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CHAPTER 24
ASSISTING DISASTER SURVIVORS

By Mandi L. Matlock, Mary Ann David, R. Paul Tuttle, and Andrew Van Singel

24.1 OVERVIEW

24.1.1 Introduction

Millions of Americans are affected by disasters each year. There were, on average, about 60 federally declared disasters per year from 2001 to 2010, and 90 per year from 2011 to the present. This chapter addresses common tax law issues faced by disaster survivors and resources for helping them.

24.1.2 Types of Disasters

Common disasters include fires, earthquakes, tornadoes, hurricanes, floods, and terrorist acts. In America, about 90% of natural disasters involve flooding. Historically, many flood survivors did not have insurance. Hurricane survivors, by contrast, often have some form of insurance. The Code provides some general tax relief for all casualty survivors, but Stafford Act disasters and other “qualified disasters” within the meaning of section 139 trigger additional federal tax relief provisions providing more favorable tax treatment.

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1 Patrick E. Tolan, Jr., The Flurry of Tax Law Changes After the 2005 Hurricanes, 72 Brook. L. Rev. 799, 806 n.36 (2007).
2 E.g., I.R.C. §§ 165, 1033.
3 References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (“the Code”), unless otherwise indicated.
A Stafford Act disaster is a federally declared emergency or major disaster that is beyond the capacity of state and local governments. Stafford Act disasters require federal assistance and are qualified disasters for federal tax purposes. Other types of qualified disasters include disasters resulting from terrorist or military actions, common carrier accidents, and any other events defined by the Secretary of the Treasury to be catastrophic in nature. Even a foreign disaster may be declared a qualified disaster for federal tax purposes. The Service will issue notices if it finds that a disaster is a qualified disaster for federal tax purposes. The designation as a qualified disaster may trigger both permanent sections of the Code and special tax laws for a specific disaster. See ¶ 24.2.3.

24.1.3 Tax and Tax-Related Legal Problems in Disasters

All disasters present some common issues such as casualty losses and involuntary property conversions. Each disaster may also present additional, unique issues, such as a greater incidence of certain tax problems or the passage of disaster-specific legislation by Congress.

Taxpayers will often need tax advice, assistance with reconstruction of tax records, and access to tax returns to recover from a disaster. Disaster survivors may face other legal problems that can generate tax law problems, such as bankruptcy, foreclosure, divorce, domestic violence, disaster relief payments, tax liens, and contractor fraud, etc.

Generally, recovery from a disaster involves several phases, each of which may generate tax law problems. For example, the first phase of disaster recovery involves obtaining government assistance, filing insurance claims, securing loans, and accessing retirement accounts. Later phases may include assessing the tax consequences of disaster relief payments, disaster grants, disaster compensation in environmental disasters, foreclosures, demolitions, debt cancellations, and bankruptcies.

24.2 TAX ADVOCATE’S RESPONSE TO A DISASTER

24.2.1 Anticipate Disaster Survivors’ Needs

A tax professional should anticipate common tax law problems that arise in disasters and identify any special tax provisions that will apply to a specific disaster.

As an initial matter, disaster survivors will need immediate access to past tax returns or return transcripts for loan applications, insurance payments, public assistance, and other disaster assistance or compensation. They may also need to file or amend tax returns for prior years to access refunds. Self-employed disaster survivors will need past tax returns or return transcripts to qualify for disaster unemployment insurance.

Advocates should also consider other urgent needs in the immediate aftermath of a disaster. These include access to cash, reconstruction of records, advice on how to respond to deadlines, and any other tax problems faced by a disaster survivor. Survivors will also need help with various tax planning and compliance issues in the later phases of disaster recovery and with specific disaster-related tax provisions enacted by Congress.

24.2.2 Assist with Substantiation and Record Reconstruction

Many disaster survivors lose some or all of their records in a disaster. In such cases, taxpayers may have to reconstruct business records or cobble together adequate substantiation to prove eligibility for deductions and credits. But the Service and courts may also consider other credible evidence to approximate deductions. The Service will consider documentation requirements satisfied by the “best
reasonably available information presented in good faith” when it is not feasible to obtain documentation to re-create lost records.7

Under the Cohan rule, a court may approximate the amount if the taxpayer presents sufficient evidence to establish a rational basis for the estimate when a taxpayer establishes a deductible expense but cannot substantiate its exact amount.8 Section 274(d), which was enacted partially to overrule Cohan, imposes strict substantiation requirements to support certain types of business expense deductions, including travel expenses. A disaster survivor whose records are lost or destroyed through circumstances beyond his control, however, may nevertheless substantiate deductions that would otherwise be barred pursuant to section 274(d) by offering other credible evidence.9 Even so, the Cohan rule will not be applied when there is evidence the taxpayer is not being honest.10

Practice Tip: IRS Publication 2194, Disaster Resource Guide for Individuals and Businesses, contains helpful information on how to reconstruct records. Federal Emergency Management Agency (FEMA) records may help establish the amount of a casualty loss.11

24.2.3 Identify Applicable Tax Legislation and Service Guidance

A disaster may generate new tax law issues or Congress may pass special legislation for a particular disaster. In a major disaster, the Service will issue Notices and News Releases that provide tax guidance to survivors and advocates. In the aftermath of Hurricane Katrina, for example, the Service issued more than 60 official Notices and News Releases.

When the Service recognizes a qualified disaster, parts of various permanent sections of the Code will be triggered. Examples of permanent sections of the Code affected or triggered in part by a qualified disaster are:

- Section 56 Adjustments in computing alternative minimum taxable income
- Section 104 Exclusion of disability income for survivors of terrorist attacks (but not for survivors of other qualified disasters)
- Section 139 Exclusion of qualified disaster relief payments
- Section 165 Disaster losses
- Section 172 Net operating losses
- Section 198A Expensing of qualified disaster expenses
- Section 1033 Involuntary conversion
- Section 7508A Postponement of deadlines

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8 Cohan v. Commissioner, 39 F.2d 540, 543-544 (2d Cir. 1930); Zilberberg v. Commissioner, T.C. Memo. 2011-5.
10 See Callahan v. Commissioner, T.C. Memo. 1996-65 (loss limited to amount of FEMA grant despite taxpayer attempt to support claimed loss with reconstructed records).
11 See id.
Sections of the Code affected or triggered by casualties in general, not just qualified disasters, include:

- Section 123  Exclusion of insurance payments for living expenses
- Section 451  Crop insurance proceeds or disaster payments

**Practice Tip:** Be certain to identify all tax laws that apply to a particular disaster! A disaster may be governed by several laws. For example, the 2008 Midwestern disasters were governed not only by the permanent disaster relief sections of the Code, but also by the Heartland Disaster Tax Relief Act of 2008 and parts of the National Disaster Relief Act of 2008.\(^{12}\)

### 24.2.4 Help the Service Identify Disaster Survivors’ Needs

Some tax law issues will be unsettled until they are resolved by the Service or Congress. The Service took almost two years to answer several new tax questions that affected many survivors of Hurricanes Katrina and Rita. Tax professionals should be proactive in helping the Service identify new or difficult issues that their clients face after a disaster. To this end, tax professionals should communicate with their Local Taxpayer Advocate and the National Taxpayer Advocate.\(^{13}\) It is a good idea to explore joint post-disaster community outreach efforts with your Local Taxpayer Advocate.

Limited English Proficient (LEP) taxpayers and ITIN filers face additional challenges in the aftermath of a disaster. Government agencies often lack adequate translation services for LEP taxpayers in need of information and disaster-related services.\(^{14}\) Noncitizen taxpayers may be ineligible for FEMA assistance and other forms of government benefits, or may forego assistance for which they are eligible based on misinformation and fear of identifying themselves to government agencies.\(^{15}\) Advocates should work with their Local Taxpayer Advocate to identify and address the particular needs of LEP communities and ITIN filers post-disaster.

### 24.2.5 Be Aware of How a Disaster May Impact Existing Tax Issues

Many disaster survivors have pending pre-disaster tax problems. These taxpayers’ tax problems may be exacerbated by the economic hardship resulting from the disaster. Some disasters may expose nonfilers and present them with challenging tax compliance issues. For example, the compensation paid to survivors in the BP Oil Spill and Exxon Valdez Oil Spill disasters generated significant tax collection issues.

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\(^{13}\) Advocates should report systemic problems following a disaster to the Taxpayer Advocate Service using its Systemic Advocacy Management System (SAMs). See IRS, Systemic Advocacy Management System, http://www.irs.gov/Advocate/Systemic-Advocacy-Management-System-SAMS (last updated May 20, 2016). Each submission is reviewed by the TAS and may alert the Service to widespread problems of which it was unaware.


\(^{15}\) See 42 U.S.C. § 5174; Nat’l Immigration Law Ctr., Immigrant Eligibility for Disaster Assistance (June 2007), available at http://www.nilc.org/document.html?id=24. Although some noncitizens are ineligible for cash benefits following a disaster (such as FEMA cash assistance and loans from the U.S. Small Business Administration), many emergency services are available to disaster survivors regardless of immigration status. Advocates should assist survivors in navigating the complex eligibility rules for various disaster relief benefits. See id.
cases and questions about criminal liability for the failure to file tax returns. Surprisingly, disasters may also present taxpayers with new opportunities to resolve their preexisting tax problems or debts.

24.2.6 Be Aware of State Tax Considerations
Many of the same disaster-related issues that arise in the federal tax arena will also affect a client’s state tax liability. Advocates should refer to guidance issued by their state taxing agency, usually found on the agency’s website. States have previously extended filing and payment deadlines for those living within a federally declared disaster area, just as the Service does. State extensions may automatically apply to everyone residing in the disaster area, or could require a taxpayer to submit a request with an explanation of how the disaster personally affected him or her.

