

Disaster Tax Relief

GUIDE FOR ATTORNEYS

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LADRC.org



Legal Aid Disaster
Resource Center

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“When a natural disaster strikes, ruining homes, communities, and lives, the last thing a survivor should be worried about is filing their taxes.”¹ Natural disasters, such as hurricanes, tornadoes, or even global pandemics, have the ability to disrupt communities, economies, and individual livelihoods. Immediate relief that goes to those affected by disasters addresses basic necessities such as food, shelter, and medical access. Natural disasters often have long-term consequences. One of the most important, and often overlooked, areas that survivors need assistance in is tax relief.

¹ *Congress introduces bill to provide tax relief after natural disasters*, ACCOUNTING TODAY, <https://www.accountingtoday.com/news/congress-introduces-bill-to-provide-tax-relief-after-natural-disasters> (last visited Aug. 27, 2020) (quoting Judy Chu, D-CA, who introduced a bill to Congress looking to expedite IRS response to natural disasters).



The Internal Revenue Service (“IRS”) provides several tax relief alternatives for those affected by natural disasters, including tax deductions, disaster relief payments, and filing deadline extensions.² The step-by-step guide below will highlight the most important points.

I. FEDERAL TAX RELIEF

A. When is Tax Relief Available?

The IRS provides disaster tax relief when disasters are federally recognized and disaster areas are designated by the Federal Emergency Management Agency (“FEMA”) for Individual Assistance (see below for definition).³ The President of the United States has the authority to federally declare a disaster and establish a program of disaster preparedness.⁴ Disasters are defined as any catastrophe which requires federal assistance to supplement state and local efforts to save lives and protect property, public health and safety.⁵ The President, depending on the severity of the disaster, can label it either as an “emergency” or a “major disaster,” and this matters for whether a disaster area gets Individual Assistance.

Once a natural disaster designation has been made by the President, FEMA will decide what areas are affected by it and whether an area gets Individual Assistance (assistance directly to residents) and/or Public Assistance (funds directly to state and local governments).⁶ Generally, the IRS only provides tax benefits to disaster areas designated as eligible for Individual Assistance.⁷ The IRS makes

² *Tax Relief in Disaster Situations*, INTERNAL REVENUE SERVICE, <https://www.irs.gov/newsroom/tax-relief-in-disaster-situations> (last visited Aug. 27, 2020), (containing up-to-date information regarding tax relief for people affected by disasters).

³ I.R.M. § 4.2.2.2.

⁴ 42 U.S.C. § 5131. *See also Stafford Disaster Relief and Emergency Assistance Act (“Stafford Act”),* 26 U.S.C. § 165(i). This is a 1988 United States federal law designed to provide federal natural disaster assistance to state and local governments.

⁵ 42 U.S.C. § 5122.

⁶ I.R.M. § 25.16.1.2. *See also Disasters*, FEDERAL EMERGENCY MANAGEMENT AGENCY, <https://www.fema.gov/disasters> (containing a list of disasters) (last visited Aug. 27, 2020).

⁷ I.R.M. § 25.16.1.1.2.



a separate assessment each time a disaster occurs to determine the level of tax relief necessary for taxpayers.⁸

B. Who is Eligible for Relief?

When a disaster is federally declared, the IRS issues press releases to taxpayers with disaster-specific relief information.⁹ This information includes the areas/counties within a state that are impacted and whose residents are eligible for the tax relief, and provides detailed guidance on who is considered an affected taxpayer and lists all types of tax relief offered at this time.¹⁰ These press releases can be found on the IRS' website at <https://www.irs.gov/newsroom/tax-relief-in-disaster-situations> and are also distributed to local media outlets of the impacted states. **Note the guidance is disaster-specific so one should not rely on previous versions of the memorandum to determine what relief is available.**

IRS guidance and tax benefits are limited to taxpayers with a filing obligation. If a person's income falls below certain income thresholds or they are otherwise exempt from filing taxes, generally no tax relief is available. If a person's income is nontaxable (as in the case of a person receiving only Social Security benefits, Supplemental Security Income, Veteran's Administration Benefits, and Child Support), then they do not have to file taxes and would not get tax relief, unless they have income from other sources.¹¹ The general rule is that all income is taxable unless specifically excluded. If a person is self-

⁸ See I.R.M. § 25.16.1.5.2 (discussing the factors the IRS uses to determine the appropriate level of tax relief).

