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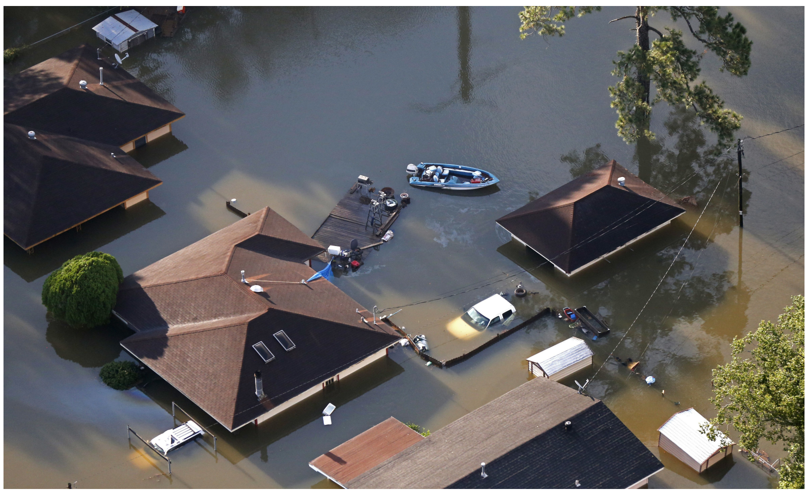
TAX REPORT

Damaged by Harvey? Get a Tax Break While You Can

Many victims of tropical storm will need to take 'casualty-loss' write-offs



A boat sits near flooded homes in the aftermath of Tropical Storm Harvey in Beaumont, Texas. **PHOTO:** GERALD HERBERT/ASSOCIATED PRESS

By Laura Saunders

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Thousands of Tropical Storm Harvey's victims will soon turn to tax deductions for help with losses not covered by insurance. If so, they could be getting in under the wire.

Floods such as the ones caused by Harvey illuminate an important gap in disaster coverage. While insurance policies typically provide better compensation to disaster victims than tax deductions, most coverage for homeowners excludes flood damage. In addition, potential victims often don't buy flood-insurance policies through a program run by the Federal Emergency Management Agency.

As a result, many victims of Harvey will need to take "casualty-loss" write-offs to recoup what they can.

These victims may be the last to benefit from this tax-code provision, however. Separate tax-reform plans proposed by President Trump and Republican leaders in the House of Representatives would eliminate the casualty-loss write-off in an effort to simplify the tax code. Congressional leaders and the White House haven't yet agreed on a final tax-reform plan.

There is a chance Harvey's damage could prompt lawmakers to reconsider the casualty-loss provision. House Ways and Means Chairman Kevin Brady (R., Texas), whose district is just north of Houston, "will work with the Texas and Louisiana delegations to make policy decisions as recovery needs become clearer," according to a spokeswoman.

But given the likelihood the write-off will be eliminated if tax reform passes, people should reassess their insurance coverage—especially if flooding is a possibility.

"The deduction doesn't make victims whole, but it provides important compensation," says Gerard Schreiber, a New Orleans-area certified public accountant. Mr. Schreiber has extensive experience preparing returns after disasters such as hurricanes and is advising the Texas Society of CPAs in the wake of Harvey.

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As people in Harvey's path prepare to rebuild, here are helpful details regarding taxes.

*__Tax-deadline extensions__: As is typical after a disaster, the Internal Revenue Service has postponed due dates. Taxpayers living in counties designated by FEMA as a federal disaster area have until Jan. 31, 2018 to make quarterly estimated payments for Sept. 15, 2017 and Jan. 16, 2018, with no penalties.

The Jan. 31, 2018 due date also applies to 2016 tax returns due on Oct. 16. Tax payments due this past April 18 don't qualify for this extension.

The IRS has also made it easier for Harvey victims and their families to take loans and hardship distributions from 401(k) and similar workplace retirement plans. For details, see release 2017-138.

Many businesses can obtain relief from penalties for late deposits of payroll taxes. For more information, see release 2017-135.

*Records: Good records are the key to proving tax deductions and insurance claims. Don’t throw out ruined items until you have photographed them. Get a notebook and paste in dated receipts for cleaning supplies and other out-of-pocket expenses.

Be specific and don’t exaggerate. Mr. Schreiber says the IRS audited a raft of returns from one tax preparer after Hurricane Katrina when it noticed that each claimed $150,000 of losses for household contents.

*Determining a loss: The law can be complex, and details are in IRS Publication 547.

For many taxpayers, the loss will be the “cost to cure” the damage done by Harvey—as long as the repairs come to less than the cost of the property plus adjustments. If the cost of repairs is greater than that sum, then victims must use the cost of the property plus improvements.

For example, say the cost of repairs to a home damaged by Harvey is $100,000. If the owner bought the house for $400,000 and put in $50,000 of improvements, then the repair cost is less than $450,000, so $100,000 is the amount of the loss.

The same process holds true for contents. IRS Publication 584 is a workbook with helpful logs for each room of the house and typical contents.

*Loss limits: Losses are reported on IRS Form 4684, but there are important limits. The loss must be reduced by any insurance reimbursements.

In addition, taxpayers can only deduct losses greater than 10% of their adjusted gross income—the number at the bottom of the front page of the 1040 form.

The 10% limit didn’t apply to losses from Hurricane Katrina and some other disasters, but it did apply to losses from superstorm Sandy. It applies under current law.

*Loss carry-back: Harvey victims with a deductible loss have the option of claiming it on their 2017 return or applying it to their 2016 taxes and getting a refund sooner.

Taxpayers who already filed for 2016 will need to file an amended return using Form 1040-X. Those on extension can incorporate the loss on their 2016 return.

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