TAX SECTION
STATE BAR OF TEXAS

Presentation:

Tax Considerations for Victims of Hurricane Harvey

State Bar of Texas

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Agenda

I. Tax Treatment for Uninsured Casualty Losses
II. Tax Treatment for Disaster Relief Payments
III. Tax Treatment for Insurance Proceeds Received Flood Damage Claims for Property Claims and Excess Living Expenses
IV. Tax Treatment of Receipt of Small Business Administration Disaster Loans
V. Tax Treatment of Early Distributions from Employee Retirement Plans
VI. Obtaining copies of lost tax information

Casualty Losses: General Principles

- **Definition of Casualty Loss: A loss that is not compensated for by insurance that arises from a storm or other sudden and unexpected casualty event is deductible under Section 165 subject to the limitations and standards discussed below.**

- **Implication: To the extent a taxpayer receives insurance proceeds for the loss, the taxpayer's casualty loss is reduced for tax purposes.**

Casualty Losses: Valuation

- **Question**: How do I determine the amount of a casualty loss for tax purposes?
- **Answer**: The amount of the taxpayer's casualty loss is equal to the **lesser** of
  - (i) The amount which is equal to 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
  - (ii) The taxpayer's basis in the property.
- **Follow-Up Question**: For item (i) above, how does a taxpayer determine the decline in the value of the property's value immediately before Hurricane Harvey and its damaged value immediately after Hurricane Harvey?
- **Answer**: The IRS states that this should 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, in order that any deduction under this section shall be limited to the actual loss resulting from damage to the property.

Casualty Losses: Claim & Limitations

- **Question: Once I know the amount of the casualty loss, how do I claim that loss?**
- **Answer: The general rule is that a taxpayer can claim a Hurricane Harvey loss in its 2017 tax return. However, because Congress recognized that taxpayers who suffered a significant loss in a federally declared disaster may need cash more quickly, taxpayer's who suffer a loss in a federally declared disaster are allowed to claim the casualty loss on an amended return for their 2016 (prior year) tax return. This ability to immediately file a 2016 tax return instead of waiting until the end of 2017 may be beneficial in accelerating the tax refund for some taxpayers. However, see the below counter-consideration.**
- **Question as to limitations on the loss: Once I claim the casualty loss on my return, what limitations apply?**
- **Answer: Personal casualty losses are reduced by $100 and then reduced by 10% of the taxpayer's adjusted gross income for the year it is claimed. The implication here is that the taxpayer should consider which year (2016 or 2017) the taxpayer is likely to have a higher adjusted gross income as the year of the higher adjusted gross income will create a larger disallowance under the 10% rule noted above.**

Casualty Losses: Carryback and Carryforward

- **<u>Question</u>: If the casualty loss after considering the limitations mentioned in the earlier slide exceeds the taxpayer's taxable income in the year claimed, what considerations then apply?**

- **<u>Answer</u>: The taxpayer can carryback its unused casualty loss three years. If the taxpayer elected to claim the casualty loss in 2016, then the carryback would allow the taxpayer to file an amended return for 2013. If the taxpayer claimed the casualty loss in 2017, then the taxpayer would file an amended return for 2014.**

Disaster Relief Payments

- **<u>Question</u>: Are disaster relief payments excludable from the taxpayer's gross income?**
- **<u>Answer</u>: The answer is divided into three subparts depending on the identity of the payer.**
  1. **Payor is a Government Agency. Generally, payments made by federal, state, and local authorities for disaster relief or for economic hardship are not includable in income. As an exception, government payments for unemployment insurance or for lost business profits are generally included in gross income.**
  2. **Payor is a Charitable Organization or Individual. Generally, relief payments made by a nonprofit organization or by individuals are not taxable as long as there is no expectation of repayment.**
  3. **Payor is the Individual's Employer. The individual's employer are not includible in income as long as they do not substitute for compensation and are reasonably expected to meet the uninsured reasonable living expenses or to pay for the reasonably expected uninsured repair expenses.**