In many cases, taxpayers who live outside the disaster area may obtain extensions if their business was located in the disaster area or their records were stored within the disaster area. In fact, states adjacent to affected states may offer filing and payment extensions to disaster survivors as well. This is because many taxpayers who work or do business in surrounding states file returns in those states, too. For example, after a disaster was declared for flooding in Louisiana in August 2016, Arkansas, Mississippi, and Alabama granted state tax filing extensions to Louisiana residents affected by the flooding.

State income tax is typically calculated using the income and liability figures on the federal income tax return. Therefore, any available casualty losses should be claimed on the federal return to lower the state tax liability. If a federal return for a particular year is amended to include a new or additional casualty loss, clients should be advised to amend their state tax return for the same year.

There also may be special state tax programs to help victims of disasters that are not necessarily related to federal income taxes. For example, Louisiana instituted special tax programs 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. The programs made this sales tax credit refundable for taxpayers who had no state tax liability. The programs were worth many thousands of dollars to taxpayers who had to replace flooded cars, furniture, and appliances. Of course, taxpayers were required to keep careful records and receipts to substantiate their claims.

Finally, taxpayers should contact the local property tax assessor if their real property was damaged and lost value due to a disaster. Taxpayers should provide local tax assessors copies of any available damage evaluations to substantiate the loss in value. The assessor should lower the taxed value of the property, even if only temporarily, which should result in a lower property tax bill until the structures or property can be repaired.

24.2.7 ABA Young Lawyers Division Disaster Legal Services (DLS) Program

24.2.7.1 Introduction
Disaster Legal Services (DLS) is a federal assistance program operated by the American Bar Association Young Lawyers Division (ABA YLD) under a Memorandum of Understanding (MOU) with the Federal Emergency Management Agency (FEMA), a division of the U.S. Department of Homeland Security. The MOU, enacted in 1978, provides that the ABA YLD will be the exclusive legal services provider to survivors of a federally declared disaster when requested by FEMA. On such a request, the YLD will mobilize volunteers to provide free legal assistance to disaster survivors. The DLS mission is

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16 In the Exxon Valdez litigation, about 25% of the plaintiffs had liens placed on their damage awards. Many of these liens were federal tax liens, and the plaintiffs had to pay taxes on the awards even though they did not receive any of the seized funds. *Exxon Valdez Oil Spill: 20 Years Later* (CBS television broadcast Feb. 2, 2009). By comparison, only about five percent of the Hurricane Katrina and Rita survivors owed federal taxes before those disasters. U.S. Gov’t Accountability Office, GAO-08-101R, Tax Compliance: Some Hurricane Katrina and Rita Disaster Assistance Recipients Have Unpaid Federal Taxes (2007).
to provide free legal assistance to low-income persons affected by presidentially declared major disasters. The program relies heavily on collaboration between the two entities as well as with the Legal Services Corporation (LSC), the American Red Cross (ARC) and local Volunteer Organizations Active in Disaster (VOAD) chapters.

Volunteers are subject to the same responsibilities as they would have with paying clients, including the duties of confidentiality, diligence, and to provide competent and professional representation. Under the MOU, volunteer attorneys are entitled to access the Disaster Recovery Centers to conduct client intake and provide legal assistance.

24.2.7.2 Activation of DLS Program

The Stafford Act authorizes FEMA to provide free legal services after a major disaster. It is worth noting that not all disasters will prompt intervention by DLS. Three conditions are required to be met before the YLD will intervene: (1) the United States President has made a major disaster declaration; 2) the declaration provides for Individual Assistance; and 3) FEMA requests activation of DLS through an Intent to Implement Letter.

Once FEMA requests assistance from the ABA, the local YLD District Representative implements DLS by issuing a press release publicizing a toll-free hotline specific to the disaster. DLS volunteers coordinate with state and local bar associations and local Legal Services Corporation grantees to staff the hotline.

24.2.7.3 Law Student and Private Attorney Involvement

For many disaster survivors, the unfortunate reality is that legal services are not affordable. Without pro bono legal services, many who need legal counsel would not be able to access it.

After Hurricane Katrina decimated New Orleans in 2005, law students across the country took an active role as volunteers in disaster legal response and recovery. Law schools followed suit by offering disaster law courses, and some law schools created dedicated disaster clinics. At the forefront of this movement was Touro Law Center’s Disaster Relief Clinic, the first of its kind, which was created only days after Superstorm Sandy ripped through the Northeast. Legal clinics like the one at Touro Law Center allow law students to work with clients under the supervision of a licensed attorney. For law students, participating in a legal clinic provides invaluable opportunities to interact with clients and manage legal matters prior to licensure. Clients likewise benefit from the arrangement, enjoying the personal, one-on-one attention of a closely-supervised law student providing pro bono legal services.

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17 Low-income individuals are defined as “those disaster victims who have insufficient resources to secure adequate legal services, whether the insufficiency existed prior to or results from the major disaster. In cases where questions arise about the eligibility of an individual for legal services, the Regional Director or his/her representative shall make a determination.” 44 C.F.R. § 206.164(a).


19 42 U.S.C § 5182.

20 There are three forms of assistance provided during a disaster: Public Assistance, Individual Assistance, and Hazard Mitigation. Public Assistance provides funding to repair infrastructure, such as roadways and bridges, while Hazard Mitigation focuses on resilience. Individual Assistance provides relief to individuals through various programs, including DLS, Disaster Unemployment Assistance (discussed at ¶ 24.4.4), Individuals and Households Program (discussed at ¶ 24.4.2.1), and the Crisis Counseling Programs.

21 There are 34 districts serving all 50 states and the USVI. District Representatives serve two-year terms. A list of current district representatives is published on the YLD Leadership page, available at http://www.americanbar.org/groups/young_lawyers/about_us/leadership.html#district. If you are having difficulty reaching your local representative, you can contact the ABA Program Specialist, whose information is published on the DLS webpage, available at http://www.americanbar.org/groups/young_lawyers/disaster_legal_services.html.

Although DLS is operated by the Young Lawyers Division, any attorney licensed in the affected state may volunteer. Attorney volunteers are not required to have specific experience in disaster tax, but do receive support and training through the YLD.

24.3 THE SERVICE’S RESPONSE TO A DISASTER

24.3.1 Taxpayer Assistance and Resources

The Service has a Disaster Assistance Hotline at 866-562-5227. This hotline was first established in response to Hurricane Katrina, but has since been made permanent. Calls are answered only on weekdays from 7:00 a.m. to 7:00 p.m., local time. The Service recommends that those who do not speak English have their own interpreter when they call the Hotline.

The Service’s web page has a special section on disaster tax issues for tax professionals called the Disaster Relief Resource Center for Tax Professionals. It contains many resources for tax professionals who help disaster survivors. The Service’s web page has numerous FAQs for disaster survivors and their advocates. In addition, the Service’s major disaster-related publications for individuals are:

- Publication 547, Casualties, Disasters, and Thefts
- Publication 584, Casualty, Disaster, and Theft Loss Workbook
- Publication 584B, Business Casualty, Disaster, and Theft Loss Workbook
- Publication 1600, Disaster Losses-Help from the IRS
- Publication 2194, Disaster Resource Guide for Individuals and Businesses
- Publication 3833, Disaster Relief: Providing Assistance through Charitable Organizations

In the past, service center personnel were authorized to prepare tax returns for disaster survivors, regardless of their income. Under recent changes to the Internal Revenue Manual, however, such individuals will be referred to Taxpayer Assistance Centers (TACs), Volunteer Income Tax Assistance (VITA) sites, and Tax Counseling for the Elderly (TCE) sites. Notwithstanding such referrals to TACs, it appears these individuals will merely be directed to VITA and TCE sites if they contact their local TAC.

Finally, the Service may staff FEMA Disaster Recovery Centers to advise taxpayers on casualty losses, help with requests for copies of tax returns or tax transcripts, and provide other disaster tax-related services and information.

24.3.2 Postponement of Certain Tax-Related Deadlines

Shortly after a federally declared disaster, the Service will prepare a Disaster Relief Memorandum for Distribution that may extend tax-related deadlines. The Service will issue associated Notices and News Releases, which should be read to determine which deadlines are extended, the length of the extensions, and the persons to whom the extensions apply. The Service lists tax relief for recent disasters on its web page at Tax Relief in Disaster Situations.

23 I.R.M. 25.16.1.12.
24 I.R.M. 21.3.4.2.2.3.
25 I.R.M. 25.16.1.12(5).
27 The Service may expand the definition of “affected taxpayer” in an IRS Notice. See, e.g., supra note 26; see also Scott v. Commissioner, T.C. Memo. 2002-193 (applying definition of “affected taxpayer,” as expanded by two applicable IRS Notices).
Section 7508A allows the Service to extend for up to one year certain tax filing and payment deadlines that fall within the “postponement period,” which typically starts on the day the disaster strikes. The Service may, for example, postpone the deadlines for:

- Filing tax returns
- Paying taxes
- Making refund claims
- Filing suits for refunds
- Filing Tax Court petitions
- Claiming innocent spouse relief
- Making contributions to IRAs
- Taking pension actions
- The Service’s own tax actions (e.g., assessment or collection)

**Practice Tip:** Request a rescission of a statutory notice of deficiency for a taxpayer in a disaster zip code where the Service has issued an O freeze. An O freeze suspends many collection activities in disaster affected zip codes. The same reasoning supporting the suspension of collection action supports the rescission of the statutory notice of deficiency since the disaster makes it equally difficult for the taxpayer to address the merits of the proposed deficiency. If the Service has used its power under Section 7508A to extend the filing period for petitions to the Tax Court, you may have a reasonably long time period within which to request the rescission. If the Service has not exercised its authority to extend the due date of the Tax Court petition or has extended the period for a relatively short time, you may need to move quickly on the rescission request and the assistance of the Local Taxpayer Advocate may be necessary to accomplish the act of rescinding the statutory notice of deficiency before the 90-day period runs. The existence of the disaster does not automatically extend the time within which to file the Tax Court petition. You must look for an IRS announcement to determine if the period has been extended and the length of the extension.

