were few people who had not heard of Richard Hatch.

When Richard won the million dollars, he apparently didn't like what any of his proposed tax professionals were telling him. He shopped a number of tax professionals, but he never ended up picking one and he actually never filed a tax return. He ended up going to jail for tax evasion.

And then we have Leona Helmsley. She's addressed here on Page 10, the Queen of Mean. She's, again, one of the most famous tax cheats. She deducted furniture as a business expense and fake delivered jewelry to avoid sales tax. She got eight years in prison and a $7.1 million fine and 750 hours of community service. I also think it's interesting that Catherine added for us here at the bottom. that she died in August 2007 at the age of 87, leaving $12 million to her dog Trouble. Leona Helmsley was clearly a very interesting individual. Not really sure how else to word that, so, we're just going to leave it at that one.

Let's go on, on the bottom of Page 10 and onto Page 11. We have some musical mishaps to address. The first one involves Conway Twitty. And this is a crossover of music and business, I suppose. This is starting on Page 10 and onto Page 11. Possibly Mr. Twitty should have stuck with music, but he ended up forming a corporation to sell franchises called Twitty Burger. He got 75 individuals to invest in this corporation to sell these franchises, but the restaurants failed. And he actually tried to do the right thing. He felt bad, he felt badly. So, he decided to pay his investors back out of his future earnings. So, I think this is a case of someone trying to do the right thing, but then the question was, were those payments deductible?

He repaid $97,000 and then he deducted it as a business expense under Section 172, but it's interesting because under the law, shareholders can't deduct expenses paid on behalf of the corporation and he personally repaid the expenses. So, the question was, "Were they his expenses or were they expenses of the corporation?" At the end of the day, the IRS said, "Look, they're not expenses of his music business," but the court found that they were because the court said, "Actually, part of the value of his music business is his reputation;" right?

Let's go back to Michael Jackson and the question of what was the value of his likeness when he had no reputation; right? There is clear evidence that if your reputation is degraded, the value of your likeness is degraded. The value of your earnings are going to go down.

So, the IRS said, look, he paid these people back as part of the hamburger business, but the court said, "No, he really paid them back because he was protecting his name and his reputation." I like this again, because for those of you who don't know this about me, I am a big tax nerd. I like reading tax cases. I think they're interesting because I like to go through all the facts.

I like to look at what causes the court to be swayed one way or another, what factors the IRS or the Franchise Tax Board are going to point to. I think those are all things that we can learn from. And then also, I think it's always interesting because every once in a while, you'll find just something that's fun when you're coming across these cases or entertaining, guess fun is all a matter of perspective, but in this case, the court actually closed its opinion with a footnote, which is an ode to Conway Twitty. I am not going to sing this for all of you, although Katherine and Mike Giangrande and Sandy Weiner all requested that I do that. I will not be torturing any of you with my singing, but any of you who have musical talents might be interested in recreating this little ditty and singing it. Maybe you could share it with your clients. I'll leave it up to you, but it's a fun read there on Page 12 and onto Page 13.

Other musicians that have had trouble along the way, there is an interesting case unraveling or sort of unwinding with regards to Shakira. Shakira is being accused of failing to pay tax in Spain. If she is found to be guilty, she could owe up to 28 million euro in taxes and penalties. Now in Shira's -- "Shakira," not "Shira." In Shakira's case, she argues that she paid the tax that she owed. I think the problem here is at the time, she argues that her official residence was the Bahamas, but she also had a significant other who was a Spanish resident, and she spent time in Spain living with him.

So, it looks like at the end of the day, the argument is going to be that she had some Spanish residency, which would have created a much larger Spanish tax liability. I think she's arguing that she wasn't a resident of Spain. I think for these celebrities in particular, residency is an issue because they tend to move from place-to-place, but I think it's a good reminder for your clients when they don't establish strong residency in one place, how it can create a tax problem in other areas. So, I think that's a good reminder for you there.

Willie Nelson, he had problems where he had advisors that set up invalid tax shelters. It left him with a $16.7 million tax bill. He negotiated it down to $6 million, but he did have to sell properties and memorabilia to pay the bill.

And, you know, this is again, you know, we often hear about people shopping for advisors. They keep going around until they find someone who gives them the answer that they want to hear. I don't know that Willie Nelson did that, but in this case, they put him into some invalid tax shelters and he had some problems. So, he did have to sell off quite a few assets to pay that very large tax bill.

Lauren Hill avoided paying taxes to guarantee the safety of her and her children. She argued that she wasn't paying taxes because she was protecting them, their privacy. She ended up with house arrest, so, that didn't work out for her. And Mark Anthony has been busted not once, but twice. He also tried blaming his advisors. At the end of the day, there is no excuse that gets you out of paying the taxes and penalties because you relied on advisors. It might get you out of jail, but you're still owed the tax and penalties. So, relying on bad tax advice doesn't save you any money in the long run.

Charlie Sheen, he had a situation where he originally owed $7 million. He tried to enter into an offer in compromise with the IRS. The IRS said, “No. We think you have the ability to pay the bill.” He ended up going to tax court. He was able to successfully show that with his current status, his earnings are not what they were previously, that he doesn't have the ability to pay the full $7 million liability. And after the facts were presented in the tax appeal, they did accept the compromise, and he did get a lower amount. He did have to have a court appearance to do that. But I think it's also a reminder that when you file for an offer in compromise, it's not just automatic that they're going to take a large liability and reduce it. You're truly going to have to show that for some reason you can't pay it. And they argued that they thought he could pay. He was able to show that he could not.

We have a race car driver on Pages 14 and 15, definitely not as well of a known celebrity. He was a two-time national Hot Rod Association, Funny Car drag racing champ champion. So maybe Tony Pedragon is more well known than I know. I didn't know his name, but I did think his case was interesting because he deducted beauty pageant expenses for his daughter. His tax professional put his daughter's winnings on her parents' Schedule C. He was able to avoid accuracy-related penalties, but he did have to pay the tax and penalties on those amounts.

And then on Page 15, we have a discussion about the fact that an author's brand is part of their trader business. So, income from the use of an author's name and likeness was found to be self-employment income, even though the contract stated that there were promotion fees, they weren't separately allocated. So, the tax preparer allocated a portion as investment income, but they lost in court because they weren't separately allocated. I think possibly if you had separately allocated certain amounts, you might be able to make the argument, but in this case, they were not successful.

And then on Pages 15 and 16, this is a sad case. The founder of HD Vest, this starts, sorry, actually this is on Pages 16 and 17. The founder of HD Vest, spent $6.4 million investigating his father's murder. I think anyone can sympathize with someone who has lost a parent and certainly if their parent was murdered. You could not blame someone for spending significant sums of money trying to find the murderer. Unfortunately, in his case, he formed entities and he tried to deduct the expenses. The problem is you can only deduct expenses if there is a profit motive. In this case, they were unable to show that he had any sort of profit motive; right? It's clear what his motive was. He was trying to find his father's murderer. There is no question about that. The problem is there was no actual profit motive, and so, he was unsuccessful in deducting those expenses.

That brings me to the end of my discussion for today. I know this isn't our normal type of course, but I hope that you enjoyed having a little bit of fun taking some of these obscure cases and tying them back to some fact patterns and talking about maybe how you can apply them to your clients' fact patterns and maybe help them make some better considerations in their tax scenarios. If anything, they make for interesting conversation. And like I said, be careful going down the rabbit holes of reading some of those articles and doing some research on some of these individuals because 15 minutes can easily turn into an hour. Trust me, it happens to me all the time. I call it an occupational hazard, but I think it's really my curiosity getting carried away.

CELEBRITY TAX CASES

CELEBRITY ESTATE BATTLES

TUPAC GRADUATES FROM HOLOGRAM TO NFT

Almost 30 years after Tupac Shakur's 1996 murder, his estate is still struggling with issues related to the management of the musical assets he left behind. Past issues centered around rights to royalties and whether the estate executor was embezzling funds.

The most recent dispute concerns Shakur's last album, which was posthumously released. The album cover artwork, which was created by California artist Ronald "Riskie" Brent, was turned into a nonfungible token (NFT) and sold at auction together with the original physical painting for $212,500. Shakur's estate claimed the artwork fell under the umbrella of his property and that it "owns all of Tupac's DRR [Death Row Records] releases and recordings, including…all of the artwork created in connection with those releases and recordings."

The estate also claimed there was a copyright issue because the album cover constituted a work-for-hire under the U.S. Copyright Act. If a work is made for hire, the employer or other person for whom the work was prepared is the owner of the copyright unless both parties involved have signed a written agreement stating otherwise. If the NFT is an exact copy of the album cover, a court could find that the creator of the NFT infringed on the estate's right to the exclusive use of the intellectual property. (Sulkin, A. (August 17, 2022) "All Eyez on Tupac Shakur's Estate," Wealth Management. Available at: www.wealthmanagement.com/estate-planning/all-eyez-tupac-shakur-s-estate)

BRIDGING A $74.1 MILLION VALUATION GAP

Six years after Prince's death, the IRS and his estate settled on a value of $156.4 million, which is fairly close to the amount the IRS had proposed in 2020 ($163.2 million), and significantly more than the estate administrator's value of $82.3 million. (Estate of Prince R. Nelson v. Comm. (October 2, 2020) U.S. Tax Court, Docket No. 11442-20)

Prince died without leaving behind a will, which sent the case through a long and complicated probate and various other legal proceedings. He did not have any children, so his estate is to be divided among a music company and his siblings, two of whom have died since Prince's death in 2016.

But the issues with the IRS stemmed from the discrepancy in value between what his estate reported on the estate tax return and the IRS's valuation, with the IRS arguing for $32.4 million in estate taxes and $6.4 million in accuracy-related penalties. The assets in question were real estate interests in undeveloped land, an industrial building, and residential lots, plus interests in Paisley Park Enterprises Inc. and NPG Records, as well as a share of music compositions. There were also some issues around rights of publicity, although nothing to the extent facing Michael Jackson's estate (see "Right of publicity: An estate planning issue" on page 5).

A BATTLE OF WILLS

When Aretha Franklin passed away in August 2018, there was no known will in place. Instead, her estate was to be divided equally among her four sons in accordance with state law. At the time of her death, her total fortune was estimated to be worth up to $80 million.

However, the later discovery of not only one but three wills threw a wrench into what was otherwise a reportedly peaceful division of the estate. (Sisario, B. and Freiss, S. (May 24, 2019) "Aretha Franklin's Sons Debate Whether New Will Is Valid" New York Times)

Two of the wills were discovered in a locked cabinet, and the third was in a spiral notebook under a living room couch cushion. All three wills are holographic, meaning they are handwritten and signed by the testator. The two cabinet wills are signed and dated June 2010 and October 2010; the will found under the couch cushion was unsigned, was dated March 2014, and was barely legible, with many strikeouts and edits.

When it comes to wills, three is definitely a crowd… and then in 2021 a fourth typed will was found. It was drafted in 2018 by a law firm but was never signed by Franklin (although there are handwritten additions), and it's unclear why it emerged so many years after her death. (McCollum, B. (March 9, 2021) "Draft of 4th Aretha Franklin will emerges, two years after handwritten wills discovered" Detroit Free Press. Available at: www.freep.com/story/entertainment/music/brian-mccollum/2021/03/09/aretha-franklin-fourth-will-drafted-year-she-died-unsigned/6867582002/) May

Are the wills valid?

The presence of the first three wills had already divided the family, with two of Franklin's four sons protesting their validity. Ms. Franklin passed away at her home in Detroit, and under Michigan law, a will is valid if it's dated and the signature and the "material portions" of the will are in the testator's handwriting; no witness is required. (Michigan Estates and Protected Individuals Code §700.2502(2))

Under Michigan law, the document that is considered valid is the one that is found to provide that Ms. Franklin intended for the document to constitute her:

- Will;
- A partial or complete revocation of her will;
- An addition to or an alteration of her will; or
- A partial or complete revival of her formerly revoked will or of a formerly revoked portion of her will. (Michigan Estates and Protected Individuals Code §700.2503)

This is essentially the same as the "harmless error rule" in the Uniform Probate Code. (Uniform Probate Code §2-503)

✐ Practice Pointer

This is the reason why it's best to have a will or trust drafted by an attorney who will keep a copy. This is particularly true if the estate will contain a large number of assets.

And the winner is…

In mid-July 2023, a jury determined the 2014 couch cushion document was valid as Franklin's will. Although parts of it were difficult to read, a jury found that this document had the singer's name signed at the bottom and included "a smiley face written inside the letter 'A'" which is characteristic of her signature. The jury also found that this document showed Franklin's intent.

INSUFFICIENT INSTRUCTIONS ARE JUST AS BAD

Musician and composer Frank Zappa died in 1993 without leaving specific instructions on what to do with his publishing rights and massive archive of master recordings. Gail Zappa, his widow and mother of their four children (Moon, Dweezil, Ahmet, and Diva), eventually founded the Zappa Family Trust in 2002 to manage Frank's intellectual property. (www.nytimes.com/2015/10/09/ arts/music/gail-zappa-keeper-of-her-husbands-legacy-dies-at-70.html)

Gail died in 2015, leaving only Ahmet and Diva with controlling shares of the trust. Frank's two most famous children, Moon (who sang on Frank's top-40 single Valley Girl in 1982) and Dweezil (who was an MTV VJ in the 1980s and a musician in his own right) were left with smaller shares. (www.latimes.com/entertainment/music/la-et-ms-frank-zappa-children-where-are-they-now-20160628-snap-htmlstory.html)

Anyone who has ever filed a trust return can see where this is going.

