Oct. 10, 2017

Recent hurricanes have left many homeowners and businesses with major, unprecedented damage. In addition to the widespread property losses, disasters can have tax and other financial implications. Fortunately, a new law passed on September 29 provides special tax breaks for victims of Hurricanes Harvey, Irma and Maria. If you've been affected, consider these five tips as you work to rebuild your home or business.

1. Take advantage of more valuable personal casualty loss write-offs

For federal income 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 — to the extent losses aren't covered by insurance. Property losses due to theft or vandalism also count as casualty losses.

Normally, personal casualty loss deductions are 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 recent hurricane victims larger deductions. Here's what changed:

- You must normally 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 Harvey losses.

- You normally don't get a deduction if you don't itemize. But under the new law,

2. Understand 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.

3. 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.

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.

When you have an involuntary conversion gain, you generally must report it as taxable income unless you make a special election to defer the gain and make sufficient expenditures to repair/replace the affected property..

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. The deferred gain amount is subtracted from

For a principal residence you own. You can probably use the federal gain exclusion tax break to reduce or eliminate any 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 taking advantage of 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 own or rent. If contents in your principal residence were damaged or destroyed by an event in a federally declared disaster area, there is no taxable gain from insurance proceeds that cover losses to unscheduled personal property. 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.

5. You may be able to tap into your retirement account

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

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. Under the new law, eligible victims under age 59½ can take tax-favored distributions from retirement plans without paying the 10% early

As you work to rebuild, be sure to consult with a tax advisor for a full explanation of the implications of a major property loss as there could be additional considerations in your situation. This area of the tax law can be complicated, but the tax dollars involved may be significant.

A free special report and online resources are available from Thomson Reuters at tax.tr.com/relief-resources.