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29 Taxpayers who had delinquencies before the first day of a designated postponement period, however, will not benefit from the section 7508A postponement. Reg. § 301.7508A-1(b)(2), Example 6. Such taxpayers should apply for penalty abatement on reasonable cause grounds.
30 Note that the ten-year statute of limitations for collections may have been extended if the taxpayer lived in an area impacted by a disaster. Reg. § 301.7508A-1(c)(2).
31 See I.R.M. 25.16.1.7.2. The term “O freeze” reflects the Service terminology for a type of computer freeze code input into the Service’s computer system for managing taxpayer accounts. Within that system the Service has developed a number of freeze codes to alert the system and system users of special activity on a taxpayer’s account. There are other freeze codes in the system for other special actions, e.g., bankruptcy or criminal investigation, which also alert Service employees that the account requires special handling.
32 See Reg. § 301.7508A-1(f) and the examples provided in that subparagraph. Look particularly at example 3 where the Service’s exercise of authority under section 7508A extended the time to file the Tax Court petition by 35 days based on the Service’s decision to extend time periods for less than one year.
Sections 6081 and 6161(a)(1) give the Service discretion to grant extensions of up to six months to file tax returns for disasters that are not federally declared. The deadline for eligible disaster survivors' tax returns in a federally declared disaster will be at the end of the section 7508A postponement period, or, if the taxpayer timely filed for an extension, the extended date provided by section 6081, whichever is later.

Note: A section 7508A extension generally extends the payment date, but a section 6081 application for extension does not.

24.3.3 Tax Collection

In some major disasters, the Service has suspended certain types of tax collection activities, including the filing of liens, wage levies, and seizures. Taxpayers who receive notices may call the Disaster Assistance Hotline for help.

Installment agreement payments that come due during a section 7508A disaster relief period are suspended. After the relief period ends, the installment agreement will be reinstated without a fee. The taxpayer must resume payments the month after the disaster relief period ends.

Practice Tip: The Service may issue an O freeze or S freeze on collection activities. An O freeze suspends many collection activities for taxpayers in designated zip codes affected by the disaster. S freezes for disaster relief are input systematically for all taxpayers in an IRS-covered disaster area. S freezes give the Service flexibility to grant filing and payment relief without suspending compliance activities. Affected taxpayers outside the IRS-covered disaster area, or tax practitioners on their behalf, may call the Disaster Special Services toll-free line to request an O or S freeze be manually input in applicable circumstances.

24.3.4 Access to Tax Returns

The Service will provide expedited tax return transcripts free of charge to disaster survivors. Call the Service’s Disaster Assistance Hotline at 866-562-5227 or file Form 4506-T (Request for Transcript of Tax Return) with the appropriate campus.

Disaster survivors may also obtain free copies of tax returns from the Service by using Form 4506 (Request for Copy of Tax Return). To avoid the $50 fee, disaster survivors should write the assigned Disaster Designation in red ink across the top of Form 4506. Taxpayers can now download their own tax return transcripts at http://www.irs.gov/Individuals/Get-Transcript (last updated March 7, 2017).

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33 See also I.R.M. 25.16.1.4 (discussing the Service’s authority to abate failure to file and failure to pay penalties for up to six months based on reasonable cause criteria).

34 Currently, section 6081 extensions are granted through October 15 of the year following the tax year. See IRS 2016 Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return.

35 See Reg. § 301.6081-1 which states that “provisions concerning extensions of time for filing returns …, see the regulations relating to the particular tax.” Reg. section 1.6081-5 concerns taxpayers located outside the United States and Puerto Rico.


38 I.R.M. 25.16.1.7.1.6 and I.R.M. 25.16.1.7.2.

39 I.R.M. 25.16.1.12.5.
Practice Tip: Other quick ways to obtain past tax information include ordering tax return transcripts through e-services or requesting a copy of the tax returns from the taxpayer’s tax preparer.

24.3.5 Expedited Processing of Amended Tax Returns

The Service will expedite the processing of amended tax returns for survivors of federally declared disasters. The disaster should be noted on the amended return. The average expedited processing time is 60 days. Former Internal Revenue Manual (IRM) section 25.16.1.7.5.1(2) (May 28, 2009), which specifically provided for manual refunds for taxpayers who suffer extreme hardship from a disaster loss, has been removed from the IRM. Affected taxpayers should nevertheless request manual refunds under other available provisions.

An amended return may provide immediate funds to a taxpayer who suffered casualty losses and elects to take the deduction in the tax year prior to the disaster.

Note: A disaster survivor who owes a pre-existing tax debt may be able to avoid an offset of his refund claim for a disaster loss.

24.3.6 Interest and Penalty Abatement

Section 7508A(a)(2) allows the Service to abate interest, penalties, or additions to taxes with respect to any period of a section 7508A extension for up to one year. The Service will not abate interest or penalties for tax years prior to the disaster based on section 7508A. Nor will it abate penalties and interest on underpayments that were already accruing for the disaster year prior to the first day of the postponement period, but representatives should still review the general provisions on penalty and interest abatement to determine whether their clients qualify under those rules. Use Form 843 to request abatement. Additions to tax for failure to pay estimated taxes by reason of casualty or disaster are not imposed if it is against equity and good conscience.

24.3.7 Lien Subordination

Disaster assistance grants to rebuild a home may require the subordination of federal tax liens. This is a process whereby the Service permits a lender to move ahead of the Service’s lien position. IRS

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41 Any taxpayer with outstanding liabilities who files a return requesting a refund can request that the Service issue the refund rather than exercise its offset rights. See I.R.M. 21.4.6.5.5. The manual refund request should precede the assessment, however. The request should be made through the Taxpayer Advocate Service by filing a Form 911 together with the original, unfiled return wherever possible. The manual refund generally will be issued if the Taxpayer Advocate determines that the failure to obtain the refund will cause the taxpayer significant hardship.
42 See also I.R.M. 25.16.1.4 (establishing procedures for making penalty adjustments for disaster affected taxpayers).
45 Section 6325(d) provides that the Service may subordinate its federal tax lien in certain circumstances. Subparagraph (d)(2) applies to the circumstances of a disaster. It permits the issuance of a certificate of subordination where the Service believes that the amount realized from the property will ultimately be increased because the Service subordinates its lien to that of a new lender. In a disaster situation, for example, the disaster may have reduced the value of the property to an extremely low value. Borrowing money to repair the property may increase the value of the property far above the amount of the loan creating more equity in the property than currently exists in its state of disrepair in the aftermath of the disaster. Subordination in this circumstance precisely meets the intent of Congress in subparagraph (d)(2). In the disaster setting, the Service may generally view the facts more favorably concerning the level and amount of proof necessary to demonstrate the benefit necessary for subordination. See Chapter 11 for a greater discussion of lien and subordination issues.
Publication 784 sets forth the procedures for the subordination of federal tax liens to other creditors’ claims. To obtain a certificate of subordination, contact the Service’s Advisory Group Manager for your area. The telephone numbers and addresses can be found in Publication 4235. The request is made by sending Form 14134 to the Advisory Group Manager along with supporting documents. The Service has expedited lien subordination for disaster survivors in prior disasters.

**Practice Tip:** Prior to seeking a certificate of lien subordination, review the client’s transcripts of account or check with the Service to make sure that the lien has not expired or been satisfied. Sometimes, the Service will have information on the status of the lien that is not known to the taxpayer or to you. As part of the application process for the subordination, seek the assistance of a real estate agent or someone qualified to provide you with information about the current value of the property and the projected value of the property after repairs. This information will greatly assist you in showing the Service the benefit of issuing the certificate of subordination.

### 24.3.8 Change of Address

Disaster survivors should notify the Service of their change of address. Taxpayers can notify the Service by calling the IRS Disaster Assistance Hotline at 866-562-5227 or by filing Form 8822 (Change of Address). The post office serving the old address should also be notified of the address change.

**Practice Tip:** Be aware that in a major disaster, merely changing an address with the U.S.P.S. may not ensure that the taxpayer receives notices from the Service. Failure to file a change of address directly with the Service could lead to the taxpayer losing rights that must be timely exercised in response to tax notices. In 2011, some Katrina survivors still were not receiving mail at their current addresses even though they filed U.S.P.S. address changes.

### 24.4 INCOME ISSUES IN A DISASTER

#### 24.4.1 Introduction

Advocates helping disaster survivors need to understand the tax consequences of payments commonly received by survivors. After a disaster, survivors may receive payments or assistance from a wide variety of sources: governments, charities, employers, insurers, tortfeasors, etc. Survivors may realize gains if their homes or properties are destroyed, demolished, foreclosed, or sold. Finally, debt cancellation may result in income or other tax consequences for disaster survivors.

“Gross income” within the meaning of section 61 includes all income from any source, unless otherwise excluded by law. In the disaster context, it is important to carefully assess what is income, what is excluded from income, and when income may be deferred.\(^{47}\)

Sections 102, 104, 108, 121, 123, and 139 are the most common bases for excluding assistance and income to disaster survivors. Section 139 and the Service’s administrative “general welfare exclusion” rule exclude most disaster relief payments and government assistance from a disaster survivor’s income. The “general welfare exclusion” doctrine originated in 1938 when the Service determined that welfare payments should be excluded from income. The doctrine has since been expanded through Revenue Rulings.\(^{48}\)

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\(^{47}\) See, e.g., Rev. Rul. 2003-12, 2003-1 C.B. 283 (providing that certain disaster-related payments are excluded from income).

24.4.2 Disaster Relief Payments

Common examples of disaster relief payments are FEMA assistance, grants to rebuild homes, and charity donations. Tax treatment of these payments is discussed below.