Dweezil's most popular music project is Zappa Plays Zappa, a band he formed in 2006 as a tribute to his father's legacy that he still tours with today. The band name is owned by the trust, and he licensed it until early 2016 when Ahmet — through the Zappa Family Trust — sent him a cease-and-desist order. (www.nytimes.com/2016/04/30/business/media/whats-in-a-name-just-ask-frank-zappas-feuding-heirs.html)

The news made the New York Times, and the brothers continued arguing with each other in public through open letters on Facebook and blog posts (which have since been taken down).

Dweezil changed the name of his band and his tour, but the legal fight continued. One of the main disagreements was over the Zappa Plays Zappa merchandise money: Ahmet felt it should go to the trust, while Dweezil thought it should stay with his band — after all, they were the ones earning the money on tour year after year.

In the following months, the Zappa Family Trust put Frank Zappa's Hollywood Hills home and recording studio up for sale to help pay off the trust's debt, and Dweezil started a PledgeMusic campaign to raise money to cover legal fees in the trademark dispute over his use of the Zappa Plays Zappa name. The house sold to Lady Gaga for $5.25 million in September 2016, while Dweezil reached his fundraising goal and turned to raising money to continue to record new music.

A 2019 settlement agreement finally put the lid on the fighting between the Zappa children. As part of the settlement, before any further lawsuits can be filed, the Zappa kids must try to avert litigation by talking to each other and, if that is unsuccessful, attend mediation.

MORE INTESTATE CELEBRITIES

Abraham Lincoln was a president of many firsts: the first to wear a beard, the first to be assassinated, and (despite being a lawyer) the first to die intestate.

Even if your estate isn't worthy of celebrity status, good planning is imperative. These celebrities died either intestate or with inadequate wills, resulting in epic legal battles, as in the case of Jimi Hendrix; or life partners being left with nothing, as in the case of Stieg Larsson.

Anne Heche

Anne Heche died without a will, which led to a legal dispute between her ex-partner and her oldest son over control of her assets. While a Los Angeles court ultimately ruled in favor of Heche's son, the legal woes are expected to continue. A $2 million suit has been filed by the owners of the home Heche crashed into, and the value of the estate is in limbo following the posthumous release of Heche's second memoir.

Anna Nicole Smith

Anna Nicole received a $90 million settlement after her billionaire oil tycoon husband passed away. The settlement was later reversed and is still embroiled in legal proceedings, even though many of the original players are dead and gone.

Upon her own death in 2007, her will was woefully outdated and contradicted itself regarding provisions for any future children. The will left everything to her son, who died in 2006, and didn't provide anything for her daughter who was born in 2006. Ultimately the will was deemed invalid, because it left everything to a person who was already deceased.

Sonny Bono

When Sonny died in a skiing accident in 1998, he had no will. Among those who came forward to contest the estate were Cher, from whom he had been long divorced, and a mystery man claiming to be Sonny's lovechild from a secret relationship.

Stieg Larsson

The author of "The Girl with the Dragon Tattoo" died in 2004 without a will. Swedish law distributed his estate to his father and brother, leaving nothing to his girlfriend of 32 years.

Jimi Hendrix

Music legend Jimi Hendrix died at age 27 in 1970 and without a will. Under state law, his dad, Al, got everything, leaving his close brother Leon with nothing. Al built Hendrix's music legacy into an $80 million venture, but in his own will cut out Leon and his family in favor of his adopted daughter through a later marriage. The ensuing lawsuits brought out allegations of drug use, greed, and coercion, and lasted until 2004 — 34 years after Jimi's death.

Chief Justice Warren Burger

Chief Justice Warren Burger died in 1995 with a $1.8 million estate, but he did have a will that he typed up himself. At 176 words, Burger left out important tax clauses, and his family paid $450,000 in estate taxes, something that could have been easily avoided. His executors had to pay to go to court to get approval to complete administrative acts, such as selling real estate. Typically, a well-drafted will would have allowed for that without court approval.

Heath Ledger

When actor Heath Ledger died at age 28 in 2008, he had a will, but it was written three years before he died, prior to his relationship with Michelle Williams and the birth of their daughter, Matilda Rose. The will left everything to his parents and sister. Ledger's family has since handed over the estate to Matilda — it was estimated to be worth around $20 million.

John Denver

John Denver died in a plane crash in 1997 with no estate plan. He had an estate worth approximately $19 million, and IRS disputes lasted over six years. He also failed to name a beneficiary for his pension. As a result, millions were lost in taxes and tax-free compounding over the life of his children.

Howard Hughes

Howard Hughes left a $2.5 billion estate. The tycoon cared a great deal about leaving his estate to advance medical research, as he often indicated, but unfortunately he never put his intentions in writing. Not only did his oversight cost his estate hundreds of millions of dollars in estate taxes, but also frustrated medical treatments or cures that may have been developed with his intended gift.

<u>RIGHT OF PUBLICITY: AN ESTATE PLANNING ISSUE</u>

VALUATION OF IMAGE AND LIKENESS

In a 271-page decision, the Tax Court considered the vastly different valuations by the IRS and the estate of Michael Jackson for certain assets the star left behind: his image and likeness and his interest in two trusts that held the music copyrights and music catalogs he had purchased. (***Estate of Michael Jackson v. Commissioner of Internal Revenue***, TCM 2021-48)

The estate claimed his image was worth $2,105 (no, there are no zeroes missing), but the IRS had a slightly different number in mind: $434 million. The estate based their value on the legal issues, large debts (around $450 million), and allegations of child abuse that plagued Jackson; the IRS pointed out the estate's ability to monetize his name and image through licensing deals to the tune of $1 billion.

Ultimately, the Tax Court valued Jackson's image and likeness at $4.1 million. The court found the IRS had improperly included assets that should not have been part of the intangible value of Jackson's image and likeness. The court also found that the IRS expert had included assets that were not "known or knowable" at the point in time that the value should have been determined (i.e., at the time of Jackson's death) and had employed faulty calculations.

The IRS had assessed approximately $200 million in penalties for understatement of value. However, the court denied these penalties, because the estate had taken the steps necessary to correctly value some of the assets and had relied on reputable experts to determine appropriate value of the assets under challenge (as compared to the single expert the IRS relied upon, whose analysis the court dismissed as unreliable due to a taint of perjury).

RIGHT OF PUBLICITY

The ***Jackson*** case raises an interesting issue: valuing the right of an individual to control and choose whether and how their identity (typically, the individual's name and likeness) is used for commercial purposes, or "the right of publicity."

Right of publicity is a state law issue, so the laws vary from state to state. This was making things complicated for Prince's estate because Minnesota doesn't have a statute that protects the right of publicity.

Like Jackson's estate, Whitney Houston's estate settled with the IRS for $2 million in tax on the value of her estate's intellectual property rights. As with the ***Jackson*** case, the Houston estate had valued her right of publicity at just under $200,000, with the IRS's estimate coming in at $11.7 million. (Rothman, J. (January 5, 2018) "Whitney Houston Estate Settles with IRS over Right of Publicity Valuation" Available at: www.rightofpublicityroadmap.com/news-commentary/whitney-houston-estate-settles-irs-over-right-publicity-valuation)

VALUATION

Generally, the value of a celebrity's persona is based on the present value of the potential stream of income that could be realized from the right to that persona. This includes the future benefits of exploiting the persona, such as any existing contracts or licensing agreements plus any that are anticipated, and an estimate of the remaining useful economic life over which the celebrity's persona will continue to bring in income. (See Hope, T. J. "The Right of Publicity: An Often Overlooked Asset in Estate Planning" Available at: www.stoutadvisory.com/insights/article/right-publicity-often-overlooked-asset-estate-planning)

LANDMARK CASE

The term "right of publicity" was coined in 1953, and there were several important cases decided along the way (think Marilyn Monroe), but the 1994 landmark case that put the issue on the tax map involved the estate of V.C. Andrews, author of "Flowers in the Attic." (***Estate of Andrews v. U.S.*** (1994) 850 F.Supp. 1279)

The Andrews estate had not listed her name among its assets. But the IRS looked at the enormous success of posthumous books written by a ghostwriter and issued a deficiency for $1.25 million because of the potential for income earned under her name. The court ultimately settled on a value of $700,000, but the case solidified the notion that a celebrity's estate must acknowledge the value of the celebrity's name and likeness. (Hope, supra)

Prior to the ***Andrews*** case, the estate planning community was of the mind that a decedent's right of publicity was of no value for the purposes of calculating federal estate taxes due upon death, and therefore, did not need to be reported on the estate tax return.

Learning from others' experiences

In a move to avoid what happened to the estates of Michael Jackson, Whitney Houston, and Prince, Robin Williams filed a deed that states that his image cannot be used in any film or publicity for 25 years following his death (William passed away in 2014). He also passed the rights to his name, signature, photograph, and likeness to a charitable organization. (Hope, supra)

DEDUCTING WORK ATTIRE

For most of us, standard business casual wear is not a deductible work-related expense. Because even though we might sprint from our cars each evening to free ourselves from the shackles of tucked-in shirts and pointy heels, these items are still well within the realm of everyday wear.

Clothing expenditures, as a general rule, are not deductible as a business expense even when specific types of clothing are a necessary condition of the business or employment. There is an exception to this rule when:

1. The clothing is required or essential in the taxpayer's business or employment;
2. The clothing is not suitable for general or personal wear; and
3. The clothing is not worn for general or personal wear. (Rev. Rul. 70-474)

However, in certain professions, outlandish outfits are part of the job description… and are deductible.

GLITTERING JUMPSUITS AND MEAT DRESSES

In 2014, ABBA released a book in which they claim that the reason they wore "glittering hotpants, sequined jumpsuits, and platform heels" was to get around Swedish tax code, which only allowed the deduction for work clothing if the items were so outrageous that they weren't suitable for street use. (www.forbes.com/sites/robertwood/2014/02/18/try-lady-gagas-clever-clothes-write-off-on-your-taxes/#4e2178eb966a)

The U.S. tax code is similar, and hence, Lady Gaga's famous 2010 meat dress was deductible. The meat dress is still in existence, surprisingly. It has been dried and preserved and is on display in Las Vegas. (www.forbes.com/sites/zackomalleygreenburg/2011/04/20/lady-gaga-meaty-tax-deduction/#646d126739fc)

TRIED TO DEDUCT HER "WORK CLOSET"

A TV anchor tried to deduct $80,000 of work clothing that she claimed she kept completely separate from her personal clothing. (***Hamper v. Comm.***, TCM 2011-17) She felt that the station's wardrobe guidelines were constricting her and forcing her to purchase items that she otherwise, if not for the job, would not have purchased.

She lost, and it may have partially been because she was a little aggressive with what she included in her definition of work clothes: bedding, a robe, lingerie and underwear, active wear, running shoes, contact lenses, and an Ohio State jersey. The court noted that even though she wouldn't wear her work clothes outside of work, it didn't mean the clothes were unsuitable for personal wear.

For the rest of us, until we're allowed to show up to the office draped in carpaccio, our work attire is probably suitable for everyday wear.

CHESTY LOVE

Exotic dancer Cynthia Hess (stage name: Chesty Love) underwent multiple medical procedures to enlarge her breasts, which ultimately expanded her breast size to 56FF. (***Hess v. Comm.***, TCS 1994-79) Subsequently, her revenue doubled. When filing season rolled around, Ms. Hess took a depreciation deduction for the cost of the implants on her Schedule C.

At the ensuing Tax Court trial, it was revealed that in addition to medical problems, Hess and her husband were subjected to considerable humiliation because of the size of her breasts. She was ridiculed by people on the street, her husband suffered off-color comments and insults, and she was ostracized by most of her family.

Hess, who represented herself at trial, was able to show that her implant surgery was “incurred solely in the furtherance of the business engaged in” and “incurred in producing revenues to the business.” The sole reason she enlarged her breasts to such a “horrendous” size was to increase her success (and concomitantly her income) as a professional exotic dancer. And she succeeded, as proven by the substantial increase in her revenue immediately after the implant surgery.

Wardrobe essentials

Hess’s line of business — that of a professional exotic dancer — was such that part of her “costume” was her “freakishly” large breasts. Her implants clearly satisfy the first two criteria: 1) required or essential for her business; and 2) not suitable for general or personal wear. As to the third, she successfully argued that if she could remove her implants on a daily basis she would have done so as she preferred not to have “worn” them in her offstage personal life. However, this was physically impossible.

Because Hess’s implants were so extraordinarily large, the court found that they were useful only in her business and held that the cost of her implant surgery was depreciable.

This outlook provided by the Tax Court is more favorable than the official IRS view in Rev. Rul. 70-474 because it permits deductions for clothing that is ”essential” but not ”required” in the taxpayer’s business, and it considers whether the taxpayer really wore the clothing for personal reasons versus whether it was just suitable for personal wear.

Clearly, Hess’s breast augmentation was not “required,” but was “essential” enough for a deduction to be sustained.

<u>KEEP IT ON THE DL</u>

ADVERTISED FRAUD ON YOUTUBE

Rapper Fontrell Antonio Baines, also known as Nuke Bizzle, was arrested after boasting in a YouTube video about getting rich off an unemployment benefit scam. (https://www.yahoo.com/news/rapper-charged-coronavirus-benefit-fraud-163101525.html)

He applied for Pandemic Unemployment Assistance benefits under the CARES Act using stolen identities, and received ninety-two pre-loaded debit cards with more than $1.2 million in fraudulently obtained benefits from the California Employment Development Department. The debit cards were sent to an address linked to Bizzle.

In a YouTube video for the song “EDD,” Bizzle waves a stack of EDD envelopes and informs viewers, “You gotta sell cocaine, I just file a claim.” This advice also applies to how to land oneself in prison, because he’s now facing a sentence of up to 22 years. His case is still working its way through the courts.

