United Policyholders™

Roadmap to Recovery Program™

CA CO 2021 Wildfires Series

Taxing Matters

February 23, 2022

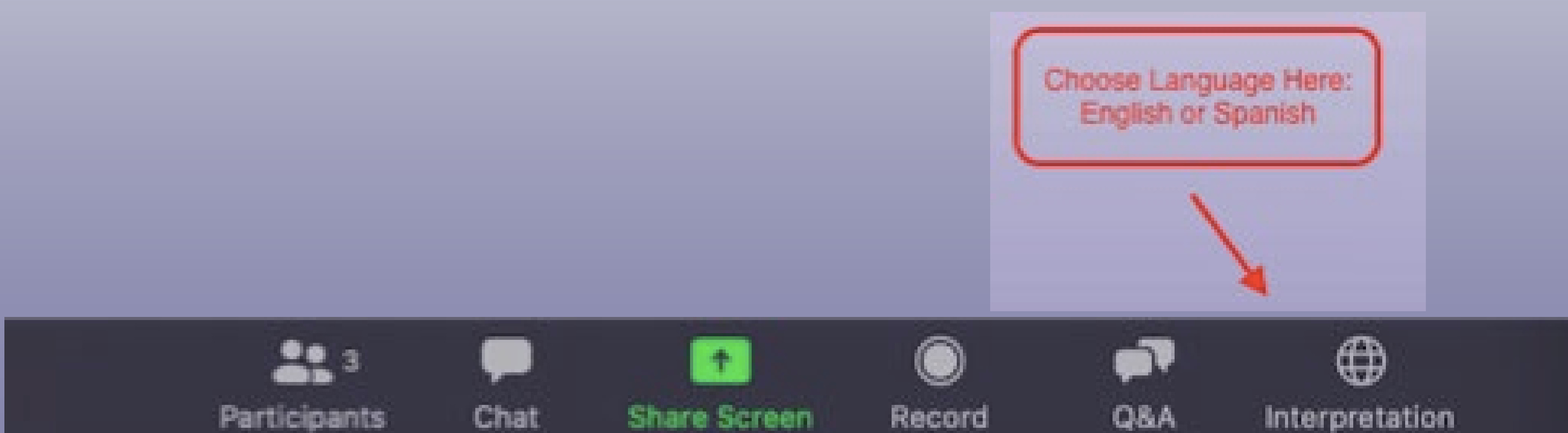
Virtual Workshop #7 (CA 2021 R2R)