24.4.2.1 Qualified Disaster Relief Payments

Under section 139, qualified disaster relief payments to disaster survivors from any source, including employers, are excluded from income.49 However, those disaster relief payments from a government for losses already reimbursed by insurance or already deducted in a prior tax year will be included in income.50 Qualified disaster relief payments within the meaning of section 139 include any amounts to reimburse or pay an individual disaster survivor for:

- Reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a qualified disaster; and
- Reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence51 or repair or replacement of contents to the extent that the need for repair or replacement is attributable to a qualified disaster.

To be excluded from income under section 139, the payment must be to a survivor of a qualified disaster. Section 139 broadly defines qualified disasters to include:

- Federally declared disasters under the Stafford Act;
- Disasters resulting from terrorist or military action;
- Disasters from a common carrier accident; or
- Any other event defined by the Secretary of the Treasury to be of a catastrophic nature.

Practice Tip: Section 139 codifies the Service’s general welfare exclusion policy for disaster relief payments, but does not supplant it.52 If section 139 does not apply, try to use the Service’s general welfare exclusion to exclude a payment from income.53

FEMA assistance is the most common disaster relief payment in a major disaster. In a federally declared disaster, FEMA assistance is provided to eligible survivors under the Stafford Act. FEMA’s Individuals and Households Program (IHP) generally covers certain uninsured, disaster-related losses for individuals such as temporary housing, repair and replacement of a homeowner’s principal residence, uninsured damage to personal property, and other disaster-related expenses. FEMA assistance for temporary living expenses, home repairs, and personal property losses is excluded from income as a qualified disaster relief payment under section 139(b)(1) and (b) (ce is also excluded from income under the Service’s general welfare exclusion doctrine.54 In a catastrophic disaster, such as Superstorm

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49 Rev. Rul. 2003-12, 2003-1 C.B. 283. Section 102(c), which provides that transfers from an employer to employee generally are not excluded from income, does not apply to section 139 qualified disaster relief payments. See J OINT COMM. ON TAXATION, J C X -86-01, TECHNICAL EXPLANATION OF H.R. 2284, THE “VICTIMS OF TERRORISM TAX RELIEF ACT OF 2001,” at 16 (2001).
50 I.R.C. §§ 139(b), 111(a).
51 J OINT COMM. ON TAXATION, supra note 49, at 14 (rented residences qualify as “personal residences” within the meaning of the section 139 income exclusion).
53 For a discussion of the “general welfare exclusion,” see generally Wood, supra note 48, at 1443-46.
Sandy, the United States Department of Housing and Urban Development (HUD) may provide temporary housing assistance to disaster survivors, which is also excluded from income.\textsuperscript{55}

\textbf{Practice Tip:} Clients may ask you about the impact of FEMA assistance on other public benefits. FEMA assistance is not counted as income or assets for the purpose of any means-tested federal benefit program.\textsuperscript{56} This includes SSI, food stamps, Medicaid, Temporary Assistance for Needy Families (TANF), and federally subsidized housing. Comparable state and local government assistance is not counted either. Neither section 139 nor the general welfare exclusion rule work to exclude payments to disaster survivors to replace lost income, including wages, unemployment compensation, or business interruption insurance proceeds for lost business income.\textsuperscript{57}

Section 139 and the general welfare exclusion only exclude disaster relief payments to individuals, so emergency grants to businesses are income.\textsuperscript{58} Even if the business is a sole proprietorship, exclusion will be denied because the payment is not for a qualified purpose under section 139(b). However, Revenue Ruling 2005-46 suggests that a business may be able to elect deferral of the gain under section 1033.

\textbf{Practice Tip:} If the owner of a sole proprietorship is made poor by a disaster, a charity may provide assistance only to the extent that it helps him regain the earning capacity necessary to provide for basic necessities. This limited assistance may be excluded from income as a gift.\textsuperscript{59}

Section 139(d) further clarifies that disaster relief payments are not treated, for purposes of employment taxes, as net earnings from self-employment or wages. Therefore, qualified disaster payments are not subject to withholding.

A recipient of a qualified disaster relief payment cannot claim a deduction or credit for, or by reason of, any expenditure to the extent of the amount excluded from income as a qualified disaster relief payment.\textsuperscript{60}

\textbf{24.4.2.2 Qualified Disaster Mitigation Payments}

Section 139 also excludes “qualified disaster mitigation payments” from income. These payments are defined as amounts paid pursuant to the Stafford Act or National Flood Insurance Act to a property owner for hazard mitigation.\textsuperscript{61} A qualified disaster mitigation payment does not increase a disaster survivor’s basis in property.\textsuperscript{62}

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\textsuperscript{55} I.R.C. § 139(b)(1); cf. Rev. Rul. 74-205, 1974-1 C.B. 20 (discussing the policy and jurisprudential reasons why replacement housing payments under repealed law were not includible in gross income).
\textsuperscript{57} Joint Comm. on Taxation, supra note 49 at 12.
\textsuperscript{59} Janet Gitterman & Marvin Friedlander, Disaster Relief-Current Developments, in 2003 EO CPE Text, at M-17; IRS, Publication 3833, Disaster Relief: Providing Assistance through Charitable Organizations 8-9 (2009).
\textsuperscript{60} I.R.C. § 139(h).
\textsuperscript{61} I.R.C. § 139(g).
\textsuperscript{62} I.R.C. § 139(g)(3).
\end{flushleft}
24.4.2.3 Other Disaster Relief Payments

Disaster relief payments that do not qualify for exclusion under section 139 may still qualify for exclusion under the general welfare exclusion rule. Disaster relief payments from any government unit for the promotion of general welfare are excluded from gross income.

Relocation payments for expenses to move from a damaged home are not taxable under the general welfare exclusion doctrine. Other examples of payments excluded by the general welfare exclusion doctrine include replacement housing payments to people displaced from their homes, assistance to hurricane survivors with the purchase of homes, and home improvement grants to survivors of environmental disasters.

Historically, oil spills have not been federally declared disasters under the Stafford Act because they are not “natural disasters.” The Oil Pollution Act makes the polluter responsible for damages and clean-up. Thus, oil spill disaster survivors who receive disaster relief payments from governments may have to rely on the Service’s general welfare exclusion doctrine to exclude the payments from income. Disaster relief payments to oil spill survivors by charities may also be excluded from income if they qualify as gifts within the meaning of section 102.

24.4.2.4 Disaster Relief Payments May Lead to Adverse Tax Consequences

24.4.2.4.1 Cancellation of FEMA Debt May Be Income

Generally, cancellation of debt is income. FEMA may discharge FEMA overpayments if it determines that repayment would cause undue hardship to the recipient. FEMA takes the position that the discharge results in taxable income. Accordingly, FEMA reports discharged overpayments as income by filing Forms 1099-C with the Service. Such debt cancellation, if it is taxable income, may cause a low-income taxpayer to become ineligible for the earned income credit, owe potentially nondischargeable tax debt, or both. Moreover, debt cancellation income may create a filing requirement for certain taxpayers whose income would otherwise fall below the filing threshold.

Waiver of a FEMA overpayment should not constitute taxable income if the conditions of the general welfare exception are satisfied, however. Disaster survivors in receipt of a Form 1099-C from FEMA nevertheless may be in a defensive posture with the Service as a result of the Service’s Automated Underreporter procedures. Such taxpayers must not only know to assert the general welfare exception in this context, but also participate in the Automated Underreporter process to prevent the erroneous assessment of tax on the waived overpayment.

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Note: FEMA maintains that every person listed on the FEMA application is liable for any overpayment. However, the persons on the application often constitute separate tax households. Must FEMA prorate the debt cancellation income among the persons listed on the application? Can it attribute the entire amount reported on the Form 1099-C to each of the tax households or to just one of the households if they are all jointly liable? By the time the debt is cancelled, a married couple may be divorced and also constitute separate tax households. The law is unclear as to how FEMA overpayments should be allocated for tax purposes. In FEMA overpayment cases, FEMA claims entitlement to recovery because the recipient was ineligible, the payment was duplicative, or it was improperly used. Under section 139, duplicative FEMA assistance may be income in the year it was received, but not in the year the overpayment was cancelled by FEMA.

In 2008, Congress repealed time limits on the collection of federal debt by Treasury administrative offsets against payments such as tax refunds, Social Security (other than SSI), federal or state salary, and certain federal or state retirement payments.\(^{75}\) Once FEMA has discharged or compromised the overpayment debt, the Treasury administrative offset is no longer available to FEMA. However, to the extent that FEMA merely suspended or terminated its collection efforts, it may be argued that debt cancellation has not occurred.\(^{76}\)

Many low-income FEMA recipients may be able to exclude the alleged cancellation of FEMA debt income under the section 108 insolvency exclusion. Nonfraudulent FEMA debt also may be discharged in bankruptcy.

### 24.4.2.4.2 The Tax Benefit Rule and Disaster Relief Payments

If a taxpayer who took a casualty loss deduction for her home receives a grant in a subsequent year to rebuild it, the “tax benefit rule” will require her to report the grant as partially-taxable income in the subsequent year.\(^{77}\) Under the tax benefit rule, a taxpayer must include as income an amount of the grant equal to the amount of the tax deduction that actually reduced her tax. The gain under the tax benefit rule is taxed as ordinary income. Tax benefit income is not subject to exclusion under section 121 or deferral under section 1033.