BRAGGED ABOUT SCAM ON FACEBOOK

In 2013, a woman posted this statement on her Facebook page: “I’M RASHIA, THE QUEEN OF IRS TAX FRAUD.” (She must have left the caps lock on after filing all those fraudulent returns…)

“Rashia” is Rashia Wilson of Tampa, Florida, and while she may not have technically been a celebrity when she was arrested, she is one now (at least, in the tax world). She was ultimately sentenced to 21 years in prison for stealing around $3 million in fraudulent refunds. Note that she was convicted for stealing $3 million – the estimate of how much she and her co-conspirators actually stole is around $20 million. (http://heavy.com/news/2013/07/rashia-wilson-tax-fraud-cheat-florida-queen/)

She and a couple of friends were e-filing fraudulent returns from a basecamp they had set up at a motel, using the motel's wi-fi to bulk file. Somehow Rashia had gained access to medical records, and they were using the patients' information to file the fraudulent returns. When the feds caught on, their investigation took two years to complete … they called it "Operation Rainmaker" because Rashia was literally making it rain cash.

Where did the millions go?

She spent $30,000 on one of her children's birthday parties. She bought an Audi and a new house, a necklace with "Rashia" spelled out in jewels, Louis Vuitton, Gucci, and Prada handbags, and an 80-inch flat-screen TV. (www.tampabay.com/news/courts/criminal/rashia-wilson-says-she-was-no-queen-just-a-woman-struggling-with-a-past/2221627)

Her boyfriend and co-conspirator reportedly spent $100,000 to chrome plate a Camaro (with other reports being as high as over $250,000). (www.tampabay.com/news/courts/criminal/tampa-tax-fraudsters-chrome-camaro-finds-a-home-in-motor-city/2144109)

After Rashia and friends were sentenced to jail terms, the Camaro was sold at auction to a gold broker in Detroit for $36,551. What better place for such a specimen than the Motor City? (www.wtsp.com/story/news/local/2014/03/12/2038656/)

<u>THEY ALWAYS GET 'EM FOR TAX FRAUD</u>

THE HOLLYWOOD MADAME

While Al Capone is the classic case of a gangster finally getting popped for tax evasion rather than his numerous other crimes, Heidi Fleiss is another such example. Known as the Hollywood Madame whose call girl scandal exploded in the 1990s, she was not convicted for pandering, but rather for money laundering and evading tax on hundreds of thousands of dollars by funneling cash into relatives' savings accounts and a house that was purchased in her father's name. Her father, a Los Feliz, CA pediatrician, pleaded guilty to conspiracy and making false statements on loan documents.

Heidi's pandering conviction was overturned in California, but she served 20 months of a 37-month federal prison sentence for tax evasion. After her release, Heidi lived on a parrot sanctuary in Pahrump, NV, until 2022 when she bought a property in Missouri and announced she would move there after someone shot one of her parrots. (www.latimes.com/archives/la-xpm-1997-01-08-me-16452-story.html;www.theguardian.com/us-news/2022/jan/08/hollywood-madam-heidi-fleiss-leave-nevada-pet-parrot-shot)

THE SURVIVOR

Back when reality TV was in its infancy, Richard Hatch, winner of the first season of "Survivor," served two jail terms for failing to file amended returns to pay the tax owed on the $1 million he won on the show.

The first accounting firm Hatch hired to prepare his 2001 tax return calculated that he owed $441,501 in taxes, but he never filed the return. He went to a second preparer who came up with about half the amount owed, but Hatch didn't file that return, either. That second firm then prepared an "informational" return that didn't include the winnings at all, but warned Hatch not to file it. Of course, he immediately filed it. He served a total of 51 months in federal prison. (www.brysonlawfirm.com/news/253-the-irs-woes-of-the-first-survivor-winner.html)

THE QUEEN OF MEAN

Of the famous tax cheats, one of the few women on the list is hotelier Leona Helmsley, a.k.a., The Queen of Mean. Despite their enormous wealth, the Helmsleys wrote off most of their personal furniture as business purchases, more often than not failed to pay contractors, and would purchase hundreds of thousands of dollars' worth of jewelry and have empty boxes shipped to their home in Connecticut to avoid paying sales tax.

Illegal billings tied to the renovation of one of the Helmsleys' weekend mansions in Connecticut clued investigators in to tax evasion. Contractors who sued the Helmsleys for nonpayment for the work they did renovating the weekend home testified that most of the renovation costs were billed to the Helmsleys' hotels as business expenses. An investigation ensued. Helmsley was convicted of one count of conspiracy to defraud the United States, three counts of tax evasion, three counts of filing false personal tax returns, sixteen counts of assisting in the filing of false corporate and partnership tax returns, and ten counts of mail fraud. She was, however, acquitted of an extortion charge.

In the end, Helmsley received an eight-year prison sentence, 750 hours of community service, and a $7.1 million tax fraud fine in New York. She was famously quoted as saying "We don't pay taxes. Only the little people pay taxes." That may be so, but the big people go to jail.

Helmsley died in August 2007 at age 87, leaving $12 million to her dog, Trouble.

<u>MUSICAL MISHAPS</u>

LADIES AND GENTLEMEN, MR. HAROLD JENKINS

Harold Jenkins, probably better known by his stage name Conway Twitty, was one of the most popular country music stars during the mid-1960s through the 1970s. But his Tax Court appeal didn't have to do with the income from his many records, songwriting, or live performances. Instead, it concerned an investment in a restaurant business: Twitty Burger, Inc., which was formed to operate and sell franchises of Twitty Burger Fast Food Restaurants. (***Jenkins v. Comm.***, TCM 1983-667)

In 1968, Mr. Twitty solicited many of his friends and fellow musicians to invest in the burger business, of which about 75 did so by submitting checks to Twitty Burger or to Mr. Twitty on behalf of Twitty Burger. The plan was to ultimately make a public offering of stock in Twitty Burger and investors would receive shares based on their investments.

Although funds had been rolling in for almost a year, by 1969 no restaurant had been opened and it was determined that it could be quite some time before Twitty Burger met the registration requirements for a public offering of stock. As a result, debentures of Twitty Burger were issued to investors.

I don't know a thing about… burgers

By 1970, while some Twitty Burger locations had opened, Mr. Twitty was alerted to possible securities laws violations that led his legal team to determine it wouldn't be possible to register the stock. The company began to have financial difficulties and decided to shut down and ceased operating in 1971.

Mr. Twitty himself admitted, "What I know about is how to make records and how to sing songs, and I'm not too good at anything else, and Twitty Burger is a prime example." He decided to pay back the investors the amount of money they had invested in the failed enterprise, plus interest. Because Twitty Burger didn't have any assets, Mr. Twitty determined he would make the repayments out of his future earnings, which he did totaling $97,000. On his 1973 and 1974 returns he deducted the repayments he made in each year as ordinary and necessary business expenses under IRC §162.

Don't take it away

In general, a shareholder may not deduct a payment made on behalf of the corporation but instead must treat it as a capital expenditure. (***Deputy v. Dupont*** (1940) 308 U.S. 488; ***Gould v. Comm.*** (1975) 64 TC 132, 134; ***Rand v. Comm.*** (1961) 35 TC 956) However, the payment may be deducted if it is an ordinary and necessary expense of a trade or business of the shareholder. (***Lohrke v. Comm.*** (1967) 48 TC 679) The Tax Court's only issue to tackle was whether the payments to investors for his failed corporation were deductible as ordinary and necessary expenses of his country music business, which is where he deducted the expenses.

The court looked at several past cases concerning a businessperson (Conway Twitty) personally assuming an obligation of a corporation (Twitty Burger) to protect his own business or reputation (Conway Twitty, country music star). The questions were:

1. What was the motive that caused the taxpayer to pay the obligation?

2. Does that make it an appropriate expenditure?

The IRS argued that the payments Conway Twitty made to the investors in Twitty Burger were not deductible as ordinary and necessary expenses of his country music business because there was no business purpose for the payments. The IRS also argued there was no relationship between his involvement in Twitty Burger and his business of being a country music entertainer.

Mr. Twitty argued that he repaid the investors in Twitty Burger from his personal funds in order to protect his personal business reputation. His attorney pointed out, "Imagine trying to keep a band together where somebody [Twitty] has stiffed the drummer's mother." While Twitty wasn't under any legal obligation to make the repayments, he felt a moral obligation to the people who had entrusted him with their funds.

In its decision, the court noted that these payments were not made to revitalize Twitty Burger or to protect his own investment in the company. Following witness testimony that Twitty's reputation within the country music world would have suffered had he not repaid these investors (who were friends and business associates), the court concluded that there was a proximate relationship between the payments made to the holders of Twitty Burger debentures and Twitty's trade or business as a country music entertainer so as to render those payments an ordinary and necessary expense of his country music business.

While a lawsuit against Twitty was unlikely, the court agreed that the adverse publicity from the transaction could have harmed his country music business had he not made the payments and allowed the deductions.

There's a little bit of country in all of us

Everyone loves a good celebrity tax case, and this one is at the top of the list. However, after the case was decided, the subsequent sparring between the Tax Court and the IRS resulted in some unrecorded country music gems.

The Tax Court closed its opinion with the following footnote:

"Ode to Conway Twitty"

Twitty Burger went belly up
But Conway remained true
He repaid his investors, one and all
It was the moral thing to do.
His fans would not have liked it
It could have hurt his fame
Had any investors sued him
Like Merle Haggard or Sonny James.
When it was time to file taxes
Conway thought what he would do
Was deduct those payments as a business expense
Under section one-sixty-two.
In order to allow these deductions
Goes the argument of the Commissioner
The payments must be ordinary and necessary
To a business of the petitioner.
Had Conway not repaid the investors
His career would have been under cloud,
Under the unique facts of this case
Held: The deductions are allowed.

(continued)

There's a little bit of country in all of us (continued)

Not to be outdone, in a tune of its own with the catchy title "Action on Decision 1984-022," the IRS announced whether it would appeal the decision:

Our reaction to the Court's opinion is reflected in the following "Ode to Conway Twitty: A Reprise":

Harold Jenkins and Conway Twitty
They are both the same
But one was born
The other achieved fame.
The man is talented
And has many a friend
They opened a restaurant
His name he did lend.
They are two different things
Making burgers and song
The business went sour
It didn't take long.
He repaid his friends
Why did he act
Was it business or friendship
Which is fact?
Business the court held
It's deductible they feel
We disagree with the answer
But, let's not appeal.

AND ON THAT NOTE…

Shakira

After being accused by the Spanish government of failing to pay €14 million in tax on income earned between 2012 and 2014, pop star Shakira rejected a plea deal with Spanish authorities and is moving forward with a trial that she says will prove she has already paid the tax in question and owes no tax debt. The trial has been set for November 2023.

For the tax years at issue, Shakira's official residence was the Bahamas, but she also lived with footballer Gerard Pique in Barcelona. If found guilty, she faces fines of €28 million and an eight-year prison term.

Willie Nelson

Country music star Willie Nelson got into tax trouble after the IRS found that the tax shelters his accountants set up were not valid. Left with a $16.7 million tax bill (negotiated down to $6 million) in 1993, Nelson's property was seized and sold at auction, including properties in six states and assets which included boxes of master tapes, touring equipment, gold and platinum records and clothes.

He revealed in his 2015 autobiography, "It's a Long Story," while he was in Austin for questioning by IRS agents, he purposely parked his tour bus outside the IRS offices and spent lunch hours doing autograph sessions not only for the fans that showed up at the building, but also for some IRS employee

Most of the assets were purchased by friends and supporters who immediately returned the items to him. To pay off the balance, Nelson released the album “The IRS Tapes: Who Will Buy My Memories?” and did an ad spot for Taco Bell. This tactic certainly cannot be used by everyone owing money to the IRS, but it worked for Nelson; his debt was paid off by the end of 1993. (Betts, S. (February 2, 2017) “Flashback: Willie Nelson Settles IRS Tax Debt” Rolling Stone. Available at: www.rollingstone.com/music/music-country/flashback-willie-nelson-settles-irs-tax-debt-196254/)

Lauryn Hill

Ex-Fugees star Lauryn Hill dropped off the radar in order to raise her six children, but she also stopped filing and paying her taxes, “…in order to guarantee the safety and well-being of myself and my family.” She was charged with, and pleaded guilty to, three counts of tax evasion for tax years 2005–2007, during which time she earned $1.8 million from music and film royalties. She was sentenced to three months in prison followed by three months of home confinement and a year of probation.

Marc Anthony

Marc Anthony, singer and former husband of Jennifer Lopez, has been in trouble with the IRS not once, but twice. The first time was in 2007, following years of not paying taxes. When he was hit with a $2.5 million tax bill, Anthony blamed his management company, and his financial advisors ultimately pled guilty to tax evasion.

Then in 2010, New York tax authorities placed a $1.6 million lien on Anthony’s Long Island property in an attempt to collect a $3.4 million debt.

<u>MISCELLANEOUS CELEBRITY WOES</u>

TWO AND A HALF MEN **ACTOR CUTS TAX BILL IN HALF**

Charlie Sheen was able to cut his tax bill in half after years of attempting to do so and continually being shot down by the IRS. (***Sheen v. Commissioner***, Dkt. Nos. 14774-18 and 29680-21) For tax tears 2015, 2017, and 2018, he owed close to $7 million, and was denied both an installment agreement and an offer in compromise.

The offer in compromise was initially for $3.1 million and he made a $626,000 payment, which the IRS rejected (they kept the payment, though). After two Tax Court filings, the court found that the offer in compromise Sheen presented was good, and that the IRS area director for Los Angeles had wrongly rejected the offer when various others at the agency had approved it.

Ultimately, following the Tax Court appearances, the IRS accepted a $3.3 million offer in compromise plus a future income collateral agreement. Under that agreement, if Sheen’s income increases exponentially, the IRS has the right to revisit the compromise to potentially collect more.

