

After Hurricane Irma



CLIENT SUMMARY



Tax and financial implications of disaster-related casualties

Hurricane Irma left many homeowners and businesses with major, unprecedented damage. In addition to widespread property loss, disasters can have tax and other financial implications. A new law, the Disaster Tax Relief and Airport and Airway Extension Act of 2017, was signed by President Trump on September 29. It provides valuable tax breaks for recent hurricane victims. Here are details about the new law as well as some other information that may help if you suffered losses due to Hurricane Irma.

New law provides bigger personal casualty loss write-offs

You can claim tax deductions for personal casualty losses to the extent they're not covered by insurance. For federal tax purposes, you suffer a casualty loss when your property's fair market value is reduced or obliterated by a sudden event such as a hurricane, flood, storm, fire or earthquake. Property losses due to theft or vandalism also count as casualty losses.

Personal casualty loss deductions are generally significantly less than what taxpayers expect — or may be nothing at all — due to limitations in tax law. But the new law loosens the restrictions to allow Hurricane Irma victims larger deductions. Here's what changed:

- Normally, you must reduce the loss amount (after offsetting it by applicable insurance proceeds) by \$100. Under the new law, this \$100 limitation per casualty is increased to \$500. However, even though this amount went up, eligible victims can claim a larger deduction as described below.
- Generally, you must further reduce your loss by 10% of your adjusted gross income (AGI) for the year you would claim the loss on your tax return. Under the new law, this requirement is eliminated for Hurricane Irma losses.
- You normally don't get a deduction if you don't itemize. But under the new law, this requirement is eliminated for eligible hurricane victims so even non-itemizers get a deduction.

Example: You incurred a \$30,000 personal casualty loss last year, had AGI of \$150,000 and itemized deductions. Your allowable deduction would have been only \$14,900 (\$30,000 minus \$100 minus \$15,000). (If instead your loss was \$15,100 or less, you would have gotten no write-off at all.) Under the new law, if you sustain a \$30,000 qualified disaster-related loss due to Hurricane Irma on or after September 4, 2017, your allowable deduction will be \$29,500 (\$30,000 minus \$500).



Special rule for federal disaster areas

Let's assume you have a deductible personal casualty loss from Hurricane Irma. The loss was caused by an event in a federally declared disaster area, so a special rule allows you to claim your deduction either this year (when the casualty occurred) or last year (the year before the casualty occurred).

That means Hurricane Irma victims can file amended 2016 returns to claim personal casualty deductions last year and get tax refunds. This rule allows disaster victims to obtain quick federal income tax savings instead of having to wait until after filing next year.

Note: This special deduction is available only for losses in federally declared disaster areas. **For a complete list of eligible counties, visit irs.gov/newsroom/help-for-victims-of-hurricane-irma.**



Business casualty loss write-offs

If you have disaster losses to business property, you can deduct the full amount of the uninsured loss as a business expense on your entity's tax return or on the appropriate Form 1040 schedule if you operate as a sole proprietor. As with personal casualties, you can opt to claim 2016 deductions for 2017 losses in a federally declared disaster area.

Beware of taxable involuntary conversion gains

If you have insurance coverage for disaster-related property damage — under a homeowners, renters or business policy — you might actually have a taxable gain instead of a deductible loss. Reason: If the insurance proceeds exceed the tax basis of the damaged or destroyed property, you have a taxable profit under tax law. This is true even if the insurer doesn't fully compensate you for the pre-casualty value of the property. These are called "involuntary conversion gains" because the casualty causes your property to suddenly be converted into cash from insurance proceeds.

Example: Your vacation home was destroyed by the hurricane. The insurance company pays \$500,000 for the loss. Your tax basis is only \$200,000 because you bought the property years ago. For tax purposes, you have a \$300,000 involuntary conversion gain.

Note: Property tax basis usually equals original cost, minus any depreciation write-offs for business or rental usage, plus the cost of improvements. A tax pro can answer your questions about basis.

When you have an involuntary conversion gain, you generally must report it as taxable income unless you make:

1. Sufficient expenditures to repair/replace the property
2. A special tax election to defer the gain

If you make the gain-deferral election, you'll have a taxable gain only to the extent the insurance proceeds exceed what you spend to repair/replace the property. The expenses generally must occur within the period beginning on the damage or destruction date and ending two years after the close of the tax year in which you have the involuntary conversion gain.