⁹ I.R.M. § 25.16.1.6.

¹⁰ I.R.M. § 25.16.1.6.

¹¹ *Tax Guide: Do I Need to File*, 1040.COM, <https://www.1040.com/tax-guide/filing-your-taxes-101/do-i-need-to-file/#:~:text=As%20a%20very%20general%20rule,taxes%20on%20the%20total%20amount> (last visited Aug. 27, 2020) (describing tax implications of receiving Social Security benefits).

See also *Read This To See if Your Social Security Benefits May Be Taxable*, INTERNAL REVENUE SERVICE, I.R.S. Notice 703, Oct. 2019, <https://www.irs.gov/pub/irs-pdf/n703.pdf> (last visited Aug. 27, 2020).

See *Taxable and Non-Taxable Income*, I.R.S. Pub. 525, Cat. No. 15047D (Feb 25, 2020) <https://www.irs.gov/pub/irs-pdf/p525.pdf>.



employed or an independent contractor (also known as a 1099 worker), they are subject to self-employment and income tax if they earn tax above \$400.¹²

While IRS guidance is disaster-specific, usually, a taxpayer is considered to be “affected” by the disaster and eligible for IRS tax relief if his or her primary residence or primary business is located in a disaster area or if records necessary to meet a filing or payment deadline are located in the disaster area.¹³ This is not an exhaustive list¹⁴, and on a case-by-case basis, the IRS can expand eligibility criteria to include other categories of people, for example relief workers assisting in a covered disaster area. This information will be included in the IRS notices described above.¹⁵

C. Types of Tax Relief Available

Relief for affected taxpayers comes in many forms: deductions on tax returns, postponement of collection activities, extensions of filing deadlines, and more. One can find this information on the Federal Emergency Management Agency (“FEMA”) and IRS websites, where there are specific resources for each federally designated natural disaster.¹⁶

1. Extensions of Filing and Payment Deadlines, Collection Holds and Penalty Relief

Once a disaster is federally declared, the IRS will issue special notices and news releases, available on their website, detailing what deadlines are impacted, the length of the extensions, and

¹² See *IRS Self-Employed Individuals Tax Center*, INTERNAL REVENUE SERVICE, <https://www.irs.gov/businesses/small-businesses-self-employed/self-employed-individuals-tax-center> (last visited Aug. 27, 2020).

¹³ See I.R.M. § 25.16.1.3 (describing the categories of taxpayers that are usually “affected” by a disaster).

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ For example, the IRS has a section on its website for helping victims of Hurricane Dorian (<https://www.irs.gov/newsroom/help-for-victims-of-hurricane-dorian>) and FEMA has a section on its website for helping victims of the COVID-19 pandemic (<https://www.fema.gov/coronavirus/>).



eligible taxpayers to whom the extensions apply.¹⁷ Statutorily, the IRS has authority to extend for up to one year certain tax filing and payment deadlines that fall within the “postponement period.”¹⁸ The start date of the postponement period depends on the date of the Presidential Declaration, typically it starts on the day the disaster strikes. Some of these deadlines include filing tax returns; paying taxes; making refund claims; filing suits for refunds; filing Tax Court petitions, etc. The IRS does not use their discretion uniformly across disasters, so it is important to check the event-specific page.

“When a federal disaster is declared, the IRS has authority to postpone certain tax-related deadlines and provide relief from compliance activity.... In addition to systemic filing and payment relief, the –O freeze also... Suspends a number of collection and examination activities, including DIF ordering through Audit Information Management System (AIMS), Underreporter activity, and TDA/TDI processing.”¹⁹ Sometimes this pause is automatically applied and is in the IRS declaration. If it is not, you may have to request it. Requesting additional time to pay does not stop interest running unless the IRS explicitly states so.²⁰

Even if a disaster is not federally declared, the IRS has discretion to allow up to a six-month extension to file tax returns under IRC Sec. 6081. Penalties for failure to file or failure to pay start running after any applicable extensions.²¹ The taxpayer would have to call the IRS at the toll-free number listed

¹⁷ Mandi L. Matlock, Mary Ann David, R. Paul Tuttle, & Andrew VanSingel, *Assisting Victims of Disasters*, in *Effectively Representing Your Client Before the IRS*, 7th Edition (2018), at 24-9, <https://www.americanbar.org/content/dam/aba/administrative/taxation/resources/litc-24-disaster.pdf>.