RACECAR DRIVER AVOIDS PENALTY FOR RECKLESS DEDUCTING

Two-time National Hot Rod Association Funny Car drag racing champion Tony Pedregon was liable for tax stemming from disallowed deductions for beauty pageant expenses, which were incurred on behalf of his daughter, C.P. (***Pedregon Lopez v. Comm.***, TCM 2017-171)

When a child receives income from services performed by the child, it is the child's income and not the parents'. (IRC §73(a)) Likewise, any related expenses are considered to be incurred and paid by the child, even if the expenses were paid by a parent. (IRC §73(b))

To determine who is the "true earner" of the income, the court looked at who had ultimate direction and control over the earning of the income. C.P. performed in the pageants and was the direct recipient of the prize money from the events which she won; the court saw this as compensation for services performed in the pageant. This meant that the income from pageant winnings ($3,175 for the tax years at issue), and therefore the associated expenses ($37,177 for those same years), belonged to her.

Mr. Pedregon's CPA believed that the income was allocable to C.P.'s parents and reported the income and the deductions on their Schedule C. Because Mr. Pedregon relied in good faith on his tax professional, he escaped the accuracy-related penalty.

AUTHOR'S "BRAND" IS PART OF HER TRADE OR BUSINESS

For the purposes of calculating self-employment (SE) tax, Karin Slaughter, a well-known author of 21 novels, was unable to separate income received for writing from income received for the use of her name and likeness. (***Slaughter v. Comm.***, 2019-65) While the taxpayer was paid additional amounts based on her status as a "brand author" who reliably sells books and entices people into bookstores, the IRS proved sufficient nexus with the income to the trade or business of writing, thus subjecting all her income to SE tax.

Contracts

The taxpayer's contracts specifically provided for two types of payments: royalties and nonrefundable advances. The contracts also required the taxpayer to be available for promotional activities and included a marketing guaranty and additional benefits. However, as is the norm in the publishing industry, the contracts did not allocate the amounts for advances and royalties between writing, promoting, and other options.

Allocation of income

The taxpayer had used the same tax preparation firm for approximately 20 years, and when her team was preparing the 2010 and 2011 returns, they perceived a distinction between the amounts the taxpayer was paid for writing versus amounts paid for her name and likeness. The team concluded that these latter amounts were actually investment income not subject to self-employment tax.

In order to allocate the taxpayer's income, the team used the amount of time the taxpayer reported she spent actually writing each year and applied that ratio to the total income to calculate the Schedule C amount. The rest was reported on Schedule E.

The tax prep team did not consult with experts or appraisers regarding this apportionment. However, they did inform the taxpayer about these computations and also informed her that while they had not found any authority for treating the income in such a manner, they did not think it was an aggressive position.

Self-employment tax

For income to be subject to self-employment tax, a taxpayer must be engaged in a trade or business and the income must derive from that trade or business. (IRC §§1401(a), 1402(a) and (b))

The taxpayer argued that the amount she was paid for her writing is what a publisher would pay a nonbrand author, and any amount in excess of that was a separate and distinct payment for her brand.

However, the court agreed with the IRS that the taxpayer's income attributable to the use of her name and likeness (her brand) had sufficient nexus to the trade or business of writing, such that all of the income from her publishing contracts is subject to self-employment tax.

Authors and SE tax

An author receiving royalty income was considered to be engaged in a trade or business where he prepared new editions of a particular book plus published 28 other books over a period of years. (Rev. Rul. 68-498) The IRS similarly held that a resident alien author receiving royalty income for books published while he was a nonresident alien was considered to be engaged in a trade or business for purposes of the SE tax. (Rev. Rul. 79-390)

However, the Tax Court has held that royalties received more than five years after completion of work on a textbook requiring no later revision by the author-professor wasn't SE income where the professor wasn't regularly engaged in writing textbooks and his only royalty income came from one completed textbook. (***Langford v. Comm.***, TCM 1988-300)

INVESTIGATION INTO FAMILY SECRET IS A HOBBY, NOT A BUSINESS

Costs incurred in a taxpayer's investigation into his father's murder were not deductible because they stemmed from an activity not engaged in for profit. (***Vest v. Comm.***, TCM 2016-187) The taxpayer, a CPA and the founder of H.D. Vest which he sold to Wells Fargo for over $127 million, created several LLCs that were dedicated to, and paid the expenses for, the search for answers in his father's murder. However, the court found that there was no profit motive, as the venture never earned a single dollar during the tax years at issue.

Too personal, no profit

The taxpayer, Herb Vest, had reason to believe that his father had been murdered in 1946 when Herb was only two years old. Starting in 2003, Herb hired private investigators, forensic experts, morticians, psychiatrists, and writers to assist him with his search for the truth. His belief was that if he found answers and evidence, he could possibly turn the story into a book or a movie.

Over the years, this ultimately cost him around $6.4 million, which was paid for by several LLCs that Herb controlled. One in particular had been set up with the specific purpose of investigating his father's death. Another was a dating website that Herb had started in 2003, which also paid for some of the investigation expenses.

Following an audit, the IRS determined that the investigation expenses were attributed to an activity that was not engaged in for profit. In looking to the nine factors that establish profit motive, none were found in Herb's favor. Most importantly, he never earned a profit from the investigation activities. He did not conduct the activity in a businesslike manner and had no professional training in publishing, media, or writing. He didn't adjust the direction of his activity, even in the face of many years of massive losses. And last, he had a significant personal motive.

The court determined that the investigation activity was not engaged in for profit, resulting in a tax deficiency of $3,991,299 for the years at issue.

The case time almost forgot

In 1946, Buddy Vest, Herb Vest's father, was found dead in the back room of his cabinet shop in Gainesville, Texas. His death was ruled a suicide, and the family swept the details under the rug … until several years later when an offhand comment made by a family member dredged up unanswered questions surrounding Buddy's death.

Following the sale of his company to Wells Fargo in 2001, which netted him several million dollars, Herb finally had the resources and the time to dig for the truth behind his father's death. Years of research, private investigators, expert witnesses, and an exhumation seemed to point to homicide, maybe even a cover-up, but no suspects. Herb pressed on. In 2003, he ran a blurb in the local newspaper, offering $10,000 for information on the case and received a letter from an "M. Smith" who accurately described the crime scene. M. said she had unwittingly instigated Buddy's murder and knew the men who had committed the crime. Two were already deceased, but another was still alive, although in poor health.

Attempts to further communicate with M. Smith failed, but Herb and his team were inching closer to discovering her identity. In the meantime, the PR firm Herb hired was creating buzz around the backstory, and 48 Hours did an episode on the case. Herb enlisted a writer to chronicle the murder and his subsequent investigation, believing that a book or a movie could come of the venture. Neither did. The buzz died down, and no one was ever accused of the crime. However, the cause of Buddy's death was officially changed from suicide to murder.

GROUP STUDY MATERIALS

A. Discussion Questions

1. Regarding the celebrity tax cases, are clothing expenditures deductible as work related expenses?

2. What are the issues and the court's ruling in Conway Twitty's Tax Court appeal dealing with his investment in the restaurant business with Twitty Burger, Inc.?

3. The issue of self-employment tax is central to the case *Slaughter v. Comm.* What are the details of this case as they relate to self-employment SE tax.

B. Suggested Answers to Discussion Questions

1. Generally, clothing expenditures are not deductible as business expenses, even if they are required for work. The IRS has a strict three-part test based on *Rev. Rul. 70-474*:

   - The clothing must be required or essential in the taxpayer's business;
   - It must be not suitable for general or personal wear;
   - And it must not be worn for general or personal wear.

   The document illustrates that standard business attire (even if not worn personally) is not deductible. For instance, a TV anchor tried to deduct $80,000 in clothing (including items like lingerie and an Ohio State jersey) and was denied the deduction (*Hamper v. Comm., TCM 2011-17*).

   However, exceptions exist in unusual professions:

   - Lady Gaga's meat dress and ABBA's glittering costumes were deductible due to their outrageous nature making them unsuitable for personal wear.
   - Chesty Love, an exotic dancer, was allowed to depreciate the cost of her breast implants, her "costume," because they were essential to her performance and not personally desirable (*Hess v. Comm., TCS 1994-79*).

   So, clothing is only deductible if it's essential to the business, unsuitable for everyday use, and not actually used personally.

2. Conway Twitty (born Harold Jenkins) invested in Twitty Burger, Inc., a failed restaurant business. After its collapse, Twitty personally repaid about $97,000 to friends and colleagues who had invested, even though he wasn't legally required to do so. He then deducted these repayments as ordinary and necessary business expenses on his personal tax return.

   The IRS argued the payments were not connected to his trade or business as a country music entertainer and were therefore not deductible. However, the Tax Court ruled in Twitty's favor, finding that:

   - The payments were made to protect his reputation and maintain goodwill in the music industry;
   - His motivation was business-related, not personal;
   - The expenses were ordinary and necessary to his trade as a country music artist.

   The court referenced *Lohrke v. Comm.* and concluded there was a proximate relationship between the repayments and his music business. The case is famous not only for the ruling but for the Tax Court's poetic "Ode to Conway Twitty," affirming the deduction was allowed.

3. Karin Slaughter, a successful novelist, argued that some of her income should be exempt from self-employment (SE) tax because it related to her name and likeness (i.e., her brand) rather than her writing.

   Her contracts included royalties and advances, but did not allocate specific amounts to branding versus writing. Her tax preparers tried to split the income using time allocation, reporting some as Schedule C income (subject to SE tax) and some as investment income (not subject to SE tax).

   The IRS disagreed, and the Tax Court sided with the IRS, ruling that:

   - All income received had a sufficient nexus to her trade or business of writing;
   - Even the branding-related payments were directly tied to her identity as an author;
   - Therefore, all the income was subject to SE tax.

   This case highlights that income tied to personal brand is still business income if it's connected to the taxpayer's ongoing trade or profession

GLOSSARY OF KEY TERMS

Adjusted Basis— A term used in taxation for the dollar amount associated with an asset or ownership interest. It would be necessary to determine adjusted basis to compute the realized gain or loss on a sale, exchange, or involuntary conversion of property or the amount realized by an individual for transfer of property and/or services in exchange for an ownership interest in a partnership or corporation. Adjusted basis of an asset is generally the original cost (or other substituted basis-as in an exchange or contribution to a business in exchange for an ownership interest or a gift) plus any additions or capitalized improvements, then reduced by depreciation allowed or allowable and amounts written off due to sale or involuntary conversion. In the case of a partnership or S corporation ownership interest, the adjusted basis can also be affected by the proportionate amount of partnership or corporation income and losses and distributions from the entity to the partner-shareholder.

Casualty Loss— A casualty loss or casualty is the complete or partial destruction of property resulting from an identifiable event of a sudden, unexpected, or unusual nature. Examples are floods, storms, fires, earthquakes, and auto accidents.

Individuals may deduct a casualty loss only if the loss is incurred in a trade or business, in a transaction entered into for profit, or is a personal loss (i.e., personal-use property) arising from a disaster such as those already mentioned. Individuals usually deduct personal casualty losses as itemized deductions subject to a $100 nondeductible amount and a reduction of the loss by 10% of the taxpayer's AGI.

The Tax Cuts and Jobs Act of 2017 provides that, effective for tax years beginning after 2017 and before 2026, no deduction is allowed for personal casualty losses and theft losses except for personal casualty losses attributable to a federally declared disaster. There is an exception that a taxpayer with a personal casualty gain may deduct personal casualty losses not attributable to a federally declared disaster to the extent of those personal casualty gains.

Disaster Loss— If a casualty is sustained in an area designated as a disaster area by the president of the United States, the casualty is designated a disaster loss. A disaster loss may be treated as having occurred in the taxable year immediately preceding the year in which the disaster actually occurred. Thus, immediate tax benefits are provided to victims of the disaster by allowing the victims to amend their prior tax return.

Estate Planning — The process by which an individual determines how to divide his or her assets upon death or during their lifetime in anticipation of death.

Form 4797— Form 4797 is used to report gains and losses on the disposition of operating assets (e.g., property, plant, and equipment) as well as intangible assets (e.g., patents, copyrights, and trade names) used in a trade or business. The form is used to report ordinary income from depreciation recapture and ordinary gains and losses from sales of assets held 12 months or less. The other gains and losses reported on Form 4797 are for those that fall under IRC Section 1231. The amount of ordinary income from Form 4797 is reported on page 1 of the tax return. Any unrecaptured Section 1231 gain is reported on Schedule D as long-term capital gain.

Intestate— A person who dies without a will is said to die intestate, in contrast to testate.

Disposition of property left intestate is governed by the rules of intestate succession (rules of descent and distribution), which vary among the states. In general, it goes as follows:

1. First to a surviving spouse (usually one-third to one-half of the estate)
2. To descendants (children and grandchildren if any survive)
3. To ascendants (parents and grandparents if any survive)

4. Per stirpes is last. It is the method of dividing an intestate share that specifies that a class or group of distributes takes the share that the deceased ancestor would have been entitled to.

For example, a widow dies, leaving a son and two grandchildren—children of a deceased daughter. The son receives one-half and the two grandchildren divide the other half.

Involuntary Conversion— Occurs when the property is destroyed, stolen, condemned, or disposed of under the threat of condemnation and you receive other property or money in payment, such as insurance or a condemnation award.

NFT— A non-fungible token (NFT) is a unique digital identifier that is recorded on a blockchain and is used to certify ownership and authenticity.

Safe Harbor— A provision granting protection from liability or penalty if certain conditions are met.

Trade or Business— An activity qualifies as a trade or business if the taxpayer's primary purpose for engaging in the activity is for income or profit and the taxpayer is involved in the activity with continuity and regularity.

