

ROBERT L. & CATHERINE L. NELKE §  
150 PRIMROSE LANE  
DADEVILLE, AL 36853-5239, §

STATE OF ALABAMA  
DEPARTMENT OF REVENUE  
ADMINISTRATIVE LAW DIVISION

Taxpayers, §

DOCKET NO. INC. 11-233

v. §

STATE OF ALABAMA §  
DEPARTMENT OF REVENUE.

### **OPINION AND PRELIMINARY ORDER**

The Revenue Department partially denied a refund of 2009 Alabama income tax requested by Robert L. and Catherine L. Nelke (“Taxpayers”). The Taxpayers appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(c)(5)a. A hearing was conducted on October 6, 2011. The Taxpayers and their representatives, Taylor Meadows and Brad Howell, attended the hearing. Assistant Counsel Lionel Williams represented the Department.

The Taxpayers’ house in Atlanta, Georgia flooded on September 21, 2009. The Taxpayers had purchased the property for \$480,000 in 2005, and had made various improvements to the property before the flood.

The Taxpayers’ insurance company inspected the house approximately one week after the flood. It subsequently paid the Taxpayers \$152,800 for the damage to the structure and clean-up costs, and \$34,911 for their personal property loss.

The Taxpayers’ house and property were also appraised at the Taxpayers’ request by the U.S. Small Business Administration. That appraisal, documented by a DCMS Loss Verification Report, Taxpayer Ex. F, was completed in early November 2009, and showed a loss in value of \$176,888 to the structure and property, and a personal property loss of \$86,300.

The Taxpayers claimed a casualty loss from the flood on their 2009 Alabama income tax return. In computing the amount of the loss, the Taxpayers determined the fair market value ("FMV") of the house and property before the flood to be \$595,000, which constituted the \$480,000 purchase price in 2005, plus all subsequent improvements. They also reported the before FMV of the personal property in the home and the garage to be \$80,000 and \$22,000, respectively. They estimated the FMV of the house after the flood to be \$380,000, and also that the personal property and garage had a \$0 value. After subtracting the insurance proceeds, the Taxpayers reported a casualty loss of \$153,691.

The Department audited the casualty loss claim and determined that the loss was only \$13,286. The examiner computed the pre-flood FMV of the house by first separating the value of the house from the value of the land. She used the 2010 Fulton County property tax appraisal done in April 2010 to determine that the house constituted 41 percent of the combined appraised value. She then multiplied the \$480,000 purchase price of the house by 41 percent to arrive at the value of the structure before the flood. She added approximately \$29,000 in pre-flood improvements that the Taxpayers could document to arrive at a before flood value of \$226,622. She estimated the post-flood FMV of the structure to be \$153,955, which constituted 41 percent of the 2010 County property tax appraised value of the house and land. Because the difference of \$72,667 was less than the insurance received for the structure, the examiner determined that there was no loss on the house. There was a \$13,786 loss above the insurance proceeds relating to the personal property, which resulted in the total casualty loss allowed by the Department.

Alabama law allows a casualty loss resulting from a sudden and catastrophic event to the same extent allowed for federal purposes at 26 U.S.C. §165. Code of Ala. 1975,

§40-18-15(a)(6). It is undisputed that the amount of the loss is the difference or decrease in value between the FMV of the property immediately before the event and the FMV of the property immediately after the event. See, Taxpayers' Ex. A, IRS Publication 547, at 5.

The Department examiner in this case made a good faith effort to determine the before and after fair market value of the subject property. I agree with the Taxpayers, however, that the value of the land should have been considered in computing the loss because there is undisputed evidence that the flood caused considerable damage to the land. Using the County property tax appraisal done in April 2010 also may not have reflected the true post-flood value of the house because repairs had already been performed, and the damage to the interior of the house was not considered. Some improvements also were not considered in the pre-flood value because the Taxpayer's records relating to those improvements were destroyed or lost in the flood.

Under the circumstances, the most accurate estimate of the actual decrease in value of the house and real and personal property caused by the flood is the SBA DCMS Loss Verification Report that was performed in early November, 2009, after the flood had receded but before repairs. The appraisal was done by an impartial government appraiser that was trained to do valuation appraisals of properties damaged by catastrophic events. The Report is sufficiently specific and detailed, and shows a loss of \$176,887.69 on the house and property and \$86,300 on the personal property in the house. Those amounts should be used in computing the casualty loss.

The Taxpayers received insurance proceeds of \$152,800 and \$34,911 for the property damage and the personal property loss, respectively. The loss must be reduced by any insurance proceeds received as a result of the damages. The Taxpayers argue,

however, that \$27,650 of the insurance proceeds should not be applied to offset the loss to the property because the insurance company paid that amount for clean-up costs.

The loss appraisal issued by the Taxpayer's insurance company specifies that \$27,650 was paid for clean up; specifically, \$1,443.22 for cleaning, \$3,645.08 for general demolishing, and \$22,561.44 for water extraction and remediation. See, Taxpayer Ex. C. Consequently, the loss to the structure and property should only be offset by insurance proceeds of \$125,150 (\$152,800 less \$27,650).

The Department should recompute the Taxpayers' 2009 Alabama liability as indicated above. A Final Order will then be entered for the adjusted refund due.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered April 5, 2011.

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BILL THOMPSON  
Chief Administrative Law Judge

bt:dr

cc: Lionel C. Williams, Esq.  
Taylor Meadows, Esq.  
Kim Peterson