Taxpayer Opportunity Network

Tax Prep Dispatch: Helping Hurricane Victims

Taxpayers from areas affected by Hurricanes Harvey, Irma and Maria may qualify for special disaster relief when they file their income tax returns. That relief can come in the form of extra time to file or pay taxes or, most importantly, qualify the taxpayer for a big casualty loss deduction. Victims have until October 16, 2018, to claim the casualty loss on their prior year return by filing an amended return for 2016 to get a quicker refund. Otherwise, the casualty loss can be claimed on the return for the year of the disaster: tax year 2017.

Claiming any casualty loss is out of scope for VITA. That is, VITA does not prepare any return that claims a casualty loss, that issue is not covered in VITA training or any VITA certification test, and it is not explained in Publication 4012. But that doesn't mean that VITA volunteers don't need to know something about casualty losses – even at VITA sites located in far-flung locations that are a great distance from those hurricane winds and damaging floods. Because of the large number of people affected in Texas, Florida, Louisiana, South Carolina and Georgia, a hurricane victim who has casualty-related tax issues may walk into a VITA site anywhere in the country. These issues can affect 2017 returns as a deductible loss or, less common, a gain from insurance proceeds on returns for tax year 2017 and beyond.

What Do VITA Sites Need to Know?

Even though VITA sites do not prepare these returns, volunteers need to know a bit about casualty losses in order to recognize returns that they shouldn't prepare.

We're talking about tax law here, so…it's complicated. The following items are generally true for most Harvey, Irma and Maria disaster situations:

1. The amount of the casualty loss is the *lesser* of: the cost of the item damaged *or* the decrease in fair market value of the item.

Example*: John is single, age 28, with no qualifying children or relatives. In August he was visiting his sister who lived in the path of Hurricane Harvey. A tree was blown onto John's 2008 Honda CR-V and totaled it. He went to the Kelley Blue Book and found that the day before Hurricane Harvey, his Honda was worth $6,800. The day after it was worth $0. He bought it used in 2015 for $9,000 and never used it for business.*

- *Cost: $9,000*
- *Decrease in value: $6,800*

The initial potential loss is the lesser of the two = $6,800.

2. The amount of loss must be reduced by any insurance or other reimbursement received.

If the amount of a future insurance reimbursement is not known, the taxpayer can deduct the entire amount of the loss and include the reimbursement as income in the year it is received.

Remember John? *He had an initial potential $6,800 loss. Turns out he had great insurance that covered the loss and paid him $5,500 right away. So now John's tax loss is:*

- *Initial potential loss: $6,800*
- *Less insurance: $5,500*
- *Leaves a loss: $1,300*

3. The casualty loss amount is reduced by $500. (This is a special rule for Harvey/Irma/Maria victims. Usually, this is a $100 subtraction.)

- *John’s loss: $1,300*
- *Less: $500*
- *Deductible loss: $800*

4. The loss does *not* need to be reduced by a percentage of AGI. (This is also a special rule for our three hurricanes. Normally, the loss must be reduced by 10% of AGI.)

- *John’s loss: $800*
- *Less AGI limit: $0*
- *Final deductible loss: $800*

5. Victims of Harvey/Irma/Maria can add their hurricane disaster loss to their standard deduction. (For most casualty losses, the taxpayer is required to itemize deductions to claim the loss.)

- *John’s std. deduction: $6,350*
- *John’s casualty loss: $800*
- *Total deduction: $7,150*

6. There is no refundable aspect to a casualty loss deduction. It can only reduce the amount of income that is taxed. When a casualty loss is greater than the taxable income, in some cases the casualty loss can be carried to another tax year.

John was unemployed most of 2017. This is his 2017 income:

- *Wages: $900*
- *Unemployment: $8,100*
- *Total income: $9,000*

His standard deduction, $6,350, plus his personal exemption, $4,050, equals $10,400. Since this is more than his total income, John will not pay any income tax anyway and there is no need for him to claim a casualty loss on his 2017 return. VITA can prepare his return.

All this will require some explanation. John feels like he lost $4,000 (the $9,000 cost of the car minus what he received from the insurance company). But, in fact, there is really no beneficial deductible loss for him on his 2017 tax return.

How Do You Identify and Help Hurricane Victims?

Taxpayers may not realize that the hurricane loss has anything to do with their tax return.

- If someone lived in Texas, Florida, Louisiana, South Carolina or Georgia, ask if they suffered any loss related to the hurricane. Even if you’re somewhere like Portland, Maine, you might notice a Texas address on one of their W-2s. Or you might see state income tax withholding for one of these states on a W-2. (But not Florida or Texas. They don’t have state income tax.)
- Watch for the relevant question on page 2 of Form 13614-C, Life Events: "Last year, did you (or your spouse) live in an area that was affected by a natural disaster? If yes, where?"
- Will the taxpayer pay any income tax? If the taxpayer has no taxable income, there is no benefit from claiming a casualty loss.

Situations where VITA should suggest that the taxpayer go to a tax professional for assistance include:

- It appears that the taxpayer would benefit from claiming a hurricane disaster casualty loss.
- The taxpayer had business or rental property that was damaged by a hurricane.
- The taxpayer’s insurance reimbursement is unknown and particularly if it may be more than the deductible loss.

In addition to referring these taxpayers to another preparer, suggest that before the taxpayer goes to the tax preparer, she visits www.irs.gov to peruse the many resources for hurricane victims.

What Resources are Available?

There are lots of online resources—almost an overwhelming amount. A good starting point is the Tax Relief in Disaster Situations page which has a wealth of information, including descriptions of the specific geographical areas covered by Hurricanes Harvey, Irma and Maria. Also, some other particularly useful resources are:

- Publication 584, Casualty, Disaster, and Theft Loss Workbook
- Form 4684, Casualties and Thefts and the accompanying instructions