Casualty Losses and the Ability to Claim Tax Credits

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August 22, 2018

OCAH Affordable Housing Conference

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Casualty Loss Defined

- Generally, casualty losses are losses, damage or destruction of property caused by fire, theft, vandalism, earthquake, storm, floods, terrorism, or some other sudden, unexpected or unusual event.
- IRC Section 165 provides a deduction for losses that are not covered by insurance or other reimbursement.
- Personal casualty and theft losses deduction eliminated starting in 2018 EXCEPT for Federally declared disaster areas.

Federally Declared Disaster Areas

- A disaster loss is a loss attributable to a casualty occurring in an area that the President declares as a disaster area and is entitled to federal assistance under the Disaster Relief and Emergency Assistance Act.

- Areas qualifying will be identified by the IRS based on determinations by the Federal Emergency Management Agency (“FEMA”)

- Additional tax benefits for individuals and businesses (Discussed later)

Determining the Amount of the Casualty Loss

- A casualty loss is calculated by subtracting any insurance or other reimbursement received or expected from the lesser of:
  - The decrease in FMV of the property as a result of the casualty, or
  - The adjusted basis in the property before the event

Determining the Amount of the Casualty Loss (Cont.)

- The decrease in FMV used to figure the amount of a casualty loss is the difference between the property's FMV immediately before and immediately after the casualty event.
- Alternative methods (See Publication 547)
  - Estimated repair cost method ($20,000 or less)
  - Insurance Method
  - Federally Declared Disaster Methods - Contractor & Loan appraisal safe harbor.
  - IRS provided safe harbor methods with Cost Indexes for Hurricane's Harvey, Irma, Maria.

Limitations

Individual Use Property

- Each Casualty loss must be reduced by $100 per casualty.
- Reduced by 10% of your Adjusted Gross Income (AGI) on Schedule A as an itemized deduction
- Certain investments or employee property may be reduced by 2% of AGI.

Business Use Property

- No limitation
- Reported as involuntary conversion

Casualty Loss Reimbursements Could Trigger Gain

- May happen when insurance reimbursements exceed the adjusted basis in the damaged property.
- If Taxpayer reinvests reimbursements in property that is similar or related in service or use to the damaged or destroyed property within a specified replacement period with is typically two years then no gain is recognized.
- If property is converted into money or dissimilar property then gain generally will be recognized.
- For Business use property a tax election is available under involuntary conversion rules (Section 1033) to decrease the depreciable basis of the property purchased to replace the destroyed assets. Does not apply if you don't spend the insurance proceeds.

Special Rules for Federally Declared Disaster Area

Additional benefits to being declared a Disaster Area

- There is a four-year replacement period for destroyed property.
- For personal property (meaning, not buildings), there is no taxable gain from insurance proceeds that cover losses for personal property that was not itemized on the homeowner's insurance policy. (IRC §1033(h)(1)(A)(i))
- Insurance proceeds for the residence and any scheduled personal property may be combined together and treated as the conversion of a single item of property.
- Any tangible personal property held for productive use in a trade or business is treated as property similar in use to the converted property.
- Can elect to treat the casually loss as having occurred in the year preceding year in which the disaster occurred.

Special Rules for Federally Declared Disaster Area (cont.)

Disaster Tax Relief and Airport and Airway Extension Act of 2017 signed on Sept 29th, 2017

- Only for certain Qualified disaster areas in 2016 and 2017.
- Increased $100 dollar limitation to $500
- Eliminates 10% of AGI reduction
- Did not have to itemize (increased Standard deduction)
- No AMT adjustments
- THESE SPECIAL RULES ARE ONLY FOR SPECIFIC DISASTERS

Disaster Impact on Credits

- Eligible basis is determined at the end of the year
- If impacted units are down as of Dec 31st credits may be impacted
- Utilize excess eligible basis on 9% projects to reduce effect

Tax Credit Relief In President Declared Disaster Area

- Guidance is from Revenue Procedure 2014-49
- Provides relief related to carryover allocations – extensions for 10% test and placed in service dates
- Provides recapture relief and no interruption of credits
- Addresses deals in the 1st year of the credit period
- Provides guidance for owners who want to temporarily house displaced people

Carryover Relief

- Tax credit allocating agency (Agency) must approve any extension
- Extension of time to meet 10% may be up to 6 months past normal due date
- Extension of time to place a building in service is not past December 31 of the year following the normal two year period
- Credits on projects that don't meet the extended due date are returned to the Agency as of end of extension period
- Agency uses Form 8610 to let the IRS know which projects have been granted relief

Recapture Relief

- Applies to projects after the 1st year of the credit period
- No recapture if restored in a reasonable restoration period (RRP)
- Agency establishes the RRP
- Not more than end of 25th month after Major Disaster declaration
- Credits during the RRP based on qualified basis at the end of year prior to start of the incident period
- Failure to restore within the RRP results in recapture
- Owner must report reduction of qualified basis to the Agency
- Failure to restore within RRP is reported to the IRS on Form 8823
- Generally no additional credits allowed for restoring qualified basis

First Year of Credit Period

- Agency may delay beginning of credit period
- Delay not more than 25 months from Major Disaster declaration
- No credits claimed during restoration

Emergency Housing Relief

- Existing project must receive written approval from Agency to provide temporary housing for displaced people
- Approved temporary housing period can't exceed 12 mos. from month of Major Disaster
- Tax Exempt bond financed deals may have different rules – See Rev Proc 2014-50
- No existing tenants can be evicted to provide emergency housing
- Rev. Proc. provides details on implementation and recordkeeping