**Practice Tip:** If a taxpayer expects to receive a government grant to rebuild, it may be a mistake to take a casualty deduction in the disaster year or the prior year. Often, the tax savings from the casualty loss will be less than the tax increase attributable to a reimbursement.\(^{78}\)

### 24.4.2.4.3 Failure to Use Disaster Relief Payments as Intended

If some or all of the grant proceeds are used for purposes other than home repair, the Service may argue that the unused or misused proceeds should be treated as income. For example, if the taxpayer

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75 31 U.S.C. § 3716(c); see also 31 C.F.R. § 285.2(d)(6); 74 Fed. Reg. 68,537 (Dec. 28, 2009).
76 See 31 C.F.R. § 903.5(a); cf. Coburn v. Commissioner, T.C. Memo. 2005-283 (no debt cancellation if statute of limitation does not bar collection).
77 Reg. § 1.165-1(d)(2)(iii); see also Montgomery v. Commissioner, 65 T.C. 511 (1975) (holding that the taxpayer may not amend his prior tax return to reduce the casualty loss deduction by the amount of the grant or insurance recovery).
78 In Hurricanes Katrina, Rita, and Wilma, many homeowners’ tax situations were worsened by the tax benefit rule when they received grants in years subsequent to their casualty loss deductions. Ultimately, Congress mitigated this adverse impact on these hurricane survivors by enacting special legislation to allow them to amend their prior tax returns to reduce their casualty loss deductions by the amounts of their grants. See Notice 2008-95, 2008-44 I.R.B. 1076 (explaining section 3082(a) of the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654). In effect, this special legislation enables these disaster survivors to overcome the holding in Montgomery, 65 T.C. 511.
received a $100,000 grant, but only used $70,000 to rebuild her home, the unused $30,000 would not be excluded from income.\(^79\)

### 24.4.2.4.4 Impact of Disaster Relief Payments on Basis in Home

The Service maintains that a taxpayer must reduce the basis in her home by the amount of any tax-free disaster grant or assistance received for repair or replacement of property. In addition, insurance proceeds reduce a taxpayer’s basis in the home. If repairs are made, the cost of repairs is capitalized and added to the taxpayer’s basis in her home. There may be tax consequences when the home is later sold for a price that exceeds the adjusted basis.\(^80\) A taxpayer may be able to exclude gain under section 121 or defer gain under section 1033 (including gain in excess of the section 121 exclusion) by timely investing in property similar or related in service or use.\(^81\)

### 24.4.3 Distributions from Retirement Plans

Under the general rule, regular distributions from qualified retirement plans are taxable income except to the extent the distribution consists of already-taxed amounts. Disaster survivors who are not eligible for regular distributions may access cash from certain retirement plans through so-called “early” distributions, under “hardship” or “unforeseen emergency” criteria, but such distributions may trigger a 10% additional tax.\(^82\) Even so, such distributions are limited as to the types of hardships covered, the amounts available for early distribution, and verification procedures set forth in their individual plan documents and governing regulations.\(^83\) Notably, the regulations enumerating the conditions for hardship distribution do not specifically include disasters.

The Service will typically provide relief after a disaster, however, by relaxing the hardship distribution rules to facilitate quick access to cash and avoid the additional 10% tax.\(^84\) The Service has traditionally removed the restrictions on the types of hardships exempted from the 10% additional tax for disaster survivors.\(^85\) It has also temporarily suspended hardship verification requirements, allowing plan administrators to rely on the representations of employees regarding the need for and amount of a hardship distribution, and eliminated restrictions on post-hardship distribution contributions.\(^86\) The Service has also extended this same relief to plan participants who reside and work outside the disaster area if the hardship distribution is used to assist a child, parent, grandparent, or other dependent who lives or works in the covered disaster area.\(^87\) Practitioners should read the related announcement with care to determine whether a particular type of retirement plan or distribution is covered.

In the wake of the particularly destructive 2017 hurricane season, Congress went further to provide additional relief from the consequences of early distributions.\(^88\) The Disaster Relief Act of 2017 created a new class of tax-favored early distributions specifically for the survivors of Hurricanes Harvey, Irma, and Maria. A “qualified hurricane distribution” is available before January 1, 2019, for Harvey, Irma, and Maria. See I.R.C. § 139.

\(^{79}\) See I.R.C. § 139.


\(^{81}\) I.R.C. § 1033(a)(1).

\(^{82}\) I.R.C. § 72(t).

\(^{83}\) See, e.g., § 401(k) and Treas. Reg. 1.401(k)-1(d)(3) (establishing criteria to be met before a 401(k) plan administrator can make a hardship distribution).

\(^{84}\) See, e.g., Announcement 2005-70, 2005-2 C.B. 682 (relating to Hurricane Katrina).


\(^{86}\) Id.

\(^{87}\) Id.

and Maria survivors with eligible retirement plans whose principal place of abode was in the particular disaster area and who suffered an economic loss as a result of the disaster.89

Recipients of qualified hurricane distributions benefit from very flexible tax treatment. The first $100,000 is automatically exempt from the additional 10% tax.90 The distributed funds, normally includible in gross income in the year received, are instead reported ratably over three years, unless the taxpayer elects otherwise.91 Qualified hurricane distribution recipients may even avoid income tax altogether by contributing an amount equal to the qualified hurricane distribution to any qualified plan, so long as the contribution takes place within three years of the date of qualified hurricane distribution.92 In such a case, the taxpayer would receive tax-free rollover treatment. Taxpayers who are unable to make a contribution in the year the qualified hurricane distribution was received will still need to report the distribution as income in that year. A taxpayer who makes a contribution in either of the subsequent two years could file Form 1040X to exclude the income and claim any available refund.

24.4.4 Gifts

Gifts to disaster survivors are not income.93 If disaster assistance from a nongovernmental entity or person fails to qualify for exclusion under section 139, advocates should still determine whether the payment is excludable as a gift under section 102. The Internal Revenue laws and regulations do not specifically define “gift” in this context, but the Supreme Court has stated that a gift, “must proceed from a detached and disinterested generosity…out of affection, respect, admiration, charity, or like impulses.”94

Government assistance in response to a disaster, however, does not qualify as an excludable gift under section 102 because the government is acting out of duty rather than out of generosity.95

The cash value of an annuity donated to a disaster survivor is not taxable. However, interest income on a charitably donated annuity is taxable.96

A needs-based payment by an employer-controlled foundation to an individual employee for purely charitable purposes may be excluded from income regardless of whether the payment is excluded under section 139 or any other Code section.97 However, these payments are not excluded as income if the only beneficiaries of the payments are the employer’s employees and the payments are intended as compensation.98 Other payments by employers to employees should be scrutinized carefully under other exclusion provisions, as they are unlikely to qualify as gifts under section 102.

24.4.5 Unemployment Compensation

Unemployment compensation is subject to income tax, but not to FICA or self-employment tax.99 Disaster Unemployment Insurance, which provides benefits for individuals, including the self-employed, is defined as unemployment compensation for tax purposes.100 If there is no withholding on unemployment compensation, taxpayers may face underpayments when they file their first tax return after the disaster. To avoid underpayment and penalties, a taxpayer should pay quarterly estimated tax payments or file a Form W-4V (Voluntary Withholding Request), to have ten percent of the unemployment compensation withheld.

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89 Id. at § 502(a)(4)(A).
90 Id. at § 502(a)(1).
91 Id. at § 502(a)(5).
92 Id. at § 502(a)(3).
96 Gitterman & Friedlander, supra note 59, at M-16.
98 JOINT COMM. ON TAXATION, supra note 49, at 15.
99 I.R.C. § 85.
100 See I.R.C. § 85(b); Reg. § 1.85-1(b)(1)(iv).
24.4.6 Loan Proceeds

Generally, loans do not constitute income because they must be repaid. Even if disaster-related loans are forgiven under a “forgivable loan” arrangement, they may still be excluded from an individual’s income under the general welfare exclusion rule.\(^{101}\)

Following a disaster, the Service has generally tried to make it easier for survivors to obtain loans from their qualified retirement plans. For example, the Service has permitted qualified plans that don’t provide for loans to nevertheless make loans, so long as the plan’s governing documents are later updated to provide for them.\(^{102}\)

The Disaster Relief Act of 2017 went even further to increase access to qualified retirement plan loans for certain individuals affected by Hurricanes Harvey, Irma, and Maria. The legislation increased plan loan limits to the lesser of (1) $100,000; or (2) the greater of $10,000 or 100% of the present value of an employee’s nonforfeitable accrued benefit.\(^{103}\) The legislation also provides relief for certain individuals affected by Hurricanes Harvey, Irma, and Maria who had outstanding plan loans on the day the designated disaster struck, as set forth in the legislation. For those individuals, any repayment due dates that fall before January 1, 2019, are extended by one year.\(^{104}\)

24.4.7 Insurance Proceeds

24.4.7.1 Insurance Proceeds for Living Expenses

Payments by an insurance company for the living expenses of a person displaced from his principal home by a disaster or government evacuation order are not included in gross income.\(^{105}\)

24.4.7.2 Business Interruption Insurance Proceeds

Payments for loss of income under business interruption insurance must be included in gross income.\(^{106}\)

24.4.7.3 Insurance Proceeds for Property Damage or Loss

Insurance payments for property damage are not included in gross income unless the payments exceed the taxpayer’s adjusted basis in the property. If the damage is an “involuntary conversion,” the taxpayer may defer the tax on any gain if he timely buys qualifying replacement property that costs as much as the payments received for the damaged property.\(^{107}\)

Insurance payments for unscheduled home contents in excess of the taxpayer’s basis are excluded from income if the contents were damaged in a federally declared disaster.\(^{108}\) Payments for scheduled contents could constitute gain if they exceed the basis in the property.

24.4.8 Casualty Gains

Disaster survivors may realize casualty gains in cases of “involuntary conversion.”\(^{109}\) This can happen when a disaster survivor receives insurance proceeds for a damaged or destroyed home that has substantially increased in value since its acquisition. This involuntary conversion could result in the

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\(^{102}\) Supra note 85.

\(^{103}\) Disaster Relief Act of 2017, supra note 88 at § 502(c)(1).

\(^{104}\) Id. at § 502(c)(2).