¹⁸ *Id.* at 24-10.

¹⁹ I.R.M. §4.2.2.4 (02-12-2020).

²⁰ *Id.* at 24-11.

²¹ *Id.* 26 CFR § 1.6081-1

Penalty Relief Due to Reasonable Cause, INTERNAL REVENUE SERVICE, <https://www.irs.gov/businesses/small-businesses-self-employed/penalty-relief-due-to-reasonable-cause> (last visited Aug 29, 2020).



on their penalty notice and explain their circumstances, and based on reasonable cause, the IRS will manually change their account.²²The IRS will not abate interest unless it is caused by their own actions.

2. Deductions of Qualified Disaster Losses & Record Keeping

Eligible taxpayers may deduct certain losses they suffered from a federally declared disaster – these are called qualified disaster losses. A qualified disaster loss is an individual’s casualty or theft loss of personal-use property attributable to a disaster declared under the Stafford Act.²³ A casualty loss is damage, destruction, or loss of property attributable to a sudden event.²⁴

Prior to 2017, these losses could be deducted as a casualty loss even if there was not a federally declared disaster.²⁵

Taxpayers in a disaster area should use Form 4684 to deduct their losses on their next tax return or can opt to amend the previous year’s return and claim it there.²⁶ Eligible taxpayers can deduct the entire portion of the loss that is attributable to the disaster less the amount paid by insurance and other reimbursements, including other relief payments.²⁷

To support their casualty loss claims, taxpayers should be able to show proof of damage and that the disaster in question was the direct cause of that damage.²⁸ Documenting these losses could include

²² I.R.M. § 25.16.15

²³ *Casualties, Disasters, and Thefts*, I.R.S. Pub. No. 547, Cat No. 15090K (Feb 19 2020) at 16, <https://www.irs.gov/pub/irs-pdf/p547.pdf>.

²⁴ *Id.* at 3.

²⁵ *Casualties, Disasters, and Thefts (For use in preparing 2019 returns)*, I.R.S. Publication 547, available at <https://www.irs.gov/pub/irs-pdf/p547.pdf>, at 2. The Section 11044 of the Tax Cuts and Jobs Act of 2017 suspends casualty loss deductions for taxable years 2018 through 2025 if they are not attributable to a federally declared disaster. *Id.*

²⁶ *See About Form 4684, Casualties and Thefts*, INTERNAL REVENUE SERVICE, <https://www.irs.gov/forms-pubs/about-form-4684> (last visited Aug. 27, 2020) (containing the form and instructions for how to complete). *See also Casualties, Disasters, and Thefts*, IRS Pub. No. 547, Cat No. 15090K (Feb 19 2020) at 19, <https://www.irs.gov/pub/irs-pdf/p547.pdf>.

²⁷ *Id.*

²⁸ *Casualties, Disasters, and Thefts*, *supra* note 22, at 6.



collecting receipts, proof of ownership, and other documents relating to the losses. Taxpayers' evidence is viewed in the light most favorable to them. The IRS has relaxed policies about supporting evidence for survivors of natural disasters if the records are lost or destroyed. Under the *Cohan* rule, a court may approximate the amount lost if the taxpayer presents sufficient evidence to establish a good faith rational basis for the estimate, even if the taxpayer cannot provide exact documentation.²⁹

Casualty losses are considered itemized deductions. Generally, taxpayers may elect either to take a standard deduction or itemize their deductions, whichever is most beneficial in their tax situation.³⁰ In the case of federally recognized disasters, taxpayers can do both – take a standard deduction and itemize their qualified disaster loss, if the disaster was designated as a “major disaster” by the President under the Stafford Act.³¹ This is beneficial especially to low-income taxpayers who often take a standard deduction over itemizing.

As with other aspects of tax relief, taxpayers should check the relevant IRS notices and legislation passed around the time of the disaster, because the requirements for qualified disaster losses may change based on the disaster, and benefits like itemizing deductions may be available even in situations not labelled “major disasters.”³² For example, for Hurricanes Harvey, Irma, and Maria, disaster legislation was passed to specifically allow all taxpayers to itemize their casualty loss deduction.³³ Another example is Congress’s Taxpayer Certainty and Disaster Tax Relief Act, which provided valuable relief to taxpayers affected by federally declared disasters that happened between January 1, 2018, and January 19, 2020.³⁴

²⁹ *Cohan v. Commissioner*, 39 F.2d 540, 543-544 (2d Cir. 1930).