Special principal residence rules

For federal tax purposes, special rules apply to involuntary conversion gains on principal residences. For this purpose, principal residence means the place has been your main home for at least the last two years. Some benefits depend on whether you own your principal residence:

For a principal residence you own. You can probably use the federal exclusion tax break to reduce or eliminate involuntary conversion gain. The maximum gain exclusion is \$250,000 for unmarried homeowners and \$500,000 for married joint-filing couples. To qualify for the maximum exclusion, you must have owned and used the property as your main home for at least two of the last five years. If you still have a gain after the gain exclusion tax break, you have four years (instead of the normal two years) to make sufficient expenditures to repair or replace the property and thereby avoid a taxable involuntary conversion gain — if your residence was damaged or destroyed by an event in a federally declared disaster area.

For a home you rent or own. If contents in your principal residence were damaged or destroyed by an event in a federal disaster area, there is no taxable gain from insurance proceeds that cover losses to unscheduled personal property (called "contents coverage").

In other words, you don't need to repair or replace contents to avoid a taxable involuntary conversion gain. You can do whatever you want with insurance money from unscheduled personal property coverage without tax concerns. This beneficial rule applies whether you own your principal residence or not.



Understand the implications

Consult with a tax advisor for a full explanation of the implications of a major property loss. We've summarized the federal rules that commonly come into play, but there could be additional considerations in your situation. This area of the tax law can be complicated, and the tax dollars involved can be significant.



IRS provides victims a variety of tax relief

Following disaster declarations issued by the Federal Emergency Management Agency (FEMA), the IRS announced that Hurricane Irma victims have until January 31, 2018, to file certain individual and business tax returns and make certain tax payments. This includes an additional filing extension for taxpayers with valid extensions that run out on September 15 or October 16. **This relief is available to counties listed here:** [irs.gov/newsroom/help-for-victims-of-hurricane-irma](https://www.irs.gov/newsroom/help-for-victims-of-hurricane-irma).

The tax relief postpones various tax filing and payment deadlines that occurred starting on September 4, 2017. As a result, affected individuals and businesses will have until January 31, 2018, to file returns and pay any taxes that were originally due during this period. This includes the September 15, 2017, and January 16, 2018, deadlines for making quarterly estimated tax payments. For individual tax filers, it also includes 2016 income tax returns that received a tax-filing extension until October 16, 2017. The IRS noted, however, that because tax payments related to these 2016 returns were originally due on April 18, 2017, those payments aren't eligible for this relief.

A variety of business tax deadlines are also affected, including the October 31 deadline for quarterly payroll and excise tax returns.

The IRS automatically provides filing and penalty relief to any taxpayer with an IRS address of record located in the disaster area. So you don't have to contact the IRS to get this relief. However, if an affected taxpayer receives an IRS late filing or late payment penalty notice that has an original or extended filing, payment or deposit due date falling within the postponement period, the taxpayer should call the number on the notice to have the penalty abated.

In addition, the IRS will work with any taxpayer who lives outside the disaster area but whose records necessary to meet a deadline occurring during the postponement period are located in the affected area. If you qualify for relief but live outside the disaster area, contact the IRS at 866.562.5227. This also includes workers assisting the relief activities who are affiliated with a recognized government or philanthropic organization.

Your tax advisor can help ensure you meet the applicable deadlines.





Employee retention tax credit for employers

The new law provides a valuable tax credit for eligible employers affected by the hurricane.

Specifically, an employee retention credit is now available for “eligible employers” affected by Hurricane Irma generally defined as those conducting an active trade or business in a qualifying disaster zone on the date of the disaster if the business was rendered inoperable for some period of time following the disaster). In general, the credit equals 40% of up to \$6,000 of qualified wages with respect to each eligible employee for the tax year.

Ask your tax advisor for more details on this important credit and how your business can benefit.

Special rule for the Earned Income Tax Credit and Child Tax Credit

Hurricane Irma has caused some working families to experience reduced earnings. This could be the result of their employers’ businesses being destroyed or unable to open for a period of time. The new law allows qualifying victims an option to maximize the Earned Income Tax Credit and the Child Tax Credit by giving them the option of using their prior year incomes to compute the credits (if that results in a bigger tax break).

Business interruption claims may require financial and legal assistance

Business interruption insurance typically pays for income that’s lost while operations are suspended after a natural disaster or one caused by humans. However, these claims can be difficult and even contentious if there are differences of interpretation about calculations, projections or the meaning of policy provisions.

When disasters such as Hurricane Irma occur, a need for a forensic accountant and an attorney can arise. Although many of the insurance claims that result from such a storm are relatively straightforward, policy claims for business interruption insurance may require detailed proof of the losses.





“After a major disaster, it can take more time than many people anticipate getting a business back on track. Depending on the policy, there is generally either a 48-hour or 72-hour waiting period before business interruption coverage kicks in.”