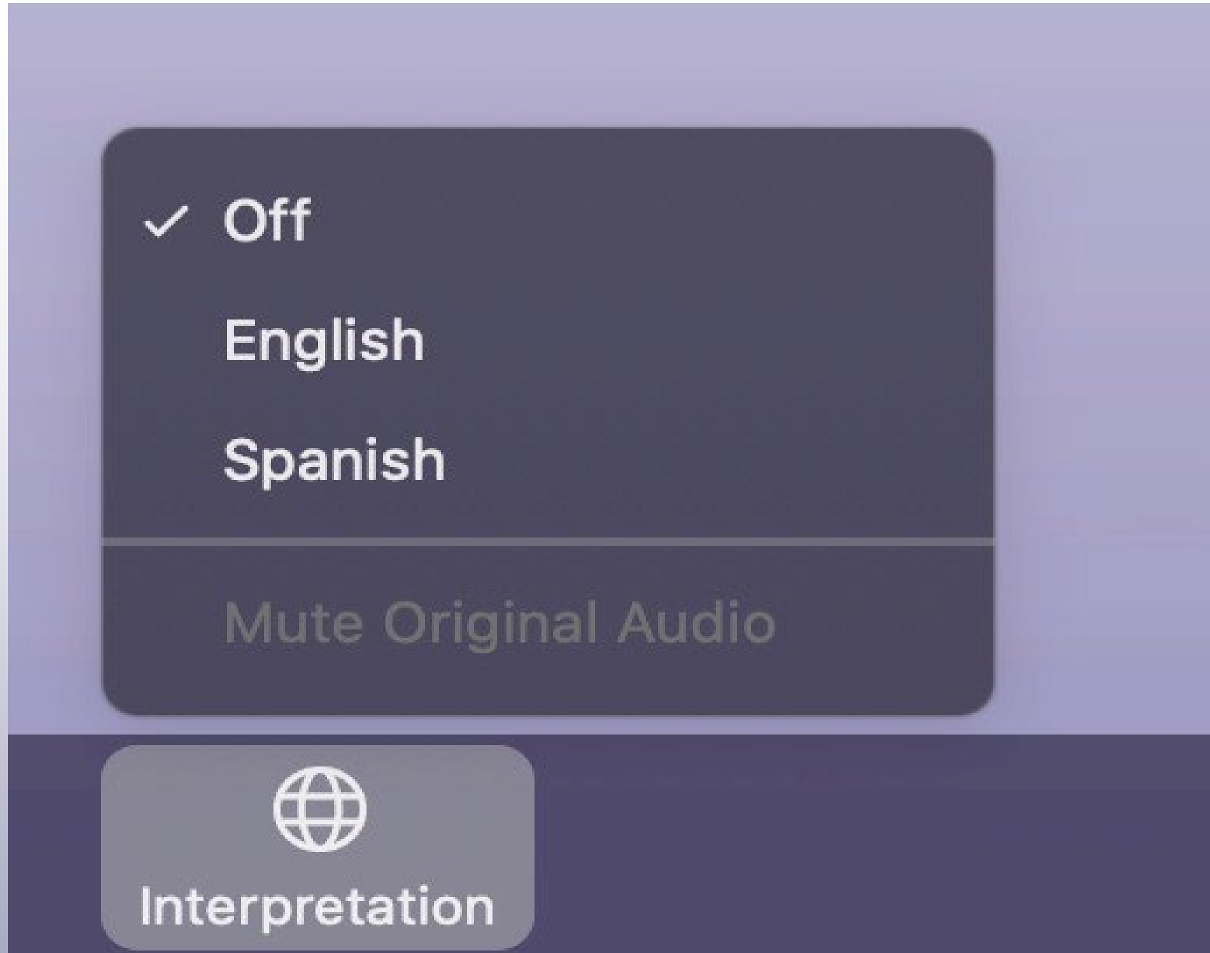
www.uphelp.org/2021wildfires

United Policyholders™
Roadmap to Preparedness Program

CA CO 2021 Wildfire Series

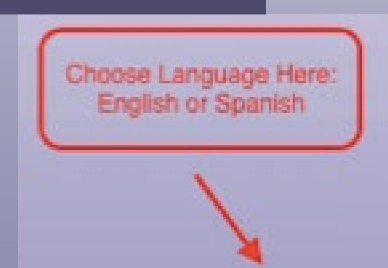
Taxing Matters

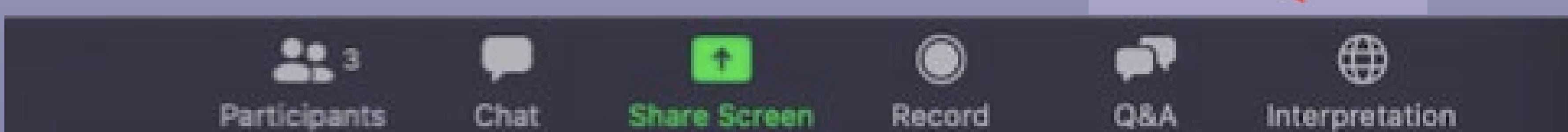




February 23, 2022

Virtual Workshop/Webinar #7 (CA)



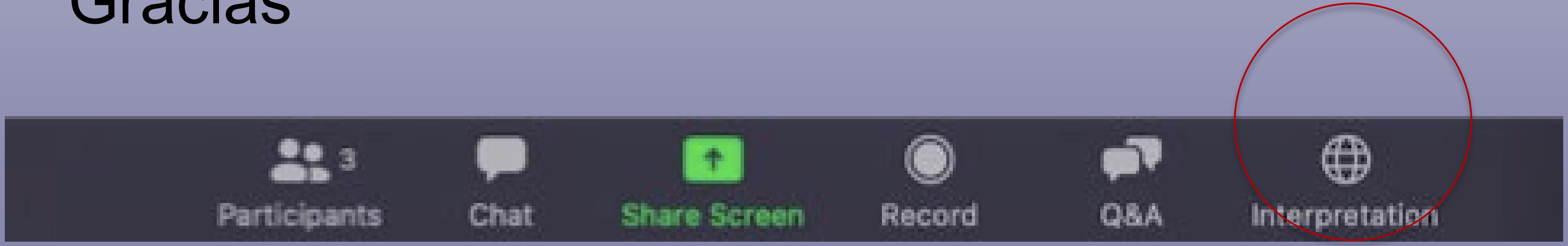


Esta reunión cuenta con interpretación al español

Para activar la interpretación, vaya a la parte baja a la derecha de su pantalla y haga clic en el icono o símbolo global titulado Interpretación/Interpreting.

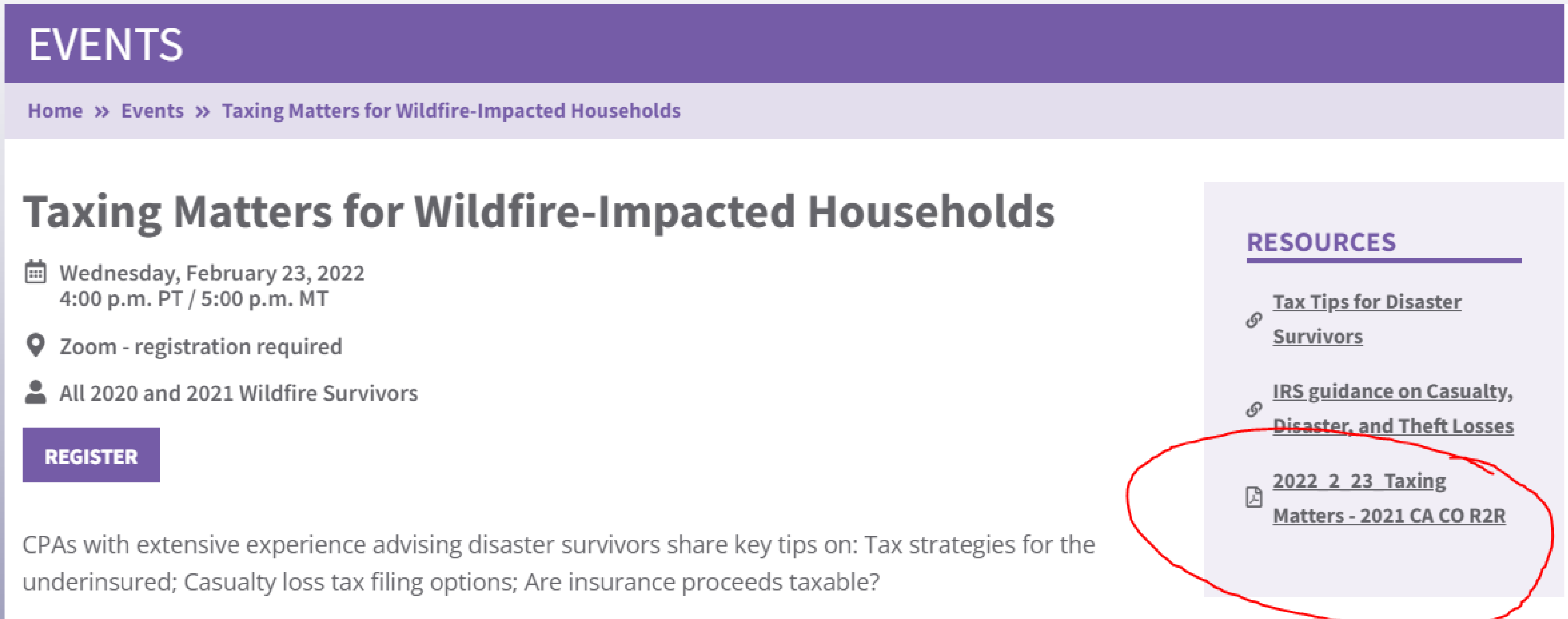
Haga clic y seleccione “español.” Automáticamente escuchara en español.

