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United States: Individual income tax considerations for taxpayers affected by Hurricane Harvey and other federally declared disasters

Overview

As parts of Texas and Louisiana recover from the damages caused by Hurricane Harvey, a federally declared disaster, the Internal Revenue Service (IRS) is providing relief to victims affected by the storm in parts of Texas.

As discussed further below, individual taxpayers have several potential alternatives for relief from the damage caused by Hurricane Harvey, including the following:

- Tax relief and deferment of certain tax filing and payment deadlines until January 31, 2018 for taxpayers impacted by Hurricane Harvey;
- Casualty loss deductions on their Form 1040 filed for the year of the casualty itself or, at the taxpayer's election, in the taxable year immediately preceding the year of the disaster;
- Qualified disaster relief payments;
- Hardship distributions from retirement accounts, and
- Charitable donations to aid affected individuals.

As of this writing, Florida is still evaluating the damage caused by Hurricane Irma. Similar relief provisions may be declared for impacted counties in Florida, but taxpayers should await information from the IRS. The information below is specific to taxpayers impacted by Hurricane Harvey.

Filing deadlines

Internal Revenue Code (IRC) Sec. 7508A authorizes the IRS to extend deadlines for up to one year for taxpayers affected by a "federally declared disaster." The IRS has used this authority to postpone certain filing and payment deadlines until January 31, 2018, for taxpayers affected by Hurricane Harvey in Texas.

In addition to the IRS extension, the Financial Crimes Enforcement Network (FinCEN), the branch of the Department of Treasury that oversees the FinCEN Report 114 – Report of Foreign Bank and Financial Accounts (FBAR), among other forms, recently announced that it also is extending the filing deadline for the FBAR until January 31, 2018.

Casualty losses

In general: Affected taxpayers in a federally declared disaster area can claim a deduction on their tax return for the loss incurred, subject to the limitations addressed below. Casualty losses for individual taxpayers are claimed as an itemized deduction and are limited to nonbusiness property losses. Special rules described below are allowed for designated disaster areas.

It is important to distinguish that deductible casualty losses are losses that arise from fire, storm, shipwreck, or other casualty, or from theft; losses arising from any other reasons (for example, a decline in home values from a nearby landslide) will not be considered a casualty loss.

In determining the amount of the loss, the regulations provide that taxpayers shall determine the fair market value immediately before and after the casualty by "competent appraisal." The regulations also state that the cost of repairs is "acceptable evidence" of the loss in value, but limit the cost of repairs to restoring the property to its prior status. Taxpayers should keep detailed records of these expenses, and should discuss the limitations with their tax professional.

When claiming a disaster-related casualty loss, the taxpayer's nonbusiness property loss is limited to the lesser of either:

1. The decrease in the fair market value of the property as a result of the casualty (i.e., the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty) or;
2. The adjusted basis of the property.

When there is more than one item of property involved in the incident, this analysis should be performed on each item damaged or destroyed.

Property covered by insurance: If the taxpayer's property is covered by insurance, the taxpayer must file a timely insurance claim before claiming a casualty loss on their federal income tax return. A taxpayer can deduct casualty losses only to the extent the taxpayer is not reimbursed for the loss. If the taxpayer receives reimbursement in excess of the casualty loss, then they may need to report a gain on their federal income tax return. Additionally, if in later years the taxpayer receives reimbursement for the casualty loss that was previously claimed on a federal tax income tax return, the income should be included on the taxpayer's federal income tax return in the year the reimbursement is received.

Limitations on deductibility: There are several limits that must be applied to determine the deduction:

1. The deductible amount is limited to the lesser of the decrease in fair market value or the adjusted basis of the property, as described above.
2. The amount of the loss must be reduced by any insurance reimbursement.
3. The total losses from each casualty event must be reduced by $100.
4. Net losses for the tax year are deductible only to the extent they exceed 10% of the taxpayer's adjusted gross income (AGI).

Timing of deduction: Casualty losses are generally deductible in the year the loss is sustained. For Hurricane Harvey, this would typically be claimed on the 2017 tax return. However, for federally declared disasters like Hurricane Harvey, taxpayers have the option of claiming disaster-related casualty losses on their federal income tax return for either the current tax year or the prior tax year. Affected taxpayers claiming a disaster loss on their prior tax year's return should include the following Disaster Designation at the top of the tax return to expedite the processing of the refund:

- "Texas, Hurricane Harvey"

Qualified disaster relief payments

Under IRC Sec. 139 certain payments that would normally be taxable are generally excludable from US federal gross income, net earnings from self-employment, wages, and compensation pursuant to sections 139(a) and (d). Common examples of qualified disaster relief payments include: government assistance (*e.g.*, FEMA assistance grants) and payments by employers to affected employees and their families to pay or reimburse reasonable and necessary personal, family, living, or funeral expenses, or to repair or rehabilitate an employee's personal residence or repair or replace its contents. Note that qualified disaster payments do not include payments for expenses covered by insurance or other reimbursements, or income replacement payments (*e.g.*, unemployment compensation).

Loans and hardship distributions from retirement plans

IRS Announcement 2017-11 allows certain types of employer-sponsored retirement plans (such as 401(k) plans) to allow victims of Hurricane Harvey and members of their families to take loans and hardship distributions from these accounts. The plan may also permit a person to take out a retirement plan loan or hardship distribution and use it to assist a son, daughter, parent, grandparent or a dependent who lived or worked in the disaster area. Clients should carefully consider the potential gift tax considerations of the assistance they provide others from such a distribution as well as the income tax or potentially adverse consequences (*e.g.*, 10% penalty for early distributions) relating to withdrawals from retirement assets. For further information regarding health benefits and retirement benefit questions, see The Department of Labor's FAQs for Participants and Beneficiaries Following Hurricane Harvey.
URL: https://www.irs.gov/pub/irs-drop/a-17-11.pdf
URL: https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/faqs-for-participants-beneficiaries-following-hurricane-harvey.pdf

The amount of the loan or hardship distribution is limited to the maximum amount that would be permitted and available for a hardship distribution under the plan under the Code and regulations. Loan and hardship distributions must be made on or after August 23, 2017 and no later than January 31, 2018.

Charitable contribution considerations

In general: Donations to federally tax-exempt charities, such as the Red Cross or United Way, should generally qualify as charitable contributions.

Fraudulent charities: Taxpayers wishing to provide assistance to victims of Hurricane Harvey should use caution to avoid donating to a fraudulent charity. Criminals may look to take advantage of taxpayers' generosity by attempting to collect personal information or money from taxpayers wishing to donate to victims of Hurricane Harvey. Be vigilant when donating and providing information to charities. Review IR-2017-137 for additional information.
URL: https://www.irs.gov/newsroom/beware-of-fake-charity-scams-relating-to-hurricane-harvey

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