— Insurance
Information
Institute

Insurance basics

Most insurance claims involve determining what costs and replacement values of equipment and materials were lost or damaged in the disaster, proving the losses and values and submitting a claim.

Business interruption insurance generally pays for income that is lost and expenses that are incurred while operations are suspended. A business interruption policy typically covers expenses including:

Profits. This is the amount that would have been earned if it weren't for the loss (usually limited to 12 months).

Continuing costs. These are the operating expenses and other fixed costs that are still being incurred by the business. (These expenses must be ordinary and necessary, such as salaries and related payroll costs during the interruption period.)

Replacement expenses. This involves your costs for replacing inventory and machinery.

Temporary location. These are the extra expenses for moving to, and operating from, a temporary location. (The expenses for permanent relocation, if necessary, may also be included.)

Other expenses. This includes reimbursement for reasonable expenses (beyond the continuing costs) that allow your business to continue operating while the damage is being repaired.

Important: This type of insurance is arguably one of the most complicated on the market today, and submitting a claim is time consuming and takes careful consideration. Claims can be delayed or denied if there are differences of interpretation about loss calculations, income projections or the meaning of policy provisions.

How CPAs and attorneys can help

A business may approach its accountant or attorney for advice on how to approach a claim for business interruption coverage, especially if the business has already filed a claim and is experiencing pushback or denial from the insurance company. The business may also need professional help to get the insurer's attention — especially after a major disaster when insurance companies can be overwhelmed with claims.

An accountant and an attorney can work with the business to determine the losses and prove them in a claim. When it comes to business interruption claims, it is important to properly calculate losses upfront.

Accountants, particularly those experienced in business valuation and litigation, have skills that are important in determining losses for business interruption claims such as forecasting, modeling and properly presenting damages and losses. Working with an attorney, who can aid in the legal interpretation of the policy, an accountant can quickly and efficiently assemble the information and calculations needed for a viable business interruption claim. Filing a well-crafted claim can help speed up resolution with the insurance company.

Filing a business interruption claim requires companies to assemble financial records, such as receipts, utility bills, salaries, vendor information and more. The insurer will want to know how much income the business was generating before and after the loss. The business must analyze, identify and segregate revenues and expenses, as well as review its profit projections, to help ensure they are accurate and solid enough to hold up to a potential dispute. Consult with an accounting firm and attorney for assistance to help ensure a successful claim.

Power loss?

If your business could not operate due to the loss of power, there might be coverage under what is typically referred to as “off-premises service interruption,” according to the Insurance Information Institute. This is typically optional coverage offered as an endorsement to a property policy. In this case, the business doesn't have to incur damage to its facility, but the power outage must be caused by damage from a covered peril under the policy such as wind, fire, electrical breakdown, etc. Speak with your insurance agent, broker or claims adjuster about coverage that may exist.



More help for affected individuals and businesses

Whether you're personally a victim of Hurricane Irma or some of your employees are, there may be other disaster-related assistance and tax-saving opportunities you should be aware of.

Victims may be able to tap their retirement accounts

The IRS previously announced that 401(k) plans and similar employer-sponsored retirement plans can make loans and hardship distributions to Hurricane Irma victims and members of their families with streamlined procedures and liberalized hardship distribution rules. But the new law provides additional relief to eligible taxpayers.

We'll explain, but first, let's look at the general rules that pertain to 401(k)s, employees of public schools and tax-exempt organizations with 403(b) tax-sheltered annuities, as well as state and local government employees with 457(b) deferred-compensation plans.

Under current law, if a participant takes distributions from a qualified retirement plan before age 59½, a 10% early withdrawal penalty is due on the amount withdrawn, unless the taxpayer meets the rules for one of several exceptions. Regular income tax is also due on the amount.

In addition, a *loan* from a qualified employer plan to a participant or beneficiary is treated as a plan distribution unless, among other things:

- The loan amount doesn't exceed the lesser of \$50,000, or half of the present value of the employee's non-forfeitable accrued benefit under the plan. (However, a loan up to \$10,000 is allowed, even if it's more than half the employee's accrued benefit).
- The loan is required to be repaid within five years, except that a longer repayment can be used for a principal residence plan loan.

Under the new law, eligible victims under age 59½ can take tax-favored distributions from retirement plans without paying the 10% early withdrawal penalty. They are also allowed the option of spreading the income resulting from the distributions over a three-year period.

In addition, the new law provides qualified hurricane victims flexibility for loans from retirement plans by increasing the maximum amount that a participant or beneficiary can borrow from \$50,000 to \$100,000, removing the "half of present value" limitation and delaying certain repayment dates.