Texas Comptroller Extensions to File Taxes

- **The Texas Comptroller's office is allowing limited temporary extensions of time to file taxes for businesses located in Texas counties designated by the Federal Major Disaster Declaration**
- **Some extensions are automatic, while others require that a request for an extension be made**
- **If a request for an extension must be made, the Comptroller's Office will make decisions to grant or deny the extensions on a case-by-case basis**
- **For more information, including which filings get automatic extensions, and how to request an extension for those filings not in the automatic extension category, visit the Texas Comptroller's website at https://comptroller.texas.gov/taxes/resources/disaster-relief.php**

Source: Texas Comptroller of Public Accounts Website

Temporary Suspension of Texas Hotel Occupancy Taxes

- **Governor Greg Abbott issued a proclamation suspending the collection of state and local hotel occupancy taxes from the victims of Hurricane Harvey or personnel participating in hurricane relief efforts**
  - **Began Aug. 23**
  - **Goes through Sept. 22**
- **If you paid hotel occupancy taxes while the suspension was in effect, the Comptroller's website provides information on how to seek a refund from either the hotel or a third-party website**
- **There is also an exemption from Texas hotel occupancy tax that applies after an individual stays at a hotel for more than 30 days if certain requirements are satisfied, and this exemption can apply even after the hurricane tax suspension expires**
- **For more information, including how to claim these exemptions from hotel occupancy tax, visit the Texas Comptroller's website at https://comptroller.texas.gov/taxes/resources/disaster-relief.php**

Source: Texas Comptroller of Public Accounts Website

Temporary Waiver of International Fuel Tax Agreement (IFTA)

- **Governor Greg Abbott issued a temporary waiver of the International Fuel Tax Agreement (IFTA) requirements when delivering relief supplies and fuel into Texas until Sept. 30**
- **The waiver covers both the payment of the IFTA tax and licensing requirements, including trip permits**
- **After Sept. 30, the Comptroller and Governor's offices will determine if this waiver should be extended**
- **For more information on the IFTA waiver, including how to document fuel purchased and miles traveled in Texas for hurricane relief efforts while providing supplies and fuel to affected areas from Sept. 1 through Sept. 30, visit the Texas Comptroller's website at https://comptroller.texas.gov/taxes/resources/disaster-relief.php**

Source: Texas Comptroller of Public Accounts Website

Sales Tax Exemptions

- **Exemptions from sales tax may exist for:**
  - **Some labor charges to repair certain types of property damaged in a disaster area**
  - **Purchases made with a FEMA debit card or voucher (except alcohol and tobacco products)**
  - **Purchases made with a Red Cross debit card or voucher (except alcohol and tobacco products)**
  - **Purchases made with Salvation Army vouchers**
  - **School districts or PTA's buying school supplies and clothes to give to students who are victims of a declared natural disaster**
- **For more information on these sales tax exemptions, including how to claim and properly document them, visit the Texas Comptroller website at https://comptroller.texas.gov/taxes/resources/disaster-relief.php**

Source: Texas Comptroller of Public Accounts Website

Visit the Texas Comptroller's Website

- **The Texas Comptroller's website has lots of valuable information on it, including information on:**
  - **Automatic extensions**
  - **Making requests for non-automatic extensions**
  - **Hotel occupancy taxes**
  - **IFTA**
  - **Motor fuels tax**
  - **Sales tax exemptions**
  - **Out-of-state businesses performing disaster or emergency related work in Texas**
  - **Much more**

Source: Texas Comptroller of Public Accounts Website

Tax Treatment of Early Distributions and Loans From Qualified Retirement Plans

- The Tax Section of the State Bar of Texas expresses its condolences to those individuals who have suffered losses as a result of Hurricane Harvey.

- This portion of the presentation addresses the greater access to retirement plan funds that Treasury, the IRS and Congress have made available for individuals who have suffered losses as a result of Hurricane Harvey.