See also Matlock, *supra* note 17, at 24-5 (containing discussion of the *Cohan* rule and its effects).

³⁰ Matlock, *supra* note 17, at 24-24.

³¹ I.R.S. Publication 501, *supra* note 11, at 2.

³² *Id.*

³³ *See id.* (describing how the legislation around Hurricanes Harvey, Irma, and Maria made casualty losses available to all affected taxpayers, not just those who itemize – and low-income taxpayers usually do not itemize).

³⁴ Further Consolidated Appropriations Act, 2020, H.R. 1865, 116th Cong., Div. Q (2020), available at: <https://www.govtrack.us/congress/bills/116/hr1865/text>.



3. Option to Amend Tax Returns for Faster Relief

As noted above, qualified disaster loss deductions are available for eligible taxpayers when they file tax returns for the year when the federally declared natural disaster occurred. However, the IRS offers eligible taxpayers an option to amend their prior year tax return to obtain quicker relief within six months of the prior year's filing deadline.³⁵

The IRS will also provide expedited processing of amended tax returns for survivors of federally declared disasters, with an average processing time of 60 days.³⁶ The amended tax return should have the disaster designation written at the top of the first page of the amended return.³⁷ Amended returns must be paper filed with the IRS.³⁸

4. Tax-Exempt Assistance

The Federal Government may issue tax-exempt disaster assistance to taxpayers in the designated natural disaster areas. This assistance takes the form of qualified disaster relief payments.³⁹ Qualified disaster relief payments are not included in gross income or subject to withholding if there is not a double benefit.⁴⁰

The most common type of tax-exempt qualified disaster relief payment is assistance provided by FEMA.⁴¹ FEMA disaster relief generally covers certain uninsured, disaster-related losses, such as temporary housing, repair and replacement of a homeowner's principal residence, reimbursement for

³⁵ *Casualties, Disasters, and Thefts*, *supra* note 22, at 16.

³⁶ *FAQs for Disaster Victims - Amended Returns*, INTERNAL REVENUE SERVICE, (July 9, 2020), <https://www.irs.gov/businesses/small-businesses-self-employed/faqs-for-disaster-victims-amended-returns> (last visited Aug. 27, 2020).

³⁷ *Id.*

³⁸ *IRS Website FAQ: Amended Returns*, INTERNAL REVENUE SERVICE, (Aug 19, 2020), <https://www.irs.gov/faqs/electronic-filing-e-file/amended-returns/amended-returns> (last visited Aug. 27, 2020).

³⁹ I.R.C. § 139.

⁴⁰ I.R.C. § 139. *See also* Matlock, *supra* note 17, at 24-14.

⁴¹ Matlock, *supra* note 17, at 24-14.



damage to personal property, and other disaster-related expenses.⁴² These payments are not automatically issued and impacted individuals must apply for assistance [online](#). Eligible individuals are those who cannot meet their disaster-caused needs through other means and whose needs were directly caused by the disaster.⁴³ After receiving the application, FEMA will send an inspector to inspect the damage done and will make a qualification decision in ten days.⁴⁴ Applicants can appeal these decisions. FEMA has instructions on their [website](#).

Qualified disaster relief payments are not limited to assistance provided by the federal government. They can also be made by employers, nonprofits, and state and local governments to affected individuals. These payments include any amounts to reimburse or pay an individual disaster survivor for (a) necessary personal, family, living, or funeral expenses incurred as a result of the qualified disaster, and (b) for reasonable and necessary expenses incurred for the repair of a personal residence or replacement of contents.⁴⁵ Application and eligibility requirements differ from organization to organization, and generally, taxpayers do not have to provide exact documentation, as long as these payments are a reasonable estimate of the employee's losses and are attributable to the disaster.⁴⁶

5. Withdrawals from Retirement Accounts

Making withdrawals from retirement accounts usually comes with steep tax consequences. An early distribution subjects the taxpayer to income tax liability as well as an additional 10% penalty for

⁴² *Id.* See also <https://www.fema.gov/individual-disaster-assistance>.