CPE Network®

Tax Report

Volume 38, Issue 4 **May 2025**

Choose the best response and record your answer in the space provided on the answer sheet.

1. What is a key requirement for a personal casualty loss to be deductible between 2018 and 2025?

   A. The loss must be due to theft only.
   B. The loss must be attributable to a Federally declared disaster.
   C. The taxpayer must have insurance.
   D. The loss must occur outside the U.S.

2. What does the Stafford Act authorize?

   A. The legal basis for federal disaster declarations
   B. State tax exemptions for disaster victims
   C. Private insurance reimbursements
   D. Local emergency response funding

3. Which of the following must be subtracted when calculating a deductible casualty loss?

   A. Fair market value before the casualty
   B. Adjusted basis of the property
   C. Insurance reimbursement received or expected
   D. Property tax value

4. If a business asset is totally destroyed and its FMV before the casualty is less than its adjusted basis, how is the loss amount determined?

   A. Based on the original purchase price
   B. By subtracting FMV after the event from FMV before the event
   C. The adjusted basis becomes the loss amount
   D. No loss can be deducted

5. What is the deductible threshold per casualty for federal tax purposes for losses classified as federal casualty losses?

   A. $250
   B. $100
   C. 5% of AGI
   D. There is no threshold

Continued on next page

6. What distinguishes business casualty losses from personal casualty losses?

   A. Business losses are not deductible.
   B. Business losses are subject to the $100-per-casualty limit.
   C. Business losses are deducted on Schedule A.
   D. Personal losses must be tied to a declared disaster.

7. Which method allows a taxpayer to estimate the decrease in FMV of personal belongings using good faith estimates?

   A. De minimis safe harbor method
   B. Estimated repair cost safe harbor method
   C. Disaster loan appraisal safe harbor method
   D. Replacement cost safe harbor method

8. If an individual expects an insurance reimbursement but does not receive it before filing their return, what must they do?

   A. Ignore the expected reimbursement
   B. Amend the return later
   C. Include the expected reimbursement in calculating the deductible loss
   D. Deduct the full amount of the loss

9. Which of the following results in an involuntary conversion gain?

   A. Property used for business purposes
   B. Insurance reimbursement that exceeds the property's adjusted basis
   C. Casualty losses without insurance
   D. Failure to file a timely tax return

10. How long does a taxpayer have to elect to deduct a qualified disaster loss in the prior year?

    A. Three years after the loss occurred
    B. One year from the end of the tax year
    C. Six months after the due date of the return for the disaster year
    D. By the filing deadline for the disaster year

Continued on next page

11. Which choice best describes issues surrounding Tupac Shakur's estate?

    A. The most current problem deals with the estate executor's embezzlement of funds.
    B. His estate claims there is a copyright issue because of the posthumous album cover, which was turned into a nonfungible token and was sold along with the original painting.
    C. The posthumously released album cover is constitutes "work for hire" under the U.S. Copyright Act, and the artist, not the estate, is considered the owner of the copyright.
    D. Shakur's estate claims that they own the original artwork for his latest album cover, and that they have no interest in the nonfungible token.

12. What are among the details of Aretha Franklin's estate?

    A. A total of three wills were discovered dividing her estate of $80 million.
    B. Under Michigan law, a will is valid if it is signed, dated, and witnessed.
    C. A jury in July of 2023 determined that an unsigned will that was discovered under Ms. Franklin's couch cushion is the valid will.
    D. Under Michigan law, a valid will must be drafted by an attorney.

13. What is true about the "right of publicity"?

    A. It is a state issue.
    B. All states have a statute that protects the right of publicity.
    C. Michael Jackson's estate claimed that the value of his image and likeness was $2 million.
    D. The term "right of publicity" was coined in 1994 with a landmark case involving the estate of Marilyn Monroe.

14. Rashia Wilson was the brains behind "Operation Rainmaker" – so called because she was actually making it rain cash. How did she do it?

    A. Filed for PPP loans under false names
    B. Received Pandemic Unemployment Assistance using stolen identities
    C. Shipped fake Louis Vuitton handbags internationally
    D. Used medical records to get patients' information to file fraudulent returns

15. What are among the details of *Sheen v. Commissioner* regarding Charlie Sheen's tax bill of close to $7 million?

    A. Sheen made an over $600,000 payment on an offer in compromise, which the IRS rejected by returning the funds.
    B. The IRS accepted Sheen's offer in compromise and an installment agreement.
    C. In the final agreement, the IRS has the right to revisit the compromise in the event Sheen's income goes up.
    D. The IRS's Los Angeles area director initially accepted Sheen's offer in compromise, but the deal was rejected by higher ups at the IRS.

CPE Network®
Tax Report
Volume 38, Issue 4 **May 2025**

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Segment 1	|______|	|_______|	|_______|	|_______|	|_______|	|_______|
Segment 2	|______|	|_______|	|_______|	|_______|	|_______|	|_______|

Which segment of this issue of **CPE Network® Tax Report** did you like the most, and why?

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If applicable, were prerequisite requirements appropriate? Yes ☐ No ☐ ________________________________

Were program materials accurate? Yes ☐ No ☐ ____

Were program materials relevant and contribute to the achievement of the learning objectives? Yes ☐ No ☐ __________

Were the time allocations for the program appropriate? Yes ☐ No ☐ ________________________________

Were the supplemental reading materials satisfactory? Yes ☐ No ☐ ________________________________

Were the discussion questions and answers satisfactory? Yes ☐ No ☐ ______________________________

Were the audio and visual materials effective? Yes ☐ No ☐ ______________________________________

Specific Comments: ____

____

Name/Company ____

Address ____

City/State/Zip ____

Email ____

Once Again, Thank You…
Your Input Can Have a Direct Influence on Future Issues!

CPE Network®

CPE Group Attendance Sheet

Firm/Company Name: ______________________________

Account #: ______________________________

Location: ______________________________

Program Title: CPE Network Tax Report, May 2025 Date: __________

Name	Email	Total Hrs	IRS PTIN ID (if applicable Tax only)	Sign In	Sign Out

I certify that the above individuals viewed and were participants in the group discussion with this issue/segment of the CPE Network® newsletter, and earned the number of hours shown.

Instructor Name: ______________________________ Date: __________

E-mail address: ______________________________

License State and Number: ______________________________

CPLgrading@cerifi.com

CPE Network/Webinar Delivery Tracking Report

Course Title	
Course Date:	
Start Time:	
End Time:	
Moderator Name, Credentials, and Signature Attestation of Attendance:	
Delivery Method:	Group Internet Based
Total CPE Credit:	3.0
Instructions:	During the webinar, the moderator must verify student presence a minimum of 3 times per CPE hour. This is achieved via polling questions. Sponsors must have a report which documents the responses from each student. The timing of the polling questions should be random and not made known to students prior to delivery of the course. Record the polling question responses below. Refer to the CPL Network User Guide for more instructions. Partial credit will not be issued for students who do not respond to at least 3 polling questions per CPE hour.
Brief Description of Method of Polling	Example: Zoom: During this webinar, moderator asked students to raise their hands 3 times per CPE hour. The instructor then noted the hands that were raised in the columns below.

			First CPE Hour			**CPE Hour 2**			**CPE Hour 3**			**CERIFI USE ONLY**
First Name	**Last Name**	**Student Email**	**Poll 1**	**Poll 2**	**Poll 3**	**Poll 1**	**Poll 2**	**Poll 3**	**Poll 1**	**Poll 2**	**Poll 3**	**Certificate Issued?**

CHECKPOINT LEARNING NETWORK

CPE NETWORK®
USER GUIDE

REVISED December 31, 2023

Welcome to CPE Network!

CPE Network programs enable you to deliver training programs to those in your firm in a manageable way. You can choose how you want to deliver the training in a way that suits your firm's needs: in the classroom, virtual, or self-study. You must review and understand the requirements of each of these delivery methods before conducting your training to ensure you meet (and document) all the requirements.

This User Guide has the following sections:

- **"Group Live" Format:** The instructor and all the participants are gathered into a common area, such as a conference room or training room at a location of your choice.
- **"Group Internet Based" Format:** Deliver your training over the internet via Zoom, Teams, Webex, or other application that allows the instructor to present materials that all the participants can view at the same time.
- **"Self-Study" Format:** Each participant can take the self-study version of the CPE Network program on their own computers at a time and place of their convenience. No instructor is required for self-study.
- **Transitioning From DVDs:** For groups playing the video from the online platform, we suggest downloading the video from the Checkpoint Learning player to the desktop before projecting.
- **What Does It Mean to Be a CPE Sponsor?:** Should you decide to vary from any of the requirements in the 3 methods noted above (for example, provide less than 3 full CPE credits, alter subject areas, offer hybrid or variations to the methods described above), <u>Checkpoint Learning Network will not be the sponsor and will not issue certificates.</u> In this scenario, your firm will become the sponsor and must issue its own certificates of completion. This section outlines the sponsor's responsibilities that you must adhere to if you choose not to follow the requirements for the delivery methods.
- **Getting Help:** Refer to this section to get your questions answered.

IMPORTANT: This User Guide outlines in detail what is required for each of the 3 formats above. Additionally, because you will be delivering the training within your firm, you should review the Sponsor Responsibilities section as well. To get certificates of completion for your participants following your training, you must submit all the required documentation. (This is noted at the end of each section.) Checkpoint Learning Network will review your training documentation for completeness and adherence to all requirements. If all your materials are received and complete, certificates of completion will be issued for the participants attending your training. Failure to submit the required completed documentation will result in delays and/or denial of certificates.

IMPORTANT: If you vary from the instructions noted above, your firm will become the sponsor of the training event and you will have to create your own certificates of completions for your participants. In this case, you do not need to submit any documentation back to CeriFi, LLC.

If you have any questions on this documentation or requirements, refer to the "Getting Help" section at the end of this User Guide **BEFORE** you conduct your training.

We are happy that you chose CPE Network for your training solutions. Thank you for your business and HAPPY LEARNING!

Copyrighted Materials

“Group Live” Format

CPE Credit

All CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

***Effective November 1, 2018:** Checkpoint Learning CPE Network products ‘group live’ sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by Checkpoint Learning Network. Checkpoint Learning Network will not issue certificates for “group live” deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures). Therefore, if you decide to deliver the “group live” session with less than 3 CPE credits, your firm will be the sponsor as Checkpoint Learning Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template after the executive summary of the transcript). You should circulate (e.g., email) to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance

You must monitor individual participant attendance at “group live” programs to assign the correct number of CPE credits. A participant’s self-certification of attendance alone is not sufficient.

Use the **attendance sheet.** This lists the instructor(s) name and credentials, as well as the first and last name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant arrives late, leaves early, or is a “no show,” the actual hours they attended should be documented on the sign-in sheet and will be reflected on the participant’s CPE certificate.

Real Time Instructor During Program Presentation

"Group live" programs must have a **qualified, real time instructor while the program is being presented.** Program participants must be able to interact with the instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A "group live" program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Make-Up Sessions

Individuals who are unable to attend the group study session may use the program materials for self-study online.

- If the emailed materials are used, the user should read the materials, watch the video, and answer the quizzer questions on the CPE Quizzer Answer Sheet. Send the answer sheet and course evaluation to the email address listed on the answer sheet and the CPE certificate will be mailed or emailed to the user. Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual Checkpoint Learning account to read the materials, watch the interviews, and answer the quizzer questions. The user will be able to print her/his/their CPE certificate upon completion of the quizzer. (If you need help setting up individual user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant's record of attendance and is awarded by Checkpoint Learning Network after the "group live" documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the “group live” session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to Checkpoint Learning Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether Checkpoint Learning Network is the sponsor for the “group live” session, it is required that the firm hosting the “group live” session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Group Study Attendance sheets; indicating any late arrivals and/or early departures)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations.

Finding the Transcript

Note: DVDs no longer ship with this product effective 3/1/2023.

When the DVD is inserted into a DVD drive, the video will immediately begin to play and the menu screen will pop up, taking the entire screen. Hitting the Esc key should minimize it to a smaller window. To locate the pdf file of the transcript either to save or email to others, go to the start button on the computer. In My Computer, open the drive with the DVD. The Adobe Acrobat files are the transcript files. If you do not currently have Adobe Acrobat Reader (Mac versions of the reader are also available), a free version of the reader may be downloaded at:

- https://get.adobe.com/reader/

The entire transcript is also available as a pdf in the Checkpoint Learning player in the resource toolbox at the top of the screen, or via the link in the email sent to administrators.

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your "group live" session should be sent to Checkpoint Learning Network by the following means:

Email: CPLgrading@cerifi.com

When sending your package to CeriFi, you must include ALL of the following items:

Form Name	**Included?**	**Notes**
Advertising / Promotional Page		Complete this form and circulate to your audience before the training event.
Attendance Sheet		Use this form to track attendance during your training session.
Subscriber Survey Evaluation Form		Circulate the evaluation form at the end of your training session so that participants can review and comment on the training. Return to CeriFi any evaluations that were completed. You do not have to return an evaluation for every participant.

Incomplete submissions will be returned to you.

"Group Internet Based" Format

CPE Credit

All CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

***Effective November 1, 2018:** Checkpoint Learning CPE Network products ‘group live’ sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by Checkpoint Learning Network. Checkpoint Learning Network will not issue certificates for “group live” deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures). Therefore, if you decide to deliver the “group live” session with less than 3 CPE credits, your firm will be the sponsor as Checkpoint Learning Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template following the executive summary in the transcript). You should circulate (e.g., email) to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance in a Webinar

You must monitor individual participant attendance at “group internet based” programs to assign the correct number of CPE credits. A participant’s self-certification of attendance alone is not sufficient.