\(^{105}\) I.R.C. § 123.

\(^{106}\) Seidenfeld v. Commissioner, T.C. Memo. 1995-61.

\(^{107}\) I.R.C. § 1033(a)(1).


\(^{109}\) For an extensive analysis of casualty gains in disasters, see Francine J. Lipman, Anatomy of a Disaster under the Internal Revenue Code, 6 Fla. Tax Rev. 953, 988-1002 (2005).
realization of income for tax purposes if the insurance proceeds exceed the taxpayer’s adjusted basis in his home.\textsuperscript{110}

Such a casualty gain can be deferred if the taxpayer purchases qualified replacement property within the prescribed time limits.\textsuperscript{111} The election to defer the casualty gain is made on the tax return.\textsuperscript{112} If a taxpayer reports the casualty gain as income on his return and later acquires qualified replacement property, he may file an amended return within the replacement period to elect deferral and receive a refund of any overpayment of taxes.\textsuperscript{113}

Generally, replacement property must be purchased within two years after the tax year in which the casualty occurred.\textsuperscript{114} However, in a federally declared disaster, the replacement period is generally four years for the involuntary conversion of a principal residence.\textsuperscript{115} If the damaged home is in the New York Liberty Zone, the Hurricane Katrina Disaster Area, the 2007 Kansas storms and tornadoes or the 2008 Midwestern Disaster Area, the replacement period is five years.\textsuperscript{116}

For a principal residence, taxpayers may use section 121 to exclude a gain of up to $250,000 ($500,000 for married taxpayers filing jointly), if they lived in the home for two of the last five years. The section 121 election does not require reduction of the basis in any replacement property. The basis is not reduced because it is an exclusion from gain, rather than a deferral of gain.

\textbf{Practice Tip:} If a taxpayer still has gain after a section 121 exclusion, he may avoid taxes on his insurance payment under section 1033 by reinvesting the balance in another home and contents. Gain may even be deferred by investing just in contents.\textsuperscript{117}

Casualty gains from the destruction of unscheduled home contents in federally declared disasters are not income.\textsuperscript{118} Casualty gains from loss or destruction of home contents expressly scheduled in an insurance policy could constitute income if the payments exceed the property’s basis.

\textbf{Practice Tip:} Insurance proceeds for unscheduled home contents may be used for any purpose without having to recognize casualty gain or buy replacement property to secure a deferral of gain. Thus, these proceeds may give the taxpayer some flexibility in addressing his recovery planning.

\subsection{24.4.9 Debt Cancellation}

There are no permanent Code sections that exclude debt cancellation income for disaster survivors. Congress has provided exclusions for debt cancellation income in some disasters.\textsuperscript{119} However, absent disaster-specific legislation, disaster survivors must rely on section 108 to exclude debt cancellation from income.

\begin{footnotes}
\item[110] I.R.C. § 1001(a).
\item[111] I.R.C. § 1033 (a)(2)(A), (B).
\item[112] Reg. § 1.1033(a)-2(c)(2).
\item[113] Id.
\item[114] I.R.C. § 1033(a)(2).
\item[115] I.R.C. § 1033(b)(1)(B).
\item[117] I.R.C. § 1033(b)(1)(A).
\end{footnotes}
Foreclosures are common after disasters. The Mortgage Forgiveness Debt Relief Act of 2007\(^\text{121}\) allows the exclusion of debt cancellation income from mortgage restructuring or mortgage foreclosure on a taxpayer’s home for debts forgiven for the years 2007 through 2016.\(^\text{122}\) The exclusion is limited to $2 million ($1 million if married and filing separately). The Act applies only to the forgiveness or cancellation of debt to buy, build, or substantially improve a “principal residence,” and to the refinancing of debt incurred for these purposes. “Principal residence” in section 108 has the same meaning as “principal residence” in section 121.\(^\text{123}\) The taxpayer should file Form 982 with his or her return to claim the section 108(a)(1)(E) exclusion.

24.4.10 Income in Environmental Disasters

24.4.10.1 Introduction

In an environmental disaster, a survivor may receive compensation for lost income or other damages from the responsible polluter. Such payment may come from a claims fund or a lawsuit.

24.4.10.2 Lost Wages

Payments for lost income or profits are included in income unless received on account of personal physical injury or sickness through a judgment or settlement.\(^\text{124}\) Lost wages paid by a nonemployer are not wages for purposes of FICA taxes and should be reported as “other income” on Form 1040.

24.4.10.3 Lost Self-Employment Income

Payments for lost self-employment income are included in income.\(^\text{125}\) The Service takes the position that lost income paid to a self-employed person is subject to self-employment tax.\(^\text{126}\) The Tax Court has held, however, that business interruption insurance for lost income or profits is not subject to self-employment tax unless there is a nexus between the income received and a trade or business that is, or was, actually carried on.\(^\text{127}\) In Newberry v. Commissioner, the court held that business interruption insurance proceeds were not subject to self-employment tax because the taxpayer did not carry on his grocery store business following its destruction. Although the Service does not acquiesce to the holding in Newberry, other courts have nevertheless followed it and applied the Newberry nexus test.\(^\text{128}\)

\(^{120}\) See Carlson v. Commissioner, 116 T.C. 87, 105 (2001) (fishing permit counted as asset even though exempt from seizure by creditors under state law and precluded taxpayer’s claim for insolvency exclusion).

\(^{121}\) Pub. L. No. 110-142, 121 Stat. 1803.


\(^{123}\) See I.R.C. § 108(b)(5).

\(^{124}\) I.R.C. §§ 61, 104.

\(^{125}\) Cf. Seidenfeld v. Commissioner, T.C. Memo. 1995-61 (holding that business interruption insurance proceeds are taxable as ordinary income).


\(^{129}\) See, e.g., Milligan v. Commissioner, 38 F.3d 1094 (9th Cir. 1994); Schelble v. Commissioner, 130 F.3d 1388 (10th Cir. 1997).
Practice Tip: Tax professionals should advise taxpayers who receive payments for lost wages or self-employment income to make estimated tax payments. There are special rules for estimated tax payments by fishermen and farmers.

Note: In the commercial fishing industry, it may be difficult to determine whether a taxpayer is a self-employed independent contractor or an employee. A crew member may be an employee for one voyage and self-employed for another voyage.

24.4.10.4 Property Damage

Recoveries of capital, basis, or amounts for compensation for property damage are not income unless they exceed a taxpayer's adjusted basis in the property. Section 1016(a)(1) provides that a proper adjustment shall be made for receipts and expenditures properly chargeable to the capital account of the damaged property. The property owner reduces his basis by any recovery and then increase it by the costs incurred for repairs or restoration.

If the recovery exceeds the basis, the owner may be able to defer income under section 1033(a)(2)(A) if the property damage is the result of an involuntary conversion. If the damaged property is a principal residence, the owner may exclude gain under section 121 if the property is either sold or deemed sold because of its destruction.

Damaged property sold to the tortfeasor as part of a buy-out agreement will generally be treated as a sale for tax purposes. However, if repair of the property is not possible due to its damage, a sale pursuant to a buy-out agreement may qualify as an involuntary conversion within the meaning of section 1033.

24.4.10.5 Personal Injury

Payments for personal injury, including lost wages on account of personal physical injury or physical sickness, may be excluded from income. The damages must be received through prosecution of a lawsuit or through a settlement agreement entered in lieu of a lawsuit. The disaster survivor has the burden of proving a section 104(a) exclusion for personal injury based on physical injury or physical sickness.

24.4.10.6 Punitive Damages

Punitive damages for an environmental disaster must be reported as income.

24.4.10.7 Attorney Fees

In an environmental disaster, many lawsuits for property damage will be class actions. In opt-out class action lawsuits, a class member usually does not have to report the attorney fees as income.

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130 See, e.g., Rev. Rul. 77-102, 1977-1 C.B. 299 (crew member does not qualify for employment tax exclusion if he receives any remuneration other than a percentage of catch); I.R.C. § 7873 (members of certain Indian tribes not subject to income tax or self-employment tax from fishing rights related to activity of tribe).


132 GCM 111606-07, supra note 131.

133 I.R.C. § 104(a).

134 Reg. § 1.104-1(c).

135 Green v. Commissioner, 507 F.3d 857, 869-70 (5th Cir. 2007); Every v. United States, 51 F.3d 279 (9th Cir. 1995) (holding that although the disaster survivors’ claims sounded in tort, they could not show that the settlement amount arose from an injury to the person in the traditional tort sense).

136 Cf. Benavides v. United States, 497 F.3d 526, 531 (5th Cir. 2007).

137 GCM PRENO-111606-07, supra note 131.
24.5 CONTRACTOR FRAUD AND SCAMS

After a disaster, homeowners may be exploited by home improvement contractors either through fraud, theft, or negligence. Compensation for property damage or breach of contract by a home repair contractor is not income unless it exceeds the basis in the property.\(^{138}\) No economic gain results from a recovery of basis in a capital asset. Moreover, taxpayers are vulnerable to identity theft and various scams that proliferate following a disaster.\(^{139}\) Taxpayers should report disaster-related fraud by calling the Disaster Fraud Task Force’s hotline at (866) 720-5721.

24.6 DEDUCTION AND CREDIT ISSUES IN DISASTERS

24.6.1 Casualty Losses

Individual disaster survivors may deduct casualty losses under section 165. If the government orders the demolition or relocation of a taxpayer’s home in a federally declared disaster area within 120 days of the disaster declaration, and the home has been rendered unsafe by the disaster, the taxpayer’s loss is treated as a loss from a casualty as described in section 165(i).\(^{140}\) The rules governing casualty loss deductions by disaster survivors have changed several times in recent years.