⁴³ *Fact Sheet: Frequently Asked Questions about FEMA Individual Assistance*, FEDERAL EMERGENCY MANAGEMENT AGENCY (May 17, 2018), <https://www.fema.gov/news-release/2018/05/17/4362/fact-sheet-frequently-asked-questions-about-fema-individual-assistance> (last visited Aug. 27, 2020).

⁴⁴ *Frequently asked questions about FEMA disaster assistance*, INSURANCE INFORMATION INSTITUTE, <https://www.iii.org/article/frequently-asked-questions-about-fema-disaster-assistance> (last visited Aug. 27, 2020).

⁴⁵ Matlock, *supra* note 17, at 24-14.

⁴⁶ *Qualified Disaster Relief Payments by Employers Not Taxable Income to Employees*, MCGUIREWOODS LLP, (Sep. 12, 2017), <https://www.mcguirewoods.com/client-resources/Alerts/2017/9/Disaster-Relief-Payments-Employers-Not-Taxable-Income-Employees> (last visited Aug. 27, 2020).



early withdrawal. c⁴⁷ Typically, the 10% penalty is not imposed if the taxpayer can show hardship, and if they are subject to a disaster declaration, they are deemed to have a hardship. This relief may be specific to each federally declared disaster, and eligible taxpayers should read the IRS notices published on [the IRS website](#) to determine which retirement plans are covered.⁴⁸ For example, for Hurricane Harvey, the IRS relaxed the hardship verification procedures for qualified plans (401(k), 403(b), 457(b), and IRAs) and documentation requirements such as spousal consent or death certificates.⁴⁹ Additionally, the IRS allowed taxpayers to take hardship distributions or loans even if their retirement plans didn't have such provisions, as long as the plan was later amended to allow them.⁵⁰ The distribution will be subject to income tax. 10% of the distributed amount will be withheld for income tax liability unless the taxpayer specifically opts to have no tax withheld.⁵¹

6. Access to Past Tax Information

Survivors of disasters often need access to past tax records to get basic relief. Many of these records are often damaged due to the disaster. The IRS will provide expedited tax return transcripts free of charge to disaster survivors. Survivors can call the Disaster Assistance Hotline at 866-562-5227, or file Form 4506-T (request for Transcript of Tax Return). If filing the Form 4506-T, the name of the disaster should be written prominently on the form. Taxpayers can also download copies of their own tax return transcripts on the IRS website.⁵²

⁴⁷ Matlock, *supra* note 17, at 24-18.

⁴⁸ *Id.*

⁴⁹ *Disaster Relief*, I.R.S. Pub. 976, Cat No. 71006W (Mar 01, 2018) at 12, <https://www.irs.gov/pub/irs-pdf/p976.pdf>

⁵⁰ *Id.*

⁵¹ *Pensions and Annuity Withholding*, INTERNAL REVENUE SERVICE (May 18, 2020), <https://www.irs.gov/individuals/international-taxpayers/pensions-and-annuity-withholding> (last visited Aug. 27, 2020).

⁵² *Welcome to Get Transcript*, INTERNAL REVENUE SERVICE, <https://www.irs.gov/individuals/get-transcript> (last visited Aug. 27, 2020).



II. STATE TAX CONSIDERATIONS

Advocates should refer to guidance issued by their state taxing agency, usually found on the agency's website, for any state-specific relief.⁵³ States have previously extended filing and payment deadlines for those living within a federally declared disaster area.⁵⁴

State income tax is typically calculated from the data on the federal income tax return.⁵⁵ Any qualified disaster losses claimed on the federal return would therefore lower the state tax liability.⁵⁶ If taxpayers are amending any of their federal tax returns to reflect a loss, then they should also amend their state tax return.⁵⁷

There may also be special state tax programs that provide relief if a disaster was not declared or relief that is not related to federal income taxes. For example, Louisiana had a special tax program after Hurricane Katrina and the August 2016 floods that allowed affected taxpayers to reduce their state income tax liability by the amount of sales tax they had paid on items that needed to be replaced due to the disaster.⁵⁸

⁵³ *E.g. Disasters and Texas Taxes*, TEXAS COMPTROLLER OF PUBLIC ACCOUNTS, <https://comptroller.texas.gov/taxes/publications/94-182.php> (last visited Aug. 27, 2020).

⁵⁴ Matlock, *supra* note 17, at 24-7.

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