Use the **Webinar Delivery Tracking Report.** This form lists the moderator(s) name and credentials, as well as the first and last name of each participant attending the seminar. During a webinar you must set up a monitoring mechanism (or polling mechanism) to periodically check the participants’ engagement throughout the delivery of the program. Participants’ two-way video should remain on during the entire presentation.

In order for CPE credit to be granted, you must confirm the presence of each participant **3 times per CPE hour and the participant must reply to the polling question**. Participants that respond to less than 3 polling questions in a CPE hour will not be granted CPE credit. For example, if a participant only replies to 2 of the 3 polling questions in the first CPE hour, credit for the first CPE hour will not be granted. (Refer to the Webinar Delivery Tracking Report for examples.)

Examples of polling questions:

1. You are using **Zoom** for your webinar. The moderator pauses approximately every 15 minutes and asks that participants confirm their attendance by using the “raise hands”

feature. Once the participants raise their hands, the moderator records the participants who have their hands up in the **webinar delivery tracking report** by putting a YES in the webinar delivery tracking report. After documenting in the spreadsheet, the instructor (or moderator) drops everyone's hands and continues the training.

2. You are using **Teams** for your webinar. The moderator will pause approximately every 15 minutes and ask that participants confirm their attendance by typing "Present" into the Teams chat box. The moderator records the participants who have entered "Present" into the chat box into the **webinar delivery tracking report**. After documenting in the spreadsheet, the instructor (or moderator) continues the training.
3. If you are using an application that has a way to automatically send out polling questions to the participants, you can use that application/mechanism. However, following the event, you should create a **webinar delivery tracking report** from your app's report.

Additional Notes on Monitoring Mechanisms:

1. The monitoring mechanism does not have to be "content specific." Rather, the intention is to ensure that the remote participants are present and paying attention to the training.
2. You should only give a minute or so for each participant to reply to the prompt. If, after a minute, a participant does not reply to the prompt, you should put a NO in the webinar delivery tracking report.
3. While this process may seem unwieldy at first, it is a required element that sponsors must adhere to. And after some practice, it should not cause any significant disruption to the training session.
4. **You must include the Webinar Delivery Tracking report with your course submission if you are requesting certificates of completion for a "group internet based" delivery format.**

Real Time Moderator During Program Presentation

"Group internet based" programs must have a **qualified, real time moderator while the program is being presented.** Program participants must be able to interact with the moderator while the course is in progress (including the opportunity to ask questions and receive answers during the presentation). This can be achieved via the webinar chat box, and/or by unmuting participants and allowing them to speak directly to the moderator.

Where individual participants log into a group live program they are required to enable two-way video to participate in a virtual face-to-face setting (with cameras on), elements of engagement are required (such as group discussion, polling questions, instructor posed questions with time for reflection, or a case study with engagement throughout the presentation) in order to award CPE credits to the participants. Participation in the two-way video conference must be monitored and documented by the instructor or attendance monitor in order to authenticate attendance for program duration. The participant-to-attendance monitor ratio must not exceed 25:1, unless there is a dedicated attendance monitor in which case the participant-to-attendance monitor ratio must not exceed 100:1.

Make-Up Sessions

Individuals who are unable to attend the “group internet based” session may use the program materials for self-study either in print or online.

- If emailed materials are used, the user should read the materials, watch the video, and answer the quizzer questions on the CPE Quizzer Answer Sheet. Send the answer sheet and course evaluation to the email address listed on the answer sheet and the CPE certificate will be mailed or emailed to the user. Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual Checkpoint Learning account to read the materials, watch the interviews, and answer the quizzer questions. The user will be able to print her/his CPE certificate upon completion of the quizzer. (If you need help setting up individual user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant’s record of attendance and is awarded by Checkpoint Learning Network after the “group internet based” documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who may not have answered the required amount of polling questions.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the “group live” session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to Checkpoint Learning Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether Checkpoint Learning Network is the sponsor for the "group internet based" session, it is required that the firm hosting the session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Webinar Delivery Tracking Report)
- Copy of the program materials
- Timed agenda with topics covered
- Date and location (which would be "virtual") of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations

Finding the Transcript

Note: DVDs are no longer shipped effective 3/1/2023

When the DVD is inserted into a DVD drive, the video will immediately begin to play and the menu screen will pop up, taking the entire screen. Hitting the Esc key should minimize it to a smaller window. To locate the pdf file of the transcript either to save or email to others, go to the start button on the computer. In My Computer, open the drive with the DVD. It should look something like the screenshot below. The Adobe Acrobat files are the transcript files. If you do not currently have Adobe Acrobat Reader (Mac versions of the reader are also available), a free version of the reader may be downloaded at:

- https://get.adobe.com/reader/

Alternatively, for those without a DVD drive, the email sent to administrators each month has a link to the pdf for the newsletter. The email may be forwarded to participants who may download the materials or print them as needed.

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your “group internet based” session should be sent to Checkpoint Learning Network by the following means:

Email: CPLgrading@CeriFi.com

When sending your package to CeriFi, you must include ALL the following items:

Form Name	**Included?**	**Notes**
Advertising / Promotional Page		Complete this form and circulate to your audience before the training event.
Webinar Delivery Tracking Report		Use this form to track the attendance (i.e., polling questions) during your training webinar.
Evaluation Form		Circulate the evaluation form at the end of your training session so that participants can review and comment on the training. Return to CeriFi any evaluations that were completed. You do not have to return an evaluation for every participant.

Incomplete submissions will be returned to you.

“Self-Study” Format

If you are unable to attend the live group study session, we offer two options for you to complete your Network Report program.

Self-Study—Email

Follow these simple steps to use the printed transcript and video:

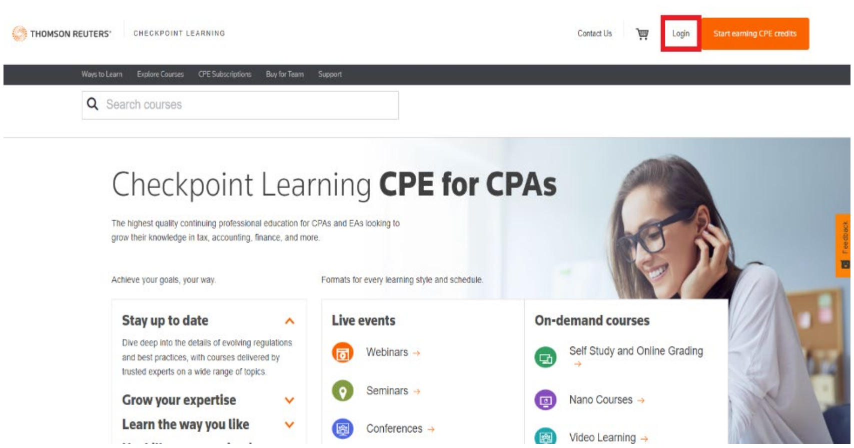
- Watch the video.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
- E-mail your completed quizzer and survey to:

CPLgrading@cerifi.com

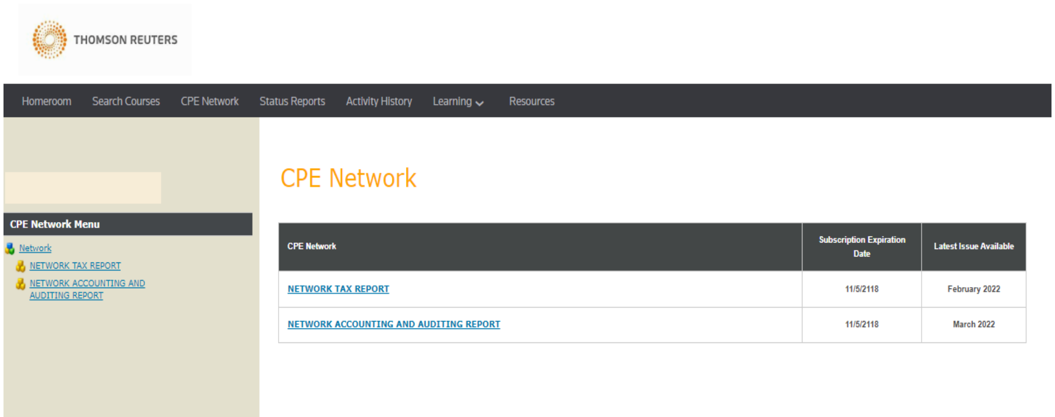
Self-Study—Online

Follow these simple steps to use the online program:

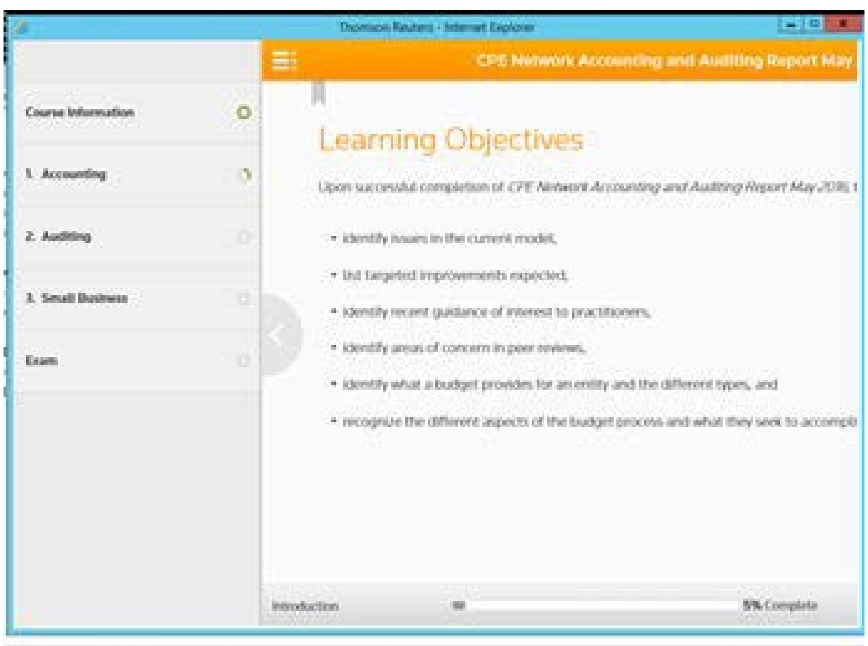
- Go to www.checkpointlearning.com
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Login or Register”).



- In the **CPE Network** tab, select the desired Network Report and then the appropriate edition.

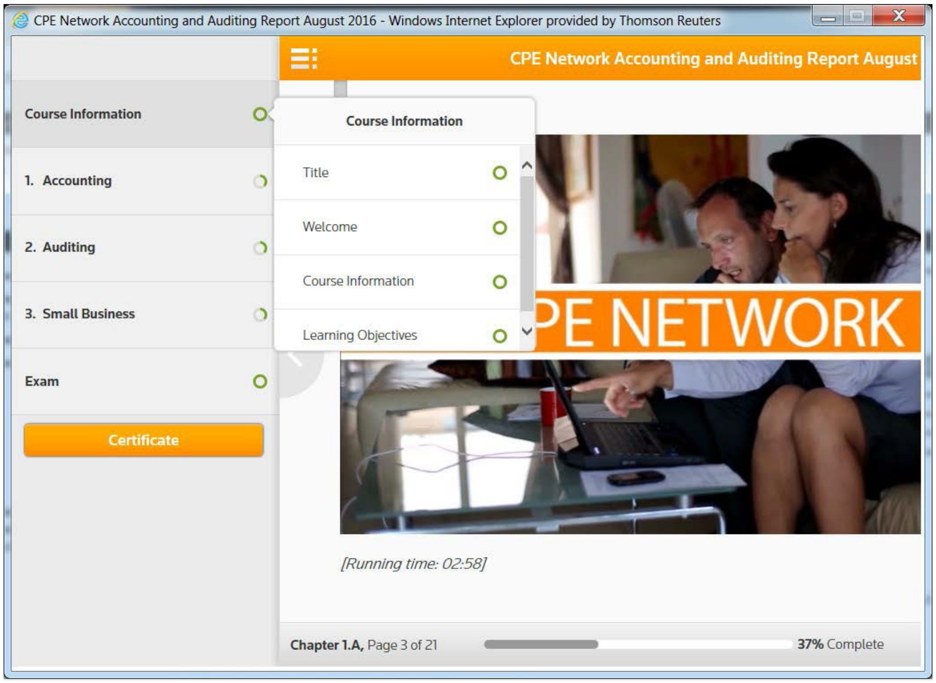


The Chapter Menu is in the gray bar at the left of your screen:

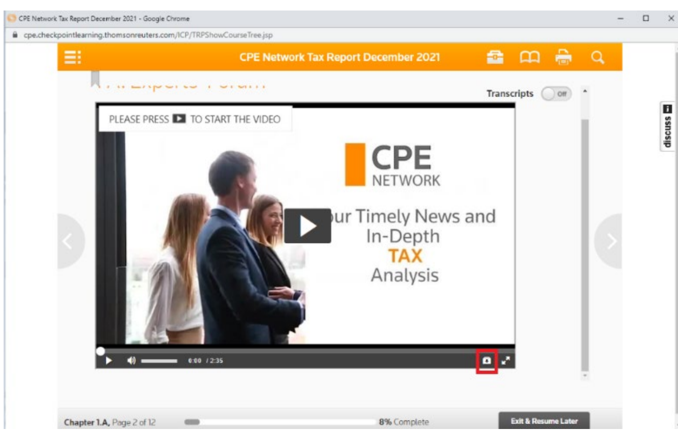


Click down to access the dropdown menu and move between the program Chapters.