The new law also allows for the re-contribution of certain retirement plan withdrawals for home purchases or construction, which were received after February 28, 2017, and before September 21, 2017, if the home purchase was cancelled due to Hurricane Irma.

For more information, contact your tax advisor or visit the IRS website at [irs.gov/newsroom/help-for-victims-of-hurricane-irma](https://www.irs.gov/newsroom/help-for-victims-of-hurricane-irma).

Diesel fuel penalty waived

In response to shortages of undyed diesel fuel caused by Hurricane Irma, the IRS announced it won't impose a penalty when dyed diesel fuel was sold for use or used on the highway for a certain period. The relief applies to certain areas and counties for which the Environmental Protection Agency issued waivers.

This penalty relief is available to any person who sells or uses dyed fuel for highway use. In the case of the operator of the vehicle in which the dyed fuel is used, the relief is available only if the operator or the person selling the fuel pays the 24.4 cents-per-gallon tax that's normally applied to diesel fuel for highway use. The IRS won't impose penalties for failure to make semimonthly deposits of this tax. IRS Publication 510, Excise Taxes, has more information.

Ordinarily, dyed diesel fuel isn't taxed because it's sold for uses exempt from excise tax, such as to farmers for farming purposes, for home heating use and to local governments for buses.

Finally, consistent with the EPA waivers, this dyed diesel penalty waiver was effective through September 22, 2017. Also, consistent with the EPA waiver, this waiver doesn't apply to the tax code penalty for using adulterated fuels that don't comply with applicable EPA regulations. Consequently, diesel fuel with sulfur content higher than 15 parts-per-million may not be used in highway vehicles.





Don't get caught in the Hurricane Irma rumor mill

Misinformation about Hurricane Irma is running rampant. Many untruths are being circulated online, especially on social media.

Here are just some of the rumors, according to FEMA, and whether they're true or false:

Rumor #1: Disaster survivors shouldn't remove flood-damaged sheetrock, flooring, carpet, etc. until the house is assessed by FEMA or insurance adjustors.

This is **FALSE**.

Cleaning up and making temporary repairs to your storm-damaged property won't disqualify you from federal disaster assistance.

If you're a property owner, document storm damage — with photographs or video — and then clean up and make the temporary repairs that are necessary to make your home safe and habitable again. Put your health and safety first, take pictures of your damaged home, make repairs to prevent further damage and retain receipts.

Rumor #2: FEMA inspectors need to ask for personal financial information or charge for services such as damage inspections or contractor repairs.

This is **FALSE**.

Be aware that scam artists may pose as government officials, aid workers, charitable organizations or insurance company employees. To protect yourself, ask for identification and hang up on cold callers. Don't respond to texts, phone calls or personal requests seeking your personal information. FEMA only asks for verification of identity, not personal information. Contact government agencies yourself using information posted on their websites or use other official sources. And don't sign anything you don't understand or contracts with blank spaces.

Rumor #3: There's a FEMA list that permits travel into the disaster areas. If a business isn't on the list, they may not do business in the area.

This report is **FALSE**.

FEMA didn't create a list like this. Public and business access into disaster-impacted areas is solely at the discretion of local officials. Some flooded areas are now dry and available for the public to return, including businesses. However, some areas remain dangerous and inaccessible and are subject to evacuation orders.

Before attempting to enter a disaster area, check with local officials.





The SBA provides loans and advertises temporary positions

The Small Business Administration (SBA) is providing disaster loans for those affected by Hurricane Irma. For more information, visit: sba.gov/disaster-assistance/hurricane-irma.

The SBA is also hiring temporary employees to assist with disaster relief efforts this hurricane season from September 1st to December 31st, 2017. Positions include damage verifiers, lawyers, paralegals, legal assistants, loan specialists, customer service representatives, IT specialists and others. For more information, visit: sba.gov/disaster-assistance/hurricane-response-jobs-sba?utm_medium=email&utm_source=govdelivery.

Homeowners insurance tips after a casualty

Begin by calling your insurance company as soon as possible to report the damage, because insurance policies place a time limit on filing claims. Ask for the required forms to be sent to you. Find out if the insurer will be sending an adjuster to your home to inspect the property and when. Keep records of the time and date of your call, as well as the names of insurance company employees you speak with.

Here are 10 more tips:

- 1. Ask questions.** For example: What's my deductible? What's the procedure for obtaining estimates to repair the damage or replace the property that was destroyed? How long will the processing of my claim take?

Be aware that standard homeowners, renters and business insurance policies cover hurricane wind and rain damage but not flooding. Flood insurance is available through the National Flood Insurance Program, a division of FEMA. It's purchased from the government or through insurance companies. However, there's a waiting period before claims are reimbursable to prevent policyholders from purchasing such insurance immediately before a serious storm.