Types of Qualified Employer Plans for Which Hurricane Harvey Relief May Be Available

- 401(a) Defined Contribution Retirement Plans (including 401(k) plans, excluding money purpose pension plans)
- 403(b) Retirement Plans (like 401(k) plans but for tax exempt employers)
- 457(b) Retirement Plans for tax exempt employers

Expanded Availability of Hardship Distributions

- Can withdraw due to any hardship of the employee for a need arising as a result of Hurricane Harvey
- The individual's principal residence or principal place of business (or those of his lineal ascendant, descendant, dependent or spouse) on August 23, 2017 must have been located in one of the Texas counties identified for individual assistance for the Federal Emergency Management Agency due to Hurricane Harvey
- A plan administrator may rely on individual's representation of Hurricane Harvey financial hardship (unless plan administrator has actual knowledge to the contrary)
- Any plan safe harbor rules imposing post-distribution contribution restrictions need not apply
- Amount available for hardship distribution is limited to amount permitted under the plan and Treasury regulations. (Cannot withdraw from QNEC or QMAC accounts, or earnings on elective contributions.)
- Plan must be amended by end of first plan year beginning after December 31, 2017 to permit the distributions.

Source: IRS Announcement 2017-11

Exemption from 10% Premature Distribution Tax For Certain Hardship Distributions Due to Hurricane Harvey

Generally, Section 72(t) of the Internal Revenue Code imposes an additional 10% tax on a distribution to a participant prior to his or her attainment of age 59 ½. Congress recently enacted a law that provides temporary relief from this tax in some circumstances.

- Generally, $100,000 is the maximum amount that may be exempt from the additional 10% tax due to Hurricane Harvey (The actual amount may be lesser if an individual had prior hurricane distributions.)
- The Hurricane Harvey hardship distribution must be made between August 23, 2017 and January 1, 2019
- The individual must either (1) on August 23, 2017 have a principal place of abode in the Hurricane Harvey major disaster area as declared by President Trump or (2) sustain an economic loss as a result of Hurricane Harvey.

Source: Section 502(a) of the Disaster Tax Relief and Airport and Airway Extension Act of 2017

Opportunity to Repay Certain Hurricane Harvey Distributions

- If the plan permits, it is possible for individuals to repay certain qualified Hurricane Harvey distributions to their qualified employer plans
- Any contributions would have to be made (in one or more installments) within 3 years after the dates the Hurricane Harvey distributions were received

Source: Section 502(a) of the Disaster Tax Relief and Airport and Airway Extension Act of 2017

Other Tax Rules Relating to Certain Hurricane Harvey Distributions

- Qualified Hurricane Harvey distributions will be taxed over a three-year period unless the individual elects to be taxed immediately.
- Qualified Hurricane Harvey distributions are not subject to the mandatory 20% tax withholding that normally applies to lump sum payments.

Source: Section 502(a) of the Disaster Tax Relief and Airport and Airway Extension Act of 2017

Expanded Availability of Loans From Qualified Employer Plans

- Can take loan due to a need arising as a result of Hurricane Harvey.
- The $50,000 limit on loans set forth in Section 72(p) of the Internal Revenue Code is increased to $100,000 for qualifying Hurricane Harvey loans; and the ½ vested balance limit set forth in Section 72(p) of the Internal Revenue Code is increased to the full vested balance.
- Plan must be amended by end of first plan year beginning after December 31, 2017 to permit the loans.

Sources: IRS Announcement 2017-11; and Section 501(c) of Disaster Tax Relief and Airport and Airway Extension Act of 2017

Extension of Loan Repayment Deadlines for Existing Loans

- Generally, the due date for a loan to a qualifying individual affected by Hurricane Harvey will be extended by one year if the due date is without the extension would be on or before December 31, 2018.
- Generally, installment loan payments otherwise due to be paid on or before December 31, 2018 by qualifying individuals affected by will be extended by one year.

Source: Section 501(c) of Disaster Tax Relief and Airport and Airway Extension Act of 2017

Availability of Relief

- The actual availability of Hurricane Harvey relief will depend on the terms of the qualified employer plan.
- There is no legal requirement that an employer make the Hurricane Harvey relief available to its participants.