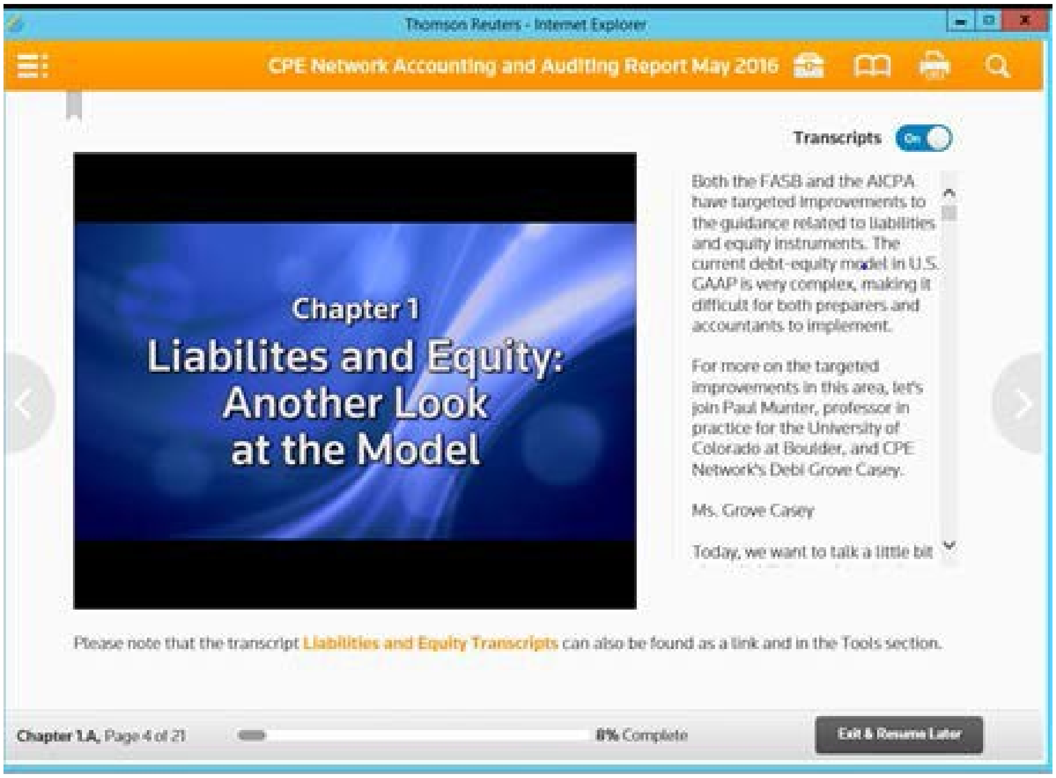
- **Course Information** is the course Overview, including information about the authors and the program learning objectives



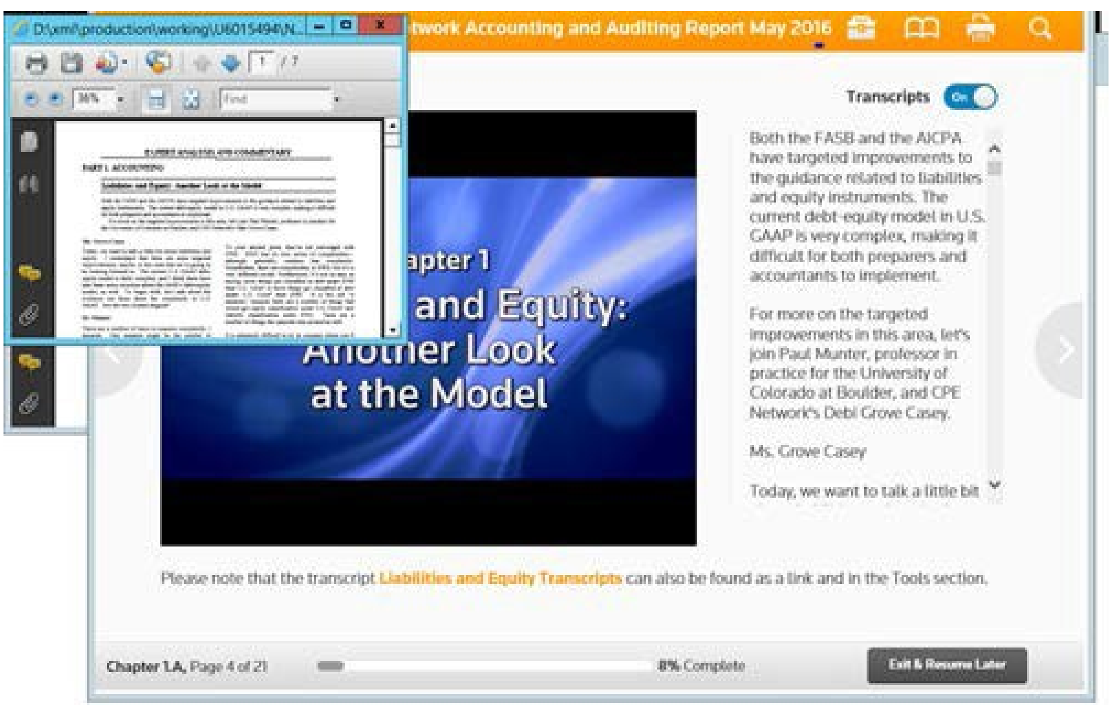
- **Each Chapter is self-contained.** Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions. This streamlined approach allows administrators and users to more easily access the related materials.



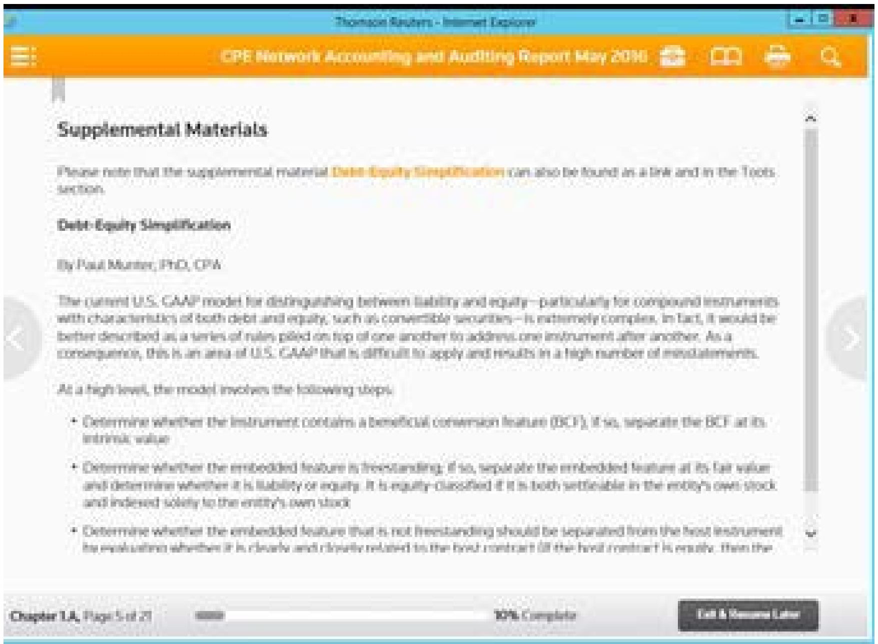
Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.

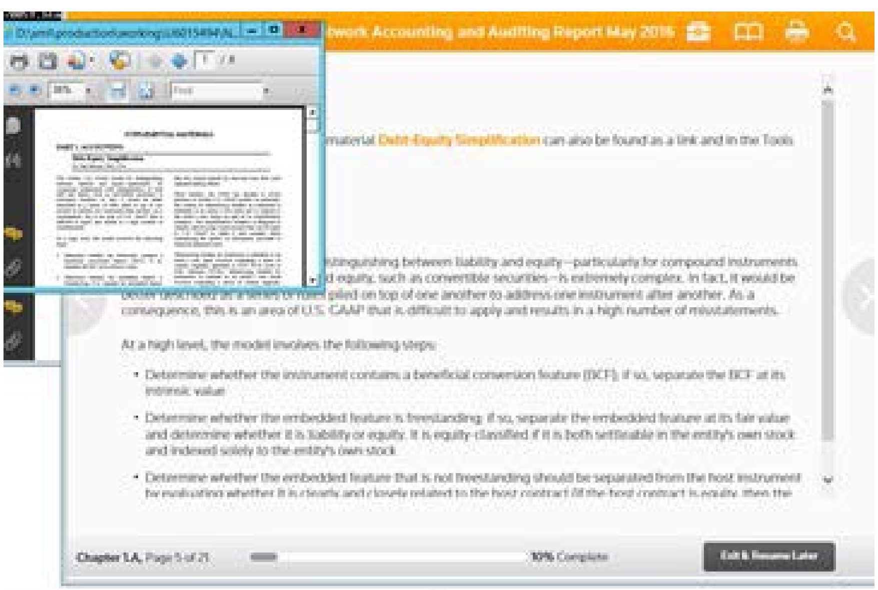


Transcripts for the interview segments can be viewed at the right side of the screen via a toggle button at the top labeled **Transcripts** or via the link to the pdf below the video (also available in the toolbox in the resources section). The pdf will appear in a separate pop-up window.



Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material. As with the transcripts, the supplemental materials are also available via the toolbox and the link will pop up the pdf version in a separate window.





Continuing to click the arrow to the right side of the screen will bring the user to the Discussion p roblems related to the segment.

The Suggested Answers to the Discussion Problems follow the Discussion Problems.

CPE Network Accounting and Auditing Report July 2016

Suggested Answers to Discussion Problems

1. ASC 320 requires that, at acquisition, an enterprise classify debt and marketable equity securities into one of three categories:

   - Held-to-maturity
   - Trading
   - Available-for-sale

   An entity decides how to classify securities based on its intended holding period for each individual security, using the framework in ASC 320. In establishing its intent, an entity should consider relevant trends and experience, such as previous sales and transfers of securities. Classification decisions should be made at acquisition and, preferably, formally documented. It is not appropriate to use "hindsight" to classify securities transactions, perhaps by considering changes in value after acquisition.

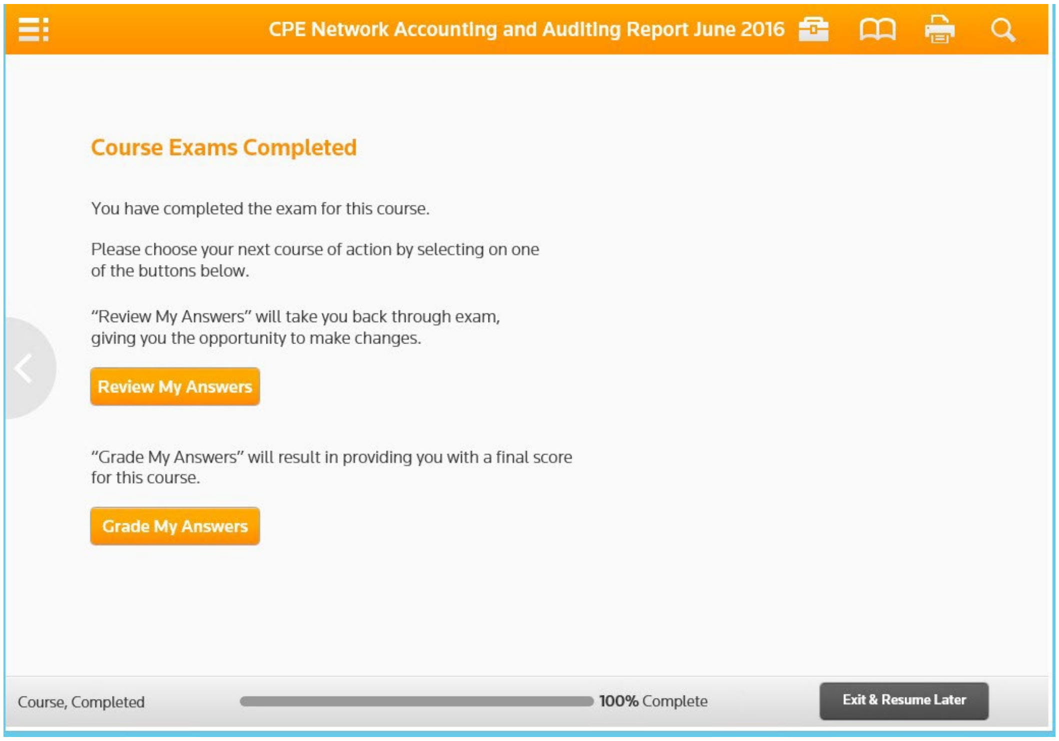
2. The trading securities category includes securities that are bought and held principally for the purpose of selling them in the short term. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price. "Short-term," in this context, is intended to be measured in hours and days, rather than in months or years, according to ASC 320. However, an entity is not precluded from classifying as trading a security it plans to hold for a longer period, as long as that designation occurs at acquisition.

3. Impairment is recognized in earnings when a decline in value has occurred that is deemed to be other than temporary, and the current fair value becomes the new cost basis for the security. An investment is considered to be impaired if the fair value of the investment is less than its cost basis. Cost includes adjustments made for

Chapter 3.A, Page 20 of 20 100% Complete Exit & Resume Later

The **Exam** is accessed by clicking the last gray bar on the menu at the left of the screen or clicking through to it. Click the orange button to begin.

When you have completed the quizzer, click the button labeled **Grade or the Review button**.



- Click the button labeled **Certificate** to print your CPE certificate.
- The final quizzer grade is displayed and you may view the graded answers by clicking the button labeled **view graded answer**.

Additional Features Search

Checkpoint Learning offers powerful search options. Click the **magnifying glass** at the upper right of the screen to begin your search. Enter your choice in the **Search For:** box.

Search Results are displayed with the number of hits.