Indeed, as this volume was set to go to press, President Trump signed H.R. 1,\(^{141}\) commonly referred to as the Tax Cuts and Jobs Act of 2017, into law on December 22, 2017. Section 11044 of the Tax Cuts and Jobs Act suspends certain casualty loss deductions for taxable years 2018 through 2025. It amends Section 165 to provide an 8-year suspension of casualty loss deductions where there has been no federally-declared disaster, except to the extent such losses offset casualty gains. Different rules usually apply for different disasters. Always check to see which legislation applies to your client.\(^{142}\)

Casualty loss deductions generally will not be available to most low-income disaster survivors because low-income taxpayers typically do not itemize deductions. Low-income taxpayers who itemize to claim casualty loss deductions may only realize a nominal tax benefit since low-income taxpayers have low tax rates and few itemized deductions in excess of the standard deduction. Also, in the disaster context, casualty losses are reduced by disaster assistance and insurance recoveries.\(^{143}\) Survivors of Hurricanes Harvey, Irma, and Maria, however, benefit from legislation making the casualty loss deduction available to all taxpayers instead of just to those who itemize.\(^{144}\)

The amount of a casualty loss is computed as the lesser of (1) the difference between the fair market value of the property immediately before the casualty and the fair market value immediately after the casualty; and (2) the adjusted basis of the property immediately before the casualty.\(^{145}\) If repairs are actually made, the casualty loss is the cost of repair.\(^{146}\) The taxpayer has the burden of proof as to each item of damaged property.

In recognition of the difficulty taxpayers may face in computing their casualty losses under the regulations, the Service offered several alternative safe harbor methods in two Revenue Procedures\(^{147}\) issued in mid-December of 2017 as this volume was about to go to press. Revenue Procedure 2018-9 provides a cost index safe harbor method to compute casualty losses for personal-use residences dam-


\(^{139}\) The Disaster Fraud Task Force, a coalition of federal, state and local agencies, was established in 2005 to respond to an increase in identity theft, government benefit, and charity fraud following disasters. See Disaster Fraud Task Force, Department of Justice, http://www.justice.gov/criminal/disasters/ (last visited October 23, 2014).

\(^{140}\) I.R.C. § 165(k).

\(^{141}\) PL 115-97, 131 Stat. 2054 [hereinafter the “Tax Cuts and Jobs Act”].

\(^{142}\) For example, the $100 floor was changed to $500 and the 10% AGI limit did not apply to personal casualty losses for survivors of Hurricanes Harvey, Irma, and Maria pursuant to § 505(b) of the Disaster Relief Act of 2017.

\(^{143}\) Callahan v. Commissioner, T.C. Memo 1996-65.

\(^{144}\) Disaster Relief Act of 2017, supra note 88 at § 504(b).

\(^{145}\) Reg. § 1.165-7.

\(^{146}\) Lamphere v. Commissioner, 70 T.C. 391, 396 (1978).

aged or destroyed in the 2017 hurricanes. Revenue Procedure 2018-8 provides additional alternative methods for computing casualty losses for damage or destruction of personal-use residential property as well as personal belongings, both generally and in disasters particularly. Practitioners should read the Revenue Procedures with care to determine what method survivors should elect.

Beginning in the 2010 tax year, the casualty loss deduction is limited to the amount by which it exceeds $100.\(^{148}\) Casualty gains are first netted against casualty losses. Only the resulting net casualty loss may be considered for a deduction. The resulting net casualty loss then must be reduced by any insurance recovery and government assistance. To claim a casualty loss for personal property, the taxpayer must file an insurance claim if he has insurance. Unless special legislation applies, the final casualty loss deduction becomes an itemized deduction only to the extent that it exceeds 10% of adjusted gross income. The basis of the damaged property is then decreased by the amount of insurance or other reimbursements and the amount of the deductible casualty loss. Again, check for specific legislation applicable to the client’s disaster because Congress has frequently modified these rules following a disaster.

Practice Tip: Use the worksheets in Publication 584 to calculate deductible casualty losses.

A casualty loss deduction can only be claimed for a year in which it is allowable.\(^{149}\) Generally, this is the year of the loss or the year when there was no reasonable prospect of recovery.\(^{150}\) In a federally declared disaster, though, the taxpayer may instead choose to claim the casualty loss deduction for the year prior to the disaster to provide quick access to cash through an immediate refund of tax paid in the prior year.\(^{151}\) However, if the taxpayer later receives an insurance recovery or other reimbursement for the casualty loss, the tax benefit rule will require him to include as income for the recovery year the amount of the deduction that actually reduced his tax burden in the prior year. Depending on the taxpayer’s circumstances, his additional taxes in the recovery year could be greater than his tax savings in the year the deduction was taken.

A taxpayer who elects under section 165(i) to take the casualty loss deduction in the tax year preceding the disaster year does so by claiming the deduction on the prior year tax return or on an amended tax return for that year. Historically, the deadline for making the election was the due date of the tax return for the disaster year.\(^{152}\) But for elections that can be made or taken after October 13, 2016, the deadline to make the election is extended by six months without regard to whether the taxpayer requests an automatic extension of time to file the disaster year return.\(^{153}\) Under the new rule, the deadline to revoke an election is 90 days after the due date for making the election.\(^{154}\)

Practice Tip: Practitioners should review Revenue Procedure 2016-53 carefully for details on how to document the election on the tax return and procedures for maintaining consistency in disaster year and preceding year returns.

The extended deadlines applicable to section 165(i) elections are pursuant to a temporary regulation at the time of this writing. Check the status of the regulation before advising clients.

\(^{148}\) For designated 2017 hurricane survivors, this $100 threshold is changed to $500. See supra, note 142.


\(^{150}\) Reg. § 1.165-1(d).

\(^{151}\) I.R.C. § 165(i)(1)-(2).

\(^{152}\) Reg. § 1.165-11(e); Oliver v. Commissioner, T.C. Memo. 1997-84.


\(^{154}\) Reg. § 1.165-1T(g).
24.6.2 Capital Losses
Uninsured disaster survivors may have to sell their homes at a loss. Generally, capital losses on a personal asset are nondeductible. If a taxpayer has capital gains, she may offset any deductible losses against the gain. Also, the taxpayer may be able to qualify for a casualty loss deduction under section 165.

24.6.3 Net Operating Losses
Section 172 allows the deduction of a net operating loss (NOL) when a taxpayer's allowable deductions exceed her taxable income. Generally, a NOL may be carried back and deducted against the taxable income in the two tax years prior to the NOL year. This carryback allows a taxpayer to file an amended return seeking a tax refund for a prior year. A three-year carryback is allowed for NOLs when a taxpayer sustains a loss of property from a fire, storm, shipwreck, casualty loss, or theft. A taxpayer also may waive the carryback and elect to carry her NOLs forward.


24.6.4 Home Mortgage Interest
Many disaster survivors cannot return to their principal residences for lengthy periods. The Service has ruled that interest paid on home mortgages can be deductible if reoccupation or reinvestment occurs within a reasonable period of time. Revenue Ruling 96-32 suggests that 34 months is reasonable. Revenue Ruling 96-32 states that interest will be deductible for all disasters, not just for qualified disasters.

Practice Tip: The apparent safe harbor in Revenue Ruling 96-32 for deducting mortgage interest may not help survivors who need more time to reoccupy their homes. In a qualified disaster, taxpayers have up to four years to buy a new home. The interest for part of the replacement period may not be deductible. Thus, a taxpayer may want to secure a private letter ruling for the deductibility of his mortgage interest or build a case that the delay in re-occupancy was reasonable.

24.6.5 Earned Income Credits
The Katrina Emergency Tax Relief Act of 2005, the Heartland Disaster Tax Relief of 2008, and the Disaster Relief Act of 2017 all gave affected taxpayers the option to use prior-year income to calculate their earned income credit. The Code does not have a permanent section permitting this election. FEMA assistance does not count in determining eligibility for or calculating the amount of the earned income credit because it is not income. However, absent special action by the Service or Congress, it may be considered public assistance for the purpose of determining head of household filing status. In the Hurricane Katrina, Rita, and Wilma disasters, the Gulf Opportunity Zone Act of 2005 authorized the Service to disregard assistance received because of temporary relocation as a

\[\text{155 I.R.C. § 172(b)(1)(F).}\]
\[\text{156 I.R.C. § 172(b)(3).}\]
\[\text{158 Rev. Rul. 96-32, 1996-1 C.B. 177.}\]
\[\text{159 See also Reg. § 1.163-10T(p)(5) (interest deductible for two-year pre-construction period of home).}\]
\[\text{160 The Disaster Relief Act of 2017 also permitted affected taxpayers to calculate their Child Tax Credit on the basis of prior-year income.}\]
\[\text{161 See I.R.C. § 139.}\]
\[\text{162 See, e.g., Huynh v. Commissioner, T.C. Memo. 2002-237.}\]
result of these disasters in determining whether an affected taxpayer contributed more than half of a child’s support.\textsuperscript{163} Temporary absence of a child from a home due to a disaster does not disqualify the child as a “qualifying child” for purposes of the earned income credit.\textsuperscript{164}

24.7 IMPACT OF DISASTER EXPENSES ON COLLECTION ALTERNATIVES

Expenses incurred because of a disaster may be relevant to an innocent spouse relief determination, release of a levy, or an offer in compromise based on effective tax administration.\textsuperscript{165} The Service will consider the disaster as a factor in its economic hardship determination in deciding whether to grant the innocent spouse relief or an ETA offer in compromise.\textsuperscript{166}

24.8 THE SERVICE AS A CREDITOR OF DISASTER SURVIVORS

If disaster payments are not exempt under federal or state law, the Service and other creditors may have rights to those disaster payments. Some types of disaster relief payments, such as FEMA assistance, are exempt from seizure by creditors generally.\textsuperscript{167} The authors are not aware of cases in which FEMA assistance has been levied or offset by the federal government to collect unpaid federal taxes, although the Service maintains it has the power to do so.\textsuperscript{168} Recipients of disaster relief payments who owe debts or judgments should be careful not to commingle exempt disaster funds with nonexempt funds in order to protect exempt funds from creditors. Commingling of exempt disaster funds with other funds also may create problems for disaster survivors who seek bankruptcy protection.