Gracias



If you'd like to follow the slide deck tonight

www.uphelp.org/events/taxing-matters-for-wildfire-impacted-households/



EVENTS

Home » Events » Taxing Matters for Wildfire-Impacted Households

Taxing Matters for Wildfire-Impacted Households

Wednesday, February 23, 2022
4:00 p.m. PT / 5:00 p.m. MT

Zoom - registration required

All 2020 and 2021 Wildfire Survivors

REGISTER

CPAs with extensive experience advising disaster survivors share key tips on: Tax strategies for the underinsured; Casualty loss tax filing options; Are insurance proceeds taxable?

RESOURCES

- Tax Tips for Disaster Survivors
- IRS guidance on Casualty, Disaster, and Theft Losses
- 2022_2_23_Taxing Matters - 2021 CA CO R2R

www.uphelp.org/events
Register for upcoming events. View recordings of past events and related resources.

About United Policyholders (UP)

- Reputable, established 501(c)3 not-for-profit charitable organization, Platinum Guide Star rating
- A trusted information resource and respected voice for insurance consumers in all 50 states
- 30 year track-record and expertise in disaster recovery
- Not for profit…not for sale
- Funded by donations and grants

Team UP

- Professional staff
- Government and nonprofit partners
- Volunteers
  - Fired UP Survivors - previous catastrophic loss survivors paying it forward
  - Consumer-oriented professionals
    - Damage and repair/rebuild cost estimators
    - Lawyers
    - Public Adjusters
    - Tax and Financial Planning experts
    - Construction and Real Estate professionals

Our Three Programs

Roadmap to Recovery®

– *Guidance on insurance, restoring assets and getting back home after a catastrophic loss*

Roadmap to Preparedness

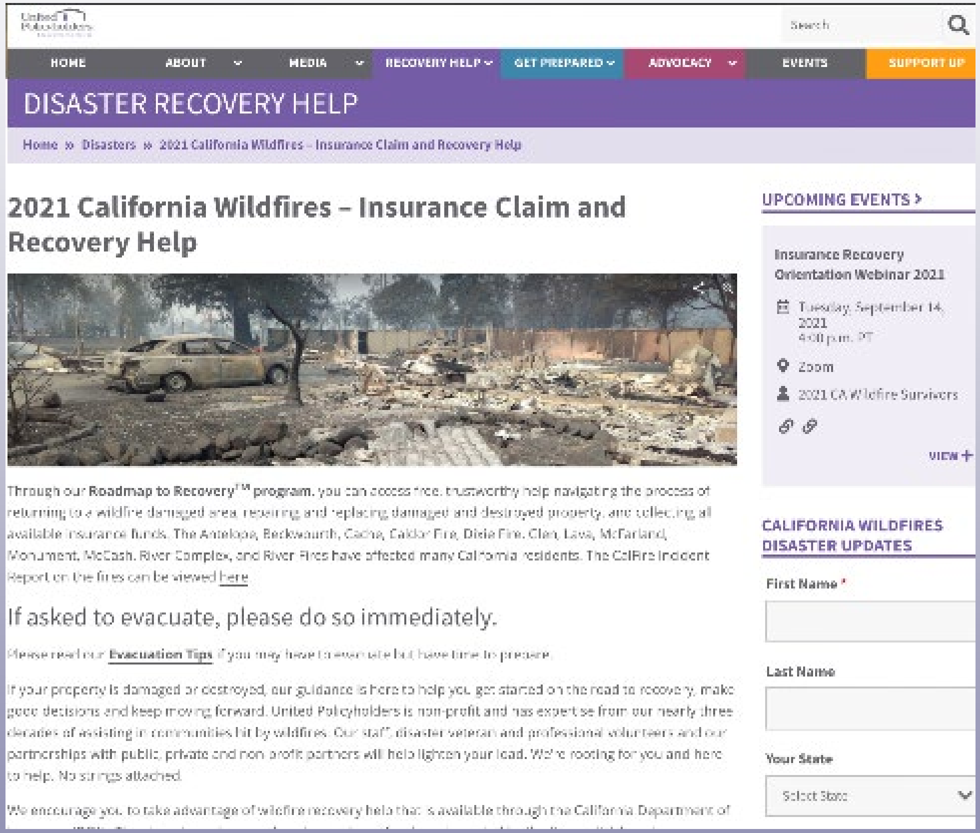
– *Helping households and communities reduce risk and be resilient to disasters and adversity*