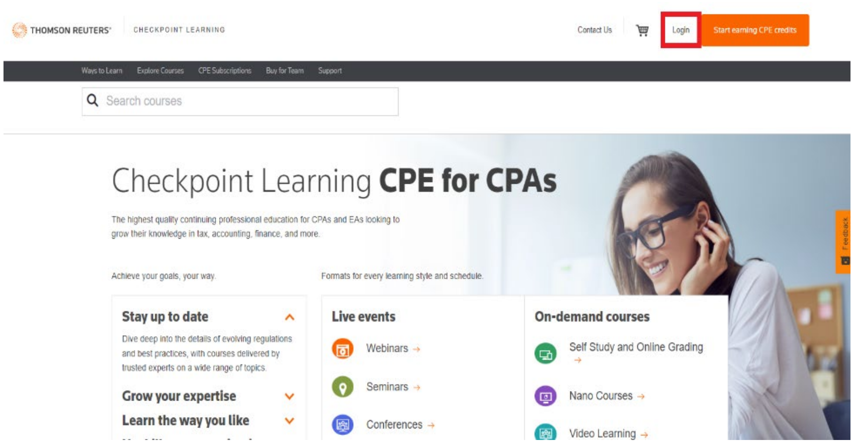
Print

To display the print menu, click the printer icon in the upper bar of your screen. You can print the entire course, the transcript, the glossary, all resources, or selected portions of the course. Click your choice and click the orange **Print**.

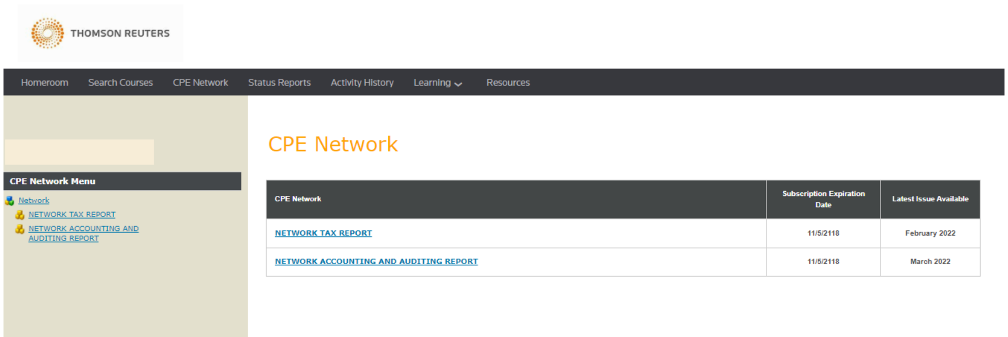
Transitioning From DVDs

Follow these simple steps to access the video and pdf for download from the online platform:

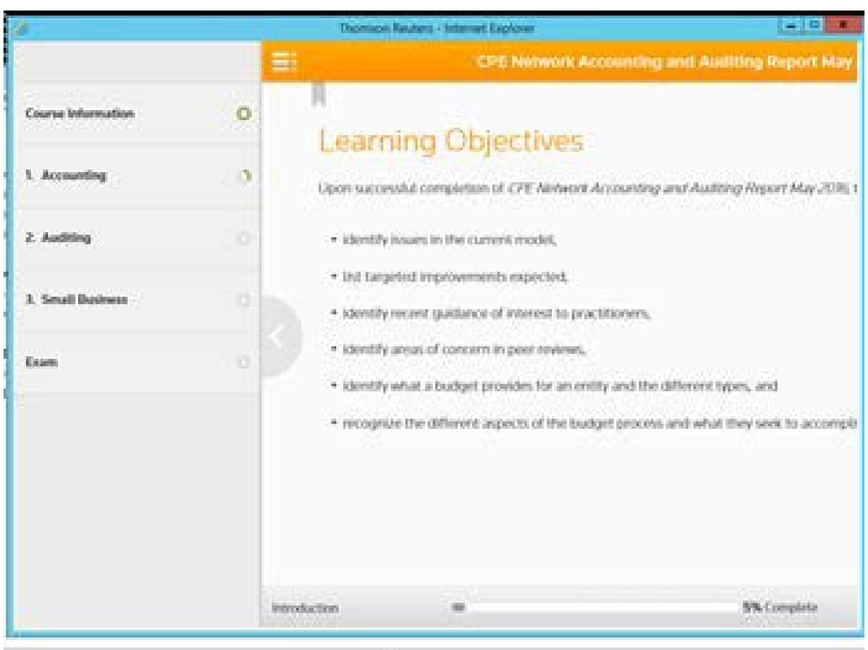
- Go to www.checkpointlearning.com
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login").



- In the CPE **Network** tab, select the desired Network Report by clicking on the title, then select the appropriate edition.



The Chapter Menu is in the gray bar at the left of your screen:



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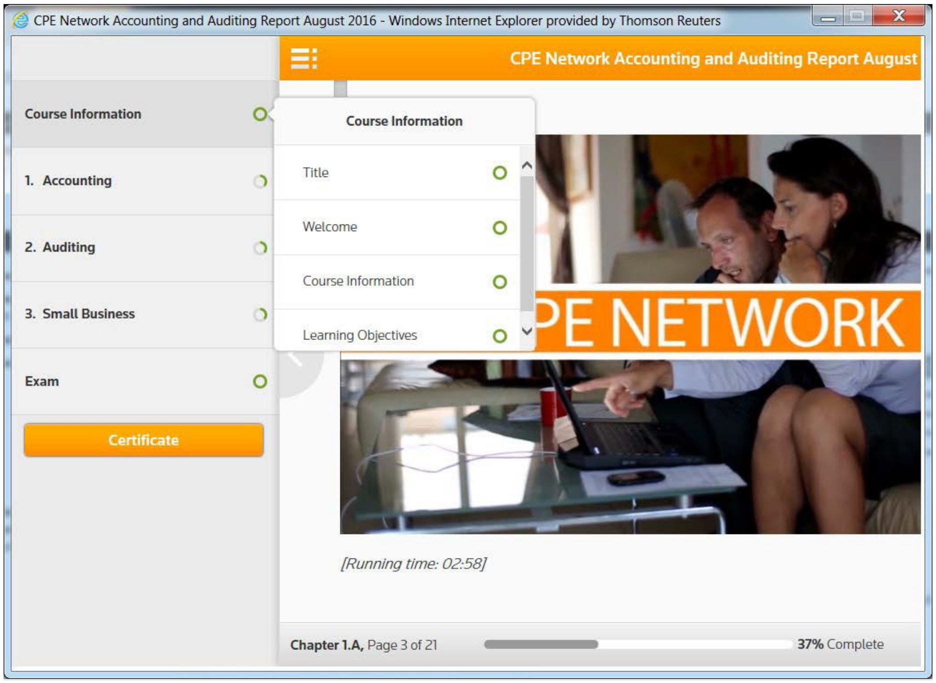
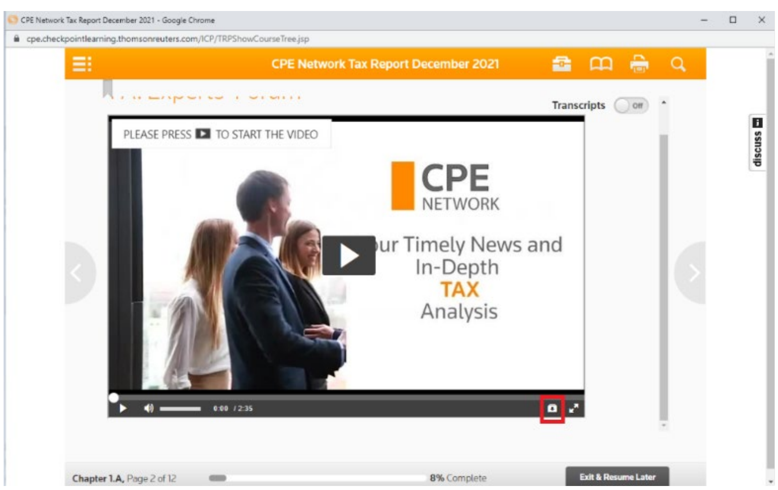


- Each Chapter is self-contained. Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions.



Video segments may be downloaded from the CPL player by clicking on the download button noted above. You may need to use the scroll bar to the right of the video to see the download button. **Tip: You may need to use the scroll bar to the right of the video to see the download button.**

PDFs may be downloaded from either the course toolbox in the upper right corner of the Checkpoint Learning screen or from the email sent to administrators with each release.

What Does It Mean to Be a CPE Sponsor?

If your organization chooses to vary from the instructions outlined in this User Guide, your firm will become the CPE Sponsor for this monthly series. The sponsor rules and requirements noted below are only highlights and reflect those of NASBA, the national body that sets guidance for development, presentation, and documentation for CPE programs. **For any specific questions about state sponsor requirements, please contact your state board. They are the final authority regarding CPE Sponsor requirements.** Generally, the following responsibilities are required of the sponsor:

- Arrange for a location for the presentation
- Advertise the course to your anticipated participants and disclose significant features of the program in advance
- Set the start time
- Establish participant sign-in procedures
- Coordinate audio-visual requirements with the facilitator
- Arrange appropriate breaks
- Have a real-time instructor during program presentation
- Ensure that the instructor delivers and documents elements of engagement
- Monitor participant attendance (make notations of late arrivals, early departures, and “no shows”)
- Solicit course evaluations from participants
- Award CPE credit and issue certificates of completion
- Retain records for five years

The following information includes instructions and generic forms to assist you in fulfilling your responsibilities as program sponsor.

CPE Sponsor Requirements

Determining CPE Credit Increments

Sponsored seminars are measured by program length, with one 50-minute period equal to one CPE credit. One-half CPE credit increments (equal to 25 minutes) are permitted after the first credit has been earned. Sponsors must monitor the program length and the participants’ attendance in order to award the appropriate number of CPE credits.

Program Presentation

CPE program sponsors must provide descriptive materials that enable CPAs to assess the appropriateness of learning activities. CPE program sponsors must make the following information available in advance:

- Learning objectives.
- Instructional delivery methods.
- Recommended CPE credit and recommended field of study.
- Prerequisites.
- Program level.
- Advance preparation.
- Program description.
- Course registration and, where applicable, attendance requirements.
- Refund policy for courses sold for a fee/cancellation policy.
- Complaint resolution policy.
- Official NASBA sponsor statement, if an approved NASBA sponsor (explaining final authority of acceptance of CPE credits**).**

Disclose Significant Features of Program in Advance

For potential participants to effectively plan their CPE, the program sponsor must disclose the significant features of the program in advance (e.g., through the use of brochures, website, electronic notices, invitations, direct mail, or other announcements). When CPE programs are offered in conjunction with non-educational activities, or when several CPE programs are offered concurrently, participants must receive an appropriate schedule of events indicating those components that are recommended for CPE credit. The CPE program sponsor's registration and attendance policies and procedures must be formalized, published, and made available to participants and include refund/cancellation policies as well as complaint resolution policies.

Monitor Attendance

While it is the participant's responsibility to report the appropriate number of credits earned, CPE program sponsors must maintain a process to monitor individual attendance at group programs to assign the correct number of CPE credits. A participant's self-certification of attendance alone is not sufficient. The sign-in sheet should list the names of each instructor and her/his credentials, as well as the name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant leaves early, the hours they attended should be documented on the sign-in sheet and on the participant's CPE certificate.

Real Time Instructor During Program Presentation

"Group live" programs must have a qualified, real-time instructor while the program is being presented. Program participants must be able to interact with the real time instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A "group live" program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Awarding CPE Certificates

The CPE certificate is the participant's record of attendance and is awarded at the conclusion of the seminar. It should reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early.

CFP credit is available if the firm registers with the CFP board as a sponsor and meets the CFP board requirements. IRS credit is available only if the firm registers with the IRS as a sponsor and satisfies their requirements.

Seminar Quality Evaluations for Firm Sponsor

NASBA requires the seminar to include a means for evaluating quality. At the seminar conclusion, evaluations should be solicited from participants and retained by the sponsor for five years. The following statements are required on the evaluation and are used to determine whether:

1. Stated learning objectives were met.
2. Prerequisite requirements were appropriate (if any).
3. Program materials were accurate.
4. Program materials were relevant and contributed to the achievement of the learning objectives.
5. Time allotted to the learning activity was appropriate.
6. Individual instructors were effective.
7. Facilities and/or technological equipment were appropriate.
8. Handout or advance preparation materials were satisfactory.
9. Audio and video materials were effective.

You may use the enclosed preprinted evaluation forms for your convenience.

Retention of Records

The seminar sponsor is required to retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (the original sign-in sheets, now in an editable, electronic signable format)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name(s) and credentials
- Results of program evaluations

Appendix: Forms

Here are the forms noted above and how to get access to them.

Delivery Method	Form Name	Location	Notes
"Group Live" / "Group Internet Based"	Advertising / Promotional Page	Transcript	Complete this form and circulate to your audience before the training event.
"Group Live"	Attendance Sheet	Transcript	Use this form to track attendance during your training session.
"Group Internet Based"	Webinar Delivery Tracking Report	Transcript	Use this form to track the 'polling questions' which are required to monitor attendance during your webinar.
"Group Live" / "Group Internet Based"	Evaluation Form	Transcript	Circulate the evaluation form at the end of your training session so that participants can review and comment on the training.
Self Study	CPE Quizzer Answer Sheet	Transcript	Use this form to record your answers to the quiz.

Getting Help

Should you need support or assistance with your account, please see below:

Support Group	Phone Number	Email Address	Typical Issues/Questions
Technical Support	844.245.5970	Cplsupport@cerifi.com	• Browser-based • Certificate discrepancies • Accessing courses • Migration questions • Feed issues
Product Support	844.245.5970	Cplsupport@cerifi.com	• Functionality (how to use, where to find) • Content questions • Login Assistance
Customer Support	844.245.5970	Cplsupport@cerifi.com	• Billing • Existing orders • Cancellations • Webinars • Certificates