Disasters force many survivors into bankruptcy, which can raise a number of ancillary tax issues.\textsuperscript{169} Nonfilers will have an urgent need to file the last four years of tax returns if they declare bankruptcy. As a general rule, disaster payments become property of the bankruptcy estate only if the disaster loss and legislation or regulations creating the entitlement occurred before the filing of the bankruptcy.\textsuperscript{170} It may be possible to argue that some government assistance grants are excluded from the bankruptcy estate if there is significant government supervision or restrictions on the use of the funds.\textsuperscript{171}

\textsuperscript{163}IRS, Publication 4492, Information for Taxpayers Affected by Hurricanes Katrina, Wilma and Rita (2006).
\textsuperscript{165} See, e.g., Rev. Proc. 2013-34 (for innocent spouse relief, economic hardship determination is based on numerous factors); Reg. § 301.6343-1(b)(4) (levy release due to economic hardship may be based on “extraordinary factors” such as natural disasters); I.R.M. 5.8.11.2.1.5 (Service must consider “extraordinary circumstances,” including a natural disaster, in its economic hardship analysis for Offers in Compromise).
\textsuperscript{166} Id.
\textsuperscript{167} 44 C.F.R. § 206.110(g). The provision does not specifically mention the Internal Revenue Service, however.
\textsuperscript{168} Counsel’s litigation position has consistently been that section 6334(c) and its legislative history permit the Service to levy anything not specifically enumerated in subsection (a) of the statute, even if another federal statute purports to create an exemption from levy. See also I.R.M. 5.11.7.2.1.1 (2)(I) (stating IRS may levy through the Federal Payment Levy Program up to 15% of any payments that are “non-means tested, such as discretionary one-time payments and expenditures paid out by different Federal agencies’ specialty programs,” which could be interpreted to include FEMA assistance). Nevertheless, the Service has made an administrative decision not to levy such payments, at least through the Federal Payment Levy Program. I.R.M. 5.11.7.2.1(5) (stating the Service will not pursue “certain public assistance payments at this time.”).
\textsuperscript{169} Robert M. Lawless, Bankruptcy Filing Rates After a Major Hurricane, 6 Nev. L.J. 7 (2005). Increases in bankruptcy filings are greater in low-income areas affected by a hurricane. Id. at 15.
\textsuperscript{170} Burgess v. Sikes, 438 F.3d 493, 507 (5th Cir. 2006); In re Bracewell, 454 F.3d 1234, 1247 (11th Cir. 2006).
\textsuperscript{171} See, e.g., Westmoreland Home Opportunities v. Walsh, 246 F.3d 233, 256 (3d Cir. 2001) (holding a federal agency’s significant supervisory role over a grantee and grant funds can exclude the grantee’s interest in that grant relationship from the grantee’s bankruptcy estate).
Practice Tip: Taxpayers should file the last four tax returns before filing a Chapter 13 bankruptcy. Failure to file the tax returns before the date set for the first meeting of creditors may prevent confirmation of the plan or result in dismissal or conversion to a Chapter 7 bankruptcy. If disaster assistance is not exempt from seizure, a disaster survivor generally will need to seek bankruptcy protection under Chapter 13, rather than Chapter 7. To the extent that disaster funds are invested in an exempt homestead, they may be protected from seizure by creditors.

Disaster survivors who were in a Chapter 13 bankruptcy at the time of a disaster may face proposed increases to their plan payments if they receive disaster assistance and the bankruptcy court finds that the assistance is “disposable income” within the definition of section 1325 of title 11 of the United States Code. A secured creditor, such as a mortgage lender, may have a security interest in the disaster assistance which could protect the assistance from other creditors. In some cases, disaster payments may not be disposable income for modification of a Chapter 13 plan if they are “reasonably necessary for the maintenance or support of the debtor or his family.”

24.9 AFFORDABLE CARE ACT CONSIDERATIONS

At the time of this writing, the Patient Protection and Affordable Care Act (the “ACA”) had narrowly survived multiple efforts by House Republicans to repeal and replace it. While repealing and replacing the ACA was a centerpiece of Donald Trump’s presidential campaign and continued to be a high priority item on his first 100 days’ agenda, it appears that for now, the ACA will remain the law of the land. President Trump and Republican lawmakers have shifted their focus to overhauling the tax code.

Cross-Reference: Chapter 29 (Affordable Care Act).

24.9.1 Hardship Exemptions

Under the ACA, individuals who do not have employer-sponsored health insurance benefits must purchase coverage or pay a penalty. This requirement is referred to as the “individual mandate.” The penalty for failing to have health insurance is referred to as the Individual Shared Responsibility Payment (“ISRP”). Among the numerous exceptions to the individual mandate, only one is applicable in cases of disaster. That exemption category applies to individuals who experienced a hardship that rendered them unable to obtain health insurance coverage. Examples of these hardships include fire, flooding or other natural or human-caused disaster. This hardship exemption only exempts an individual (or household) from the ISRP for the period that the disaster prevented the individual from obtaining health insurance coverage.

To obtain a hardship exemption, one must apply to the Health Insurance Marketplace (the “Marketplace”) using Form OMB No. 0938-1191 “Application for exemption from the Shared Responsibility Payment for individuals who experience hardship.” The form can be downloaded from the Marketplace’s website: www.healthcare.gov/exemptions. Once completed, the form should be

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172 See In re Freeman, 86 F.3d 478, 481-82 (6th Cir. 1996) (holding that tax refund was “disposable income” because debtor failed to assert that refund was necessary for maintenance and support). However, a trustee may oppose this argument.


174 PPACA § 1501.

175 PPACA § 1501 (d) and (e).

176 PPACA § 1501 (e)(5).


The hardship exemption application will include all persons in the household who are on the same federal income tax return even if the hardship exemption does not apply to everyone on the return. Taxpayers will select Hardship Number 6 for “Disaster” in Step 2 and specify the tax year for which the exemption is needed, the date the hardship started, and the date the hardship ended or will end. If the end date is not known, there is an option to indicate the hardship is ongoing. The Marketplace requires substantiating documentation be submitted with the application. Acceptable documentation for disasters includes police reports, fire reports, insurance claims, news reports, or notices from government agencies. The documentation must show that the disaster occurred during the current year or one of the two prior years.

It takes the Marketplace about four weeks to make a determination. If the hardship exemption is approved, the Marketplace will issue an Exemption Certificate Number (ECN). Taxpayers report this ECN in Part 1 of IRS Form 8965 “Health Coverage Exemptions.” It is best to file the hardship application in sufficient time to get the ECN before the due date of that return. However, if a response has not yet been received the taxpayer may write “pending” on Form 8965.

If the Marketplace rejects an application for a hardship exemption, the rejection can be appealed by filing Form OMB NO. 0938-1213 “Marketplace Eligibility Appeal Request.” The appeal form is basic and provides a blank space for a narrative explaining the basis for the appeal. Appeals are due within 90 days of the date on the rejection notice. The appeal form can be mailed or faxed, as follows:

Health Insurance Marketplace  
Attn: Appeals  
465 Industrial Blvd.  
London, KY 40750-0061  
Fax: 877 369 0130

The Marketplace Appeals Center (“MAC”) responds to appeals. The MAC attempts to resolve appeals informally. Informal resolutions can be appealed further by requesting a hearing. These hearings are typically conducted by telephone. After the hearing, the MAC will issue a final appeal decision.

Practice Tip: If a taxpayer who suffered a disaster that prevented him from obtaining health insurance coverage fails to obtain an ECN and is assessed the ISRP, consider filing Form 843 “Claim for Refund and Request for Abatement” to request the IRS abate the ISRP.

**24.9.2 Special Enrollment Period**

As previously mentioned, subject to certain exemptions, the ACA requires all individuals to have health insurance coverage. If an individual does not have employer-sponsored insurance or other coverage, such as, Medicaid, Medicare, etc., that individual must secure his or her own coverage. This can be done privately with an insurance company or facilitated through a state or federal Health Insurance Marketplace.

If an individual is purchasing coverage through a Marketplace, it must do so during the annual “Open Enrollment Period.” Certain events, however, will entitle an individual to a “Special Enrollment Period” (an “SEP”), which will allow him or her to obtain coverage through a Marketplace at times other than the Open Enrollment Period. One of the events entitling someone to a SEP is a natural disaster, such as, an earthquake, hurricane or massive flooding.

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178 PPACA § 1311(c)(6).
A person who believes he qualifies for a SEP and wants to enroll in coverage may contact the Marketplace Call Center at 800-318-2596. The Marketplace representative makes the SEP determination during the telephone call. If the SEP is approved, the representative assists the caller with enrolling in coverage. If the SEP is denied, the caller may appeal using the same appeal procedures set forth above for the hardship exemption.

24.9.3 Other

Disasters may have other consequences in relation to the ACA. For instance, disasters can impact a taxpayer's reporting obligations under the ACA and even their ability to access medical services for which they are insured. Many disaster victims find themselves in a position where they have lost most, if not all, of their records and documents. This lack of records can create problems if the taxpayer needs evidence of health insurance coverage, premium payments or advance premium tax credits (APTC) received to complete a tax return or respond to an IRS audit notice. This is particularly problematic when the taxpayer disputes the information reported by the Marketplace.

In such cases, a tax practitioner may need to obtain records from other sources, such as banks and insurance companies. In one case, for example, where the taxpayer had lost all of his records and needed APTC information to prepare his return, the tax practitioner had to help him obtain a birth certificate, and then a replacement state identification card, before the health insurance provider would release the information necessary to prepare the tax return.