Advocacy and Action

– *Fighting for insurance consumer rights and protections*

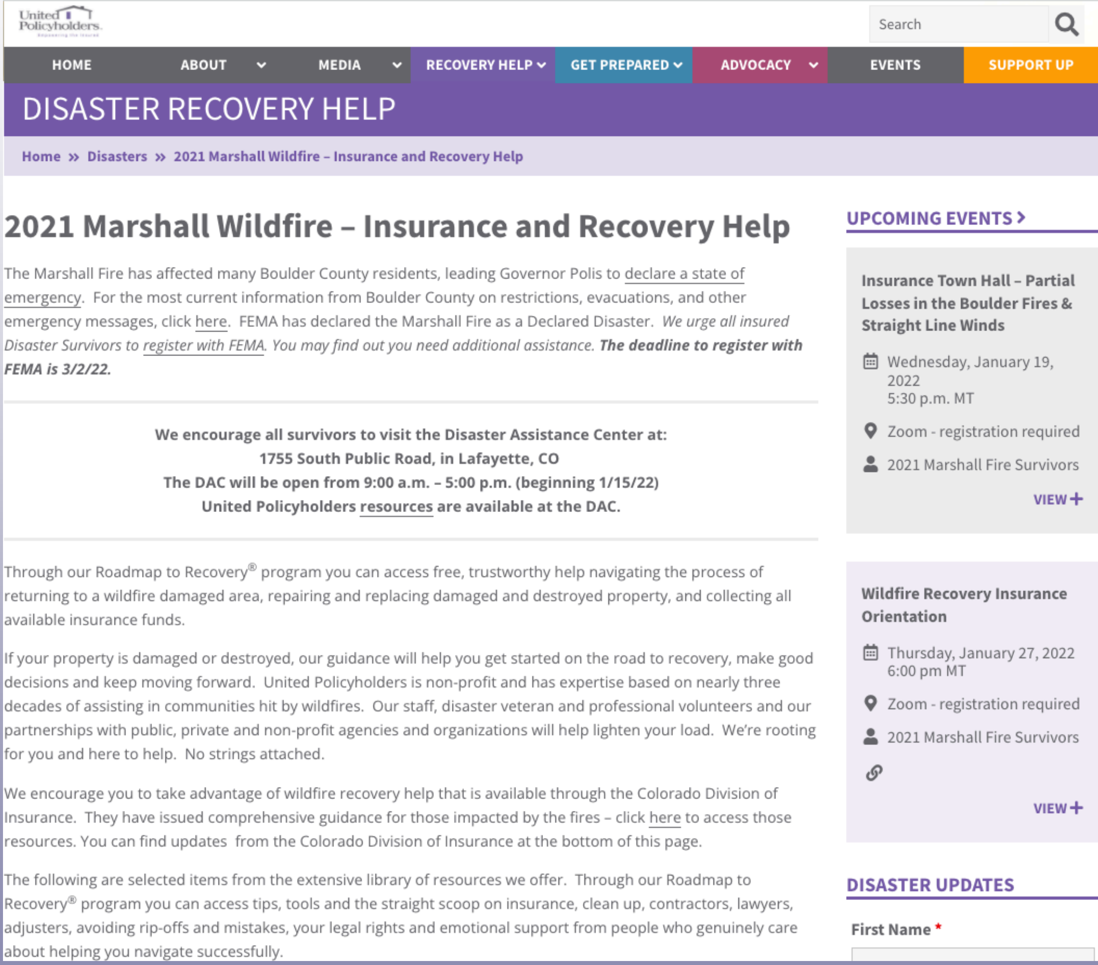
California 2021 Wildfire Help Library
www.uphelp.org/2021wildfires

- California Specific Resources with Step-by-Step Guidance
- One Click Links to Sign UP for Events And Email Notifications
- Links to Pro-consumer Professional Help www.uphelp.org/findhelp
- Sample Letters & Claim Forms www.uphelp.org/samples
- Survivors Speak Tips www.uphelp.org/survivorsspeak
- Upcoming Workshops And Resources www.uphelp.org/events



2021 Marshall Fire Help Library
www.uphelp.org/MarshallFire

- Colorado Specific Resources with Step-by-Step Guidance
- One Click Links to Sign UP for Events And Email Notifications
- Links to Pro-consumer Professional Help www.uphelp.org/findhelp
- Sample Letters & Claim Forms www.uphelp.org/samples
- Survivors Speak Tips www.uphelp.org/survivorsspeak
- Upcoming Workshops and Resources www.uphelp.org/events



United Policyholders

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DISASTER RECOVERY HELP

Home » Disasters » 2021 Marshall Wildfire – Insurance and Recovery Help

2021 Marshall Wildfire – Insurance and Recovery Help

The Marshall Fire has affected many Boulder County residents, leading Governor Polis to declare a state of emergency. For the most current information from Boulder County on restrictions, evacuations, and other emergency messages, click here. FEMA has declared the Marshall Fire as a Declared Disaster. *We urge all insured Disaster Survivors to register with FEMA. You may find out you need additional assistance.* ***The deadline to register with FEMA is 3/2/22.***

We encourage all survivors to visit the Disaster Assistance Center at:
1755 South Public Road, in Lafayette, CO
The DAC will be open from 9:00 a.m. – 5:00 p.m. (beginning 1/15/22)
United Policyholders resources are available at the DAC.

Through our Roadmap to Recovery® program you can access free, trustworthy help navigating the process of returning to a wildfire damaged area, repairing and replacing damaged and destroyed property, and collecting all available insurance funds.

If your property is damaged or destroyed, our guidance will help you get started on the road to recovery, make good decisions and keep moving forward. United Policyholders is non-profit and has expertise based on nearly three decades of assisting in communities hit by wildfires. Our staff, disaster veteran and professional volunteers and our partnerships with public, private and non-profit agencies and organizations will help lighten your load. We're rooting for you and here to help. No strings attached.

We encourage you to take advantage of wildfire recovery help that is available through the Colorado Division of Insurance. They have issued comprehensive guidance for those impacted by the fires – click here to access those resources. You can find updates from the Colorado Division of Insurance at the bottom of this page.

The following are selected items from the extensive library of resources we offer. Through our Roadmap to Recovery® program you can access tips, tools and the straight scoop on insurance, clean up, contractors, lawyers, adjusters, avoiding rip-offs and mistakes, your legal rights and emotional support from people who genuinely care about helping you navigate successfully.

UPCOMING EVENTS >

Insurance Town Hall – Partial Losses in the Boulder Fires & Straight Line Winds

Wednesday, January 19, 2022
5:30 p.m. MT

Zoom - registration required

2021 Marshall Fire Survivors

VIEW +

Wildfire Recovery Insurance Orientation

Thursday, January 27, 2022
6:00 pm MT

Zoom - registration required

2021 Marshall Fire Survivors

VIEW +

DISASTER UPDATES

First Name *

The Fine Print

- This workshop is intended to be general guidance only, not legal advice
- We don't endorse or warrant any of the sponsors listed at www.uphelp.org or speakers at our workshops
- Our speakers are volunteering their time as educators

Today's Presenters

Valerie Brown

Senior Program Officer, United Policyholders

John Trapani, CPA

Trapani, Certified Public Accountant

Cory M. Parnell, CPA

Boeckermann Grafstrom Mayer

Valerie Brown

- Senior Program Officer
- 15 years experience in disaster recovery
- Officer, Disaster Leadership Team
- Officer, National Aging in Place Council
- Chair, San Diego VOAD
- Home Ignition Zone Instructor

John Trapani, CPA

- Licensed in California and Colorado
- Disaster survivor
- 28 years of disaster tax reporting
- For 28 years, presents educational seminars to fellow professional
- Has assisted hundreds of taxpayers report the tax reporting requirements of disasters for 28 years
- www.trapanicpa.comhttp://www.accountantfordisasterrecovery.com/p/contact-us.html
- **Email: john@trapanicpa.com**
  Voice: 805.497.4411

Cory M. Parnell, CPA

- Chief Executive Officer, BGM CPAs
- For more than 35 years, Cory has served a wide range of clients throughout the United States.
- Cory and the BGM tax team understand that a sudden disaster event is not only a financial matter but also a very emotional matter for you. That is why we will assist you in concluding a result in a mindful manner with you at the forefront.

Boeckermann Grafstrom Mayer

https://bgm-cpa.com/our-team/cory-m-parnell/

Learn more at bgm-cpa.com

Keeping paperwork organized = $

- Claim/Recovery Journal
- Save all receipts (scan or photocopy and email, so you have a copy for your records)
- Open a separate bank account for insurance funds received and asset replacement spending
- Establish a special email account for your claim
- Document and track all insurance communications
- Track expenses and $ matters: https://www.uphelp.org/pubs/insurance-accounting-spreadsheet)

Goal of today's presentation: To help you understand tax rules and options for disaster impacted households and make good financial decisions, including:

- When to file / timelines for reporting
- How disaster declarations impact tax matters
- What is the difference between a Casualty Loss and an Involuntary Conversion Gain
- Why you need help

Today’s Topics

1. General tax matters
   a) Filing extensions
   b) Obtaining copies of prior tax returns
   c) What to do and when
2. Important tax terms
3. Cost Basis
4. Involuntary Conversion Gain or Casualty Loss?
5. Involuntary Conversion Gain
6. Other considerations
   1. Tax treatment for ALE
   2. Purchase of temporary home w/ALE funds
   3. Litigation / Legal proceeds
   4. Business losses
   5. Second home tax implications
   6. Rental property tax implications
   7. Timber/lumber losses
   8. Partial loss

GENERAL TAX MATTERS

Prop 19 (CA Only)

- Enacted via 2020 ballot measure. Significant **property** tax savings for many homeowners, especially those that have experienced the devastation of losing a home in a wildfire. Took effect 4/1/21
- Under Proposition 19, homeowners who are 55 and older, severely disabled, or victims of a wildfire or natural disaster may transfer their property tax base of their existing home to a new home anywhere in California without a price restriction.

Common Tax Questions

- Are some or all of my insurance proceeds taxable?
- How can I have had such a devastating loss and have my insurance proceeds be considered a gain?
- Are there “tax exclusions” available?
- If I’m underinsured in one or more categories, can I offset the losses on my tax return?
- Are litigation proceeds taxable?
- What tax considerations are there if I sell my lot without rebuilding?
- What about state tax laws? Property taxes?

Why file an extension with the IRS?

When in doubt, file an extension…

- The rules around disaster and tax regulations are complex…
- There are many provisions to help offset the potential tax implications, but it takes time to know the full extent of any potential outcomes…
- Disaster declarations can lag behind and do not always happen by the IRS filing deadlines…
- It can take several years to know the full extent of the possible tax implications…

➢ **https://uphelp.org/claim-guidance-publications/tax-information-for-disaster-survivors/**

Tax relief…Timing matters

While all of this is new – loss of your home, dealing with an insurance claim, decisions on rebuilding and more…

It is "easy" to ignore the need to deal with the tax reporting of the event and resolution of your situation

Tax reporting is part of the recovery process and the Tax Code provides a number of opportunities to save taxes – now and in the future

For those impacted by a federally declared disaster, IRS tax rules allow additional time for certain tax filings. If you receive a penalty notice and are eligible for these extensions, you can appeal

- **https://www.irs.gov/newsroom/irs-announces-tax-relief-for-california-wildfire-victims**
- **https://www.irs.gov/newsroom/irs-announces-tax-relief-for-colorado-wildfires-and-straight-line-winds**

In what tax year should I claim a loss?

- FIRST… Don’t rush to claim a Casualty Loss deduction
- Generally, losses can only be deducted in the year in which the loss occurs and all claims for reimbursement are settled
- For losses that occurred due to a federal disaster declaration (DR), you can elect to take the loss on an original or amended return for the year preceding the year the loss is settled
- For 2021 losses, you have until October 15, 2022, to elect if you would like to claim the loss on an amended 2020 return or simply claim the loss on your 2021 return assuming the loss is settled in 2021

➢ The IRS recently issued Revenue Procedure 2016-53 (**https://www.irs.gov/pub/irs-drop/rp-16- 53.pdf**) liberalizing the period available for taxpayers to claim a Code Section 165(i) deduction

How do I find copies of prior tax returns?

- Start with your CPA, bookkeeper, or online filing service as they should have records to provide (Turbo Tax, Tax Act, etc.)

- Submit Form 4506 to obtain copies directly from the IRS. The fees are typically waived for counties located in the "Federal Disaster Declaration" (DR) zone. Simply write in red, at the top of the Form 4506, the official disaster title

- The IRS has information for taxpayers in reconstructing records after a disaster. Go online to:

➢ **https://www.irs.gov/newsroom/reconstructing-records-after-a-disaster-irs-provides-tips-to-help-taxpayers**

Purpose of tax rules

To collect money for the operation of the government

Everything you receive of value has a tax consequence and is taxable, unless specified in the tax code

Tax sections we are dealing with serve to tell the IRS, if people have these situations, you want to treat them differently – starting 2018, the Tax Code has amended to change the way certain aspects of disaster are treated

To take advantage of most of these rules, the disaster declaration (Event Designations starting with “DR”) must be in place. other designations - “EM” or “FM” are not relevant

These are rules that look simple until you start to apply them

Do you have a Casualty Loss or Involuntary Conversion Gain?

Start with your insurance, have the proceeds you've received, or expect to receive, exceed the Cost Basis of the home you lost?

If they don't exceed the Cost Basis, you MAY have a Casualty Loss

If they do exceed the Cost Basis, you have an Involuntary Conversion Gain

What do I need to know NOW?

Consider requesting a "Filing Extension" before the deadline to file for your 2021 return (already extended by IRS for your disaster to May 18th, 2022 for taxpayers in affected areas)

File your return or extension **timely** and report what you know - Don't rush to claim a Casualty Loss as it may turn out to be an Involuntary Conversion Gain. Document!

Maintain records of all insurance proceeds, costs expended related to the event – extra expense, related to property lost

Keep a journal

Stage 1: Document the Cost Basis for Real Property

Your next step is to document, and preserve for later, the Cost Basis for your Real Property (home). You need to determine a reasonable, good faith computation of what was your ”Cost Basis” at time of loss

- How much you paid - Tax records, ask your Realtor, check Zillow for purchase price
- If you have plans, you can get a bid on what was built at time of construction (minus code upgrades); then depreciate construction costs back to time of construction
- Include home improvements, additions and enhancements. Improvements also include landscaping, trees, other structures, not just remodeling

Stage 2: Identify and document your insurance proceeds

Document and continue to track what you receive in insurance proceeds to use in determining what insurance proceeds decisions mean for income taxes

- Track all coverages – Dwelling, Contents, ALE, Scheduled Property, Other Structures, Ordinance & Law, Extended Coverage
- If you purchase Real Property with ALE, track that expense / purchase as well. It could lead to a taxable Gain
- Documentation can include settlement letters and checks
- UP's sample Insurance Accounting spreadsheet can help you track both your max limits and insurance proceeds - **https://www.uphelp.org/pubs/insurance-accounting-spreadsheet**

Stage 3: Document your recovery costs

Your goal is to capture all costs of rebuilding your home or purchasing a replacement home (permits, architect, required testing, etc.) and the costs of replacement of your lost personal property

- If rebuilding, document contractor costs, permits, fees, architect costs, required testing, etc.
- If buying a replacement home, document the purchase price, fees, inspections, required “fixes”, etc.
- For replacing contents, you get to count <u>these</u> as if these were paid for the Real Property replacement, which has the net effect of negating <u>some</u> deferred Gain from <u>Real Property</u> insurance proceeds

IMPORTANT TAX TERMS

Why does it matter how my disaster was designated?

It impacts your cash position and tax options

- Insurance proceeds and grants or gifts specifically designated for “contents” damaged or destroyed related to a primary residence are not subject to taxation if the disaster was federally declared, even when they cause a Gain or potential Gain

- Contents losses can be considered when calculating deductions for “Casualty Losses” (“Casualty Loss” requires a DR)

- You ***may*** be able to amend your prior year’s return and claim a loss if you sustained a loss as the IRS defines it

- If your disaster did not get a DR, then the insurance proceeds you collect for contents/personal property are “reportable” and may or may not be taxable

Does my fire have a "Federal Disaster Declaration (DR)"?

Only Presidential Federal Disaster Declarations (**DR**) are recognized by the IRS as qualifying

- **https://www.fema.gov/disasters/disaster-declarations**
- **https://www.irs.gov/newsroom/around-the-nation**

Added provisions available:

- Contents related proceeds for damaged or destroyed property related to a primary residence are not subject to taxation, even when cause a Gain or potential Gain ("Safe Harbor")

- Contents related losses can be considered (added in) when calculating deductions for "Casualty Losses" *(as defined by IRS)*

- Additional time may be allowed for replacing items and extended timelines for certain tax filings

Which payments MAY be taxable by IRS?

For those impacted by a disaster loss regardless of disaster declaration, taxable reimbursements will include:

- Unemployment compensation
- Payments for real estate are treated the same as if they are proceeds paid by the insurance company
- Some ALE insurance proceeds, if used to purchase an asset rather than to pay for temporary living expenses
- Some insurance proceeds related to contents, also contents in a second home, even if a DR

Non-taxable payments/proceeds

For those impacted by a disaster loss regardless of declaration, non-taxable reimbursements may include:

- Payments for ALE or Additional Living Expenses (to the extent they are being used to pay for additional living expenses), including insurance proceeds and FEMA payments
- Payments from social welfare agencies, charitable organizations, and in-kind services such as free meals, medical supplies, and shelters
- FEMA payments under authority of Code Section 139

Deep Breath

COST BASIS

How is Cost Basis calculated for IRS purposes?

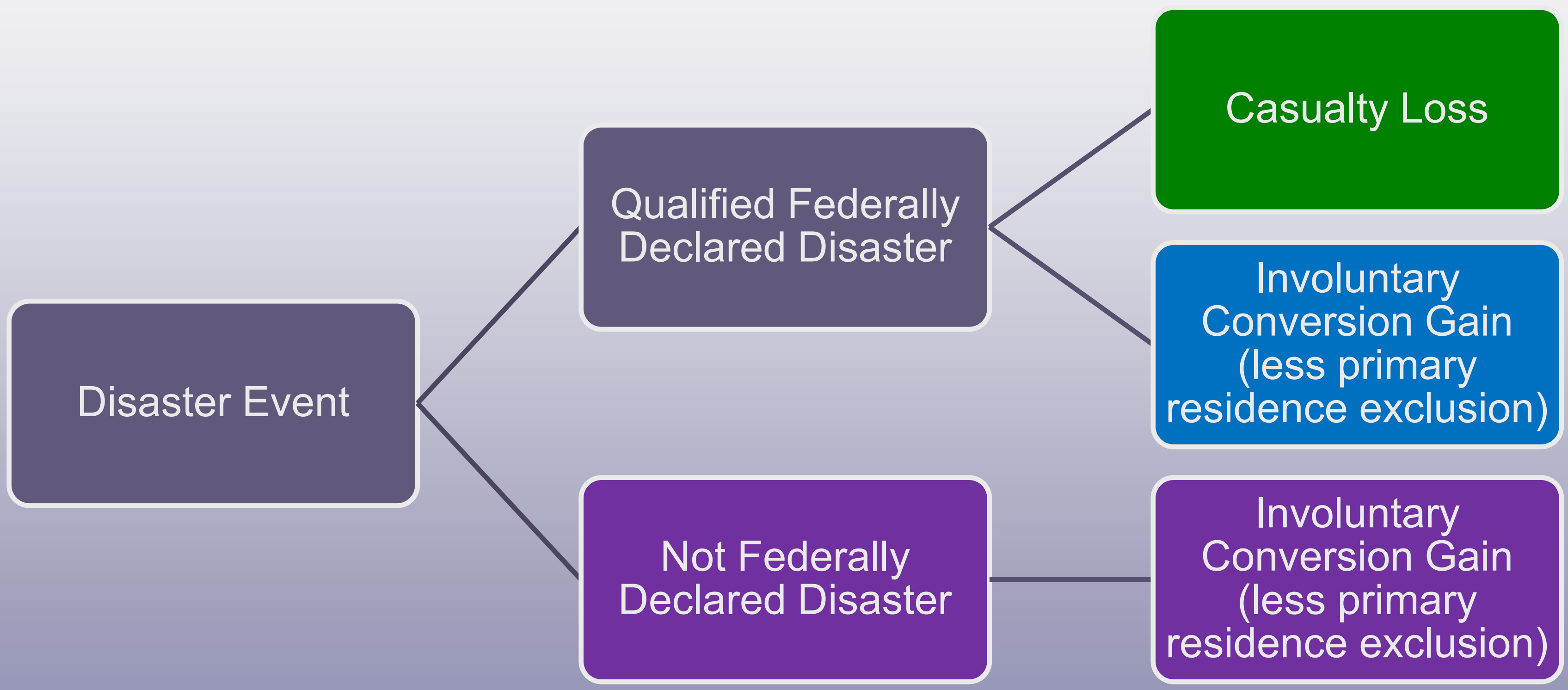
- "Purchase cost" or "inherited cost" is used, **not market value**
- Certain upgrades and additions can add to the Cost Basis
- "Integral nature" rule for personal use real estate (land, fences, home combined) can accelerate or be combined and added to your Cost Basis

If I'm underinsured, do I automatically have a loss for tax purposes?

- No, because you may have actually had a Gain (in the IRS's view) if you paid less for your home than the amount of your dwelling claim payment
- Your fire needs a Federal Disaster Declaration DR for you to be able to claim a Casualty Loss on your tax return
- Your insurance loss is calculated differently than your dwelling's "Cost Basis" to determine a "Casualty Loss"
- You may be subject to a Gain if your insurance proceeds/payments are greater than the Cost Basis of your property
- There are ways to "offset" and/or "convert" these Gains

DO I HAVE AN INVOLUNTARY CONVERSION GAIN OR CASUALTY LOSS?

Path to a Casualty Loss (primary residence)



Form 4684 Scenarios

Case:		A1	A2	A3	A4
Cost Basis	2	176	176	176	126
Insurance	3	30	150	150	150
Gain	4	-	-	-	24
Value before loss	5	130	130	300	
Value after loss	6	0	0	120	
Loss – (Economic) Line 5 less line 6	7	130	130	180	
Loss– smaller of line 2 or line 7	8	130	130	176	
Subtract line 3 from line 8, if zero or less, enter zero -LOSS	9	100	-0-	26	

Do I have a Casualty Loss?

Probably not, it is very rare that this is established and documented

Other provisions of the disaster tax code can be of assistance in reducing any potential tax burden – good news, not bad

A personal Casualty Loss is the lesser of

- The Cost Basis of the damaged or destroyed property reduced by all insurance reimbursements, payments and proceeds OR
- The decline in “Fair Market Value” (FMV) using before and after the casualty reduced by all insurance reimbursements, payments and proceeds

What about Form 4684?

- If you don’t have a Casualty Loss, then you don’t file Form 4684
- While this is the only form the IRS provides for disaster taxes, Publication 547 explains that if you have a Gain, you must provide a statement attached to tax return with all circumstances reported (15 items to be addressed)

In other words, this area is so complex that the IRS cannot even provide a form for reporting

Disaster Casualty Loss reporting

			A
2	Cost or other basis of each property . . .	2	421,801
3	Insurance or other reimbursement (whether or not you filed a claim) (see instructions)	3	103,555
	Note: *If line 2 is **more** than line 3, skip line 4.*		
4	Gain from casualty or theft. If line 3 is **more** than line 2, enter the difference here and skip lines 5 through 9 for that column. See instructions if line 3 includes insurance or other reimbursement you did not claim, or you received payment for your loss in a later tax year.	4	
5	Fair market value **before** casualty or theft	5	775,000
6	Fair market value **after** casualty or theft.	6	100,000
7	Subtract line 6 from line 5.	7	675,000
8	Enter the **smaller** of line 2 or line 7	8	421,801
9	Subtract ln 3 from ln 8. If zero or less, enter -0-. .	9	318,246

10 Casualty or theft loss. Add the amounts on line 9 in columns A throu

How to substantiate a Casualty Loss?

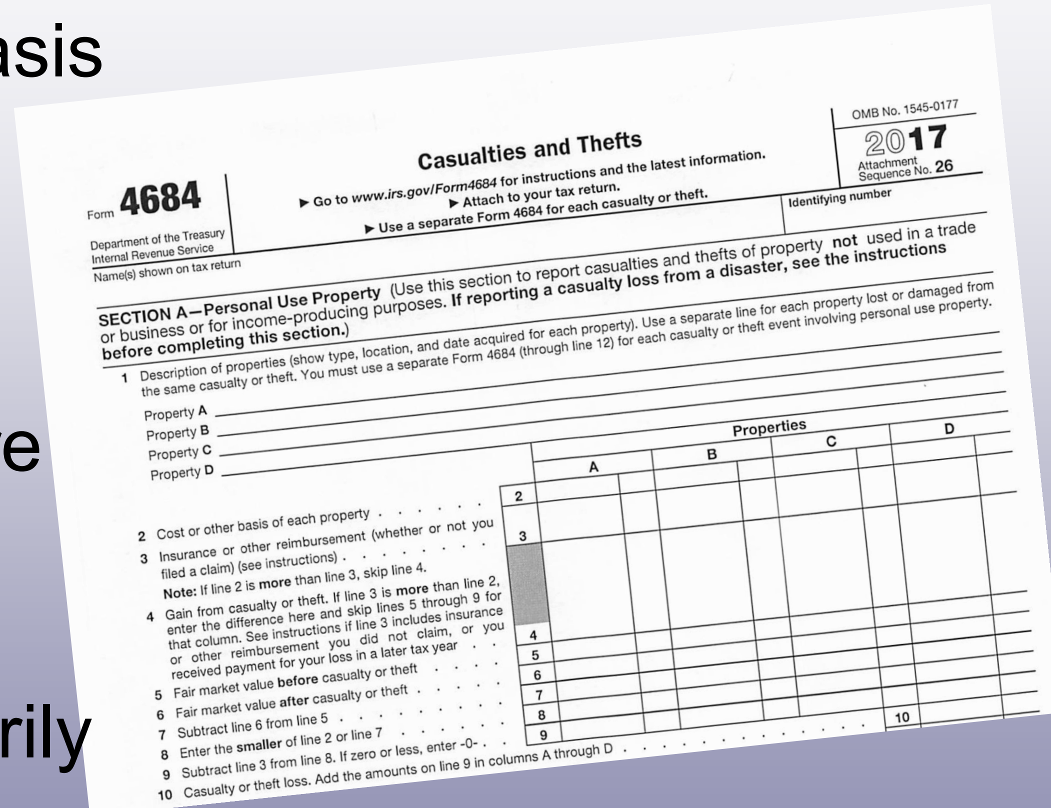
- Similar to what is required for insurance companies
- Must be able to show the following:
  - Type of loss and date that it occurred
  - Loss was a direct result of the casualty
  - Proof you owned the property, or, for leased property, you were contractually liable for the damage
  - Whether a claim for reimbursement exists for which there is a reasonable expectation for recovery
  - Documented evidence to support the claimed loss

Determining Amount of Loss

- Appraisal method
- Cost of repairs method
  - Subsequent receipts
- “Safe Harbor” computations
- Year to deduct – Loss sustained or prior year
- Loss cannot exceed Cost Basis

What information is needed to report a Casualty Loss?

- Cost Basis or other basis of each property
- Insurance or other reimbursement
- FMV of property before casualty
- FMV of property after casualty (not necessarily zero if completely destroyed since land remains)


Form 4684
Department of the Treasury
Internal Revenue Service

Casualties and Thefts

▶ Go to *www.irs.gov/Form4684* for instructions and the latest information.
▶ Attach to your tax return.
▶ Use a separate Form 4684 for each casualty or theft.

OMB No. 1545-0177
2017
Attachment Sequence No. 26

Name(s) shown on tax return | Identifying number

SECTION A—Personal Use Property (Use this section to report casualties and thefts of property **not** used in a trade or business or for income-producing purposes. **If reporting a casualty loss from a disaster, see the instructions before completing this section.**)

1 Description of properties (show type, location, and date acquired for each property). Use a separate line for each property lost or damaged from the same casualty or theft. You must use a separate Form 4684 (through line 12) for each casualty or theft event involving personal use property.

Property **A**
Property **B**
Property **C**
Property **D**

		Properties A	B	C	D
2 Cost or other basis of each property	2				
3 Insurance or other reimbursement (whether or not you filed a claim) (see instructions)	3				
Note: If line 2 is **more** than line 3, skip line 4.					
4 Gain from casualty or theft. If line 3 is **more** than line 2, enter the difference here and skip lines 5 through 9 for that column. See instructions if line 3 includes insurance or other reimbursement you did not claim, or you received payment for your loss in a later tax year	4				
5 Fair market value **before** casualty or theft	5				
6 Fair market value **after** casualty or theft	6				
7 Subtract line 6 from line 5	7				
8 Enter the **smaller** of line 2 or line 7	8				
9 Subtract line 3 from line 8. If zero or less, enter -0-	9				
10 Casualty or theft loss. Add the amounts on line 9 in columns A through D	10				

What to know about reporting

- Gain on unscheduled property – Gain is not taxable and no tax reporting/disclosure necessary
- Gain on scheduled property (combined with Real Property cost and proceeds) not replaced
- If reimbursements for business property or personal residence are not received until the year following the disaster in a Gain situation and there is no intention to reinvest, report in the year reimbursement is received

Qualified Federally Declared Disaster (DR) Casualty Loss

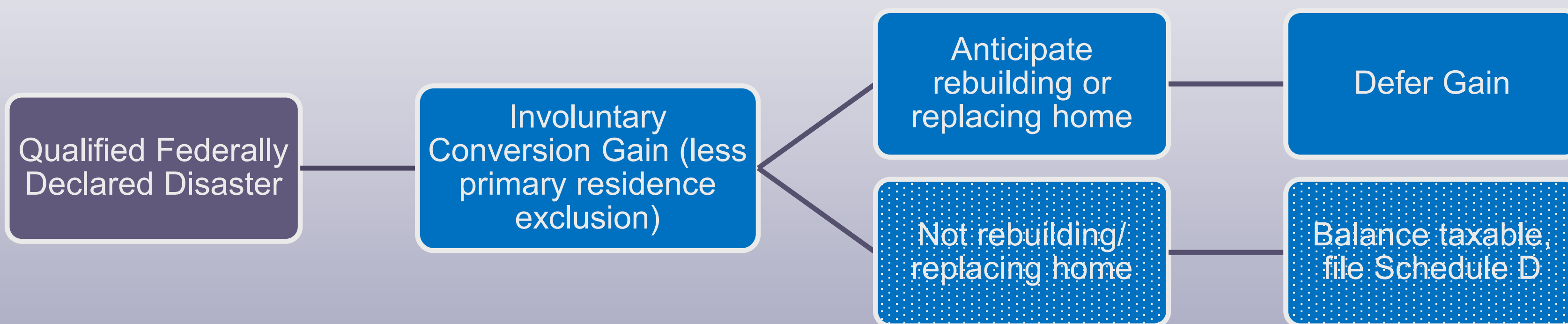
Qualified Federally Declared Disaster → Casualty Loss → File Form 4864

INVOLUNTARY CONVERSION GAIN