- 2. Find out what living expenses are covered.** If your home sustains so much damage that you cannot live there while it's being repaired, homeowners insurance generally pays some living expenses. There are limits on the coverage amount but typical expenses include the cost of a hotel and restaurant meals. Keep receipts to submit to the insurance company.

Make sure your insurer also has your cell phone number and/or the number where you're staying temporarily.

- 3. Take photos or videotape the damage as soon as possible.** This will help substantiate your claim if it's questioned or the insurance adjuster cannot come to your area right away.
- 4. Compile a list of lost or damaged items to help substantiate your claim.** Give this inventory to the insurance company, along with any photos, receipts, invoices and other documentation you have. The list should be as complete as possible, including item descriptions, purchase dates or approximate age, cost at time of purchase and estimated replacement cost.

- 5. Make temporary repairs if possible.** To protect your home from more damage, make reasonable temporary repairs such as covering broken windows and damaged roofs. (Don't make major non-emergency repairs until an insurance adjuster can see and assess the damage.) Save receipts to submit them to your insurance company for reimbursement.

- 6. Beware of fraud.** FEMA warns that after a disaster, thieves may prey on vulnerable survivors. Common post-disaster fraud practices include phony housing inspectors, fraudulent building contractors and fake offers of state or federal aid. Keep in mind that federal and state workers never ask for or accept cash and always carry identification badges. There's no fee to apply for or get disaster assistance from government agencies.

- 7. Watch out for price gouging.** FEMA explains that "price gouging occurs when a supplier marks up the price of an item more than is justified by his actual costs. Survivors are particularly susceptible because their needs are immediate, and have few alternatives to choose from."

- 8. If you sustain damage as the result of theft or vandalism, report the crime to the police.** Be sure to get a copy of the police report.

- 9. Don't accept an unfair settlement.** After your insurance company receives the necessary information, it will accept or reject your claim and offer a settlement. If you don't agree with the amount, you don't have to accept it. Ask your agent for an explanation. In many cases, insurers will negotiate until both parties agree.

If you can't reach an acceptable agreement, appeal to the company's chief claims office. There may also be an arbitration process. If you still don't get satisfaction, you can complain to the state insurance department. If necessary, contact an attorney.

- 10. Stay safe.** Many injuries happen in the calm after a storm. Downed power lines, flooded roads, unstable buildings, contaminated water, mold, falling debris and leaking gas lines are just a few of the hazards to avoid.



Answers to more damage questions from the Insurance Information Institute

Q. My car was flooded. Is it covered?

A. Possibly. Flood damage to vehicles, including flooding from a storm surge, is covered if you have purchased comprehensive coverage. This is also known as “other than collision” coverage, which is optional with a standard auto policy.

Q. My power went out for days. I lost hundreds of dollars worth of spoiled food in my refrigerator and freezer. Is it covered under my homeowners insurance?

A. It depends. After a disaster-related event in which power goes out, some insurance companies may include food-spoilage coverage. It generally covers a set amount, which can range from \$250 to \$500 per appliance, and you may get nothing depending on your deductible. Contact your insurance company.

Q. Should I file a claim if damage is less than my deductible?

A. Yes. Additional damage may become evident in the months after a large storm. Even if the damage total is under your deductible, filing a claim protects you if further repairs are needed. And if your home suffers damage from more than one event in a single policy period, the damage from the first storm may apply toward the deductible amount.

Go to iii.org for more insurance coverage information.



Finally, focus on what really matters

Hurricane Irma victims need financial, insurance and legal information. But they also need to know people care about their well-being. Often, the emotional toll is the most devastating aftermath of a disaster. FEMA provides these points:

- Be aware that everyone who witnesses or experiences a disaster is affected somehow.
- Anxiety about safety for yourself and your loved ones is normal.
- Profound sadness, grief and anger are also common reactions.
- Recovery can be speeded up when you acknowledge your feelings.
- Healing is more likely when you focus on your strengths and abilities.
- It’s healthy to accept help from community programs and resources.

Children and the elderly may need special attention. For peace of mind, consider limiting their exposure to news coverage of disaster events. The barrage of media coverage can cause despair and fear.

Don’t hesitate to seek counseling through faith-based organizations, voluntary agencies, professional counselors or possibly through FEMA and state and local government sources.

Once you begin to recover, it is critical to update your family’s disaster plan and replenish emergency supplies that may have been depleted. Protect yourself and your family by being prepared for the unexpected.

Visit usa.gov/hurricane-irma for more information about federal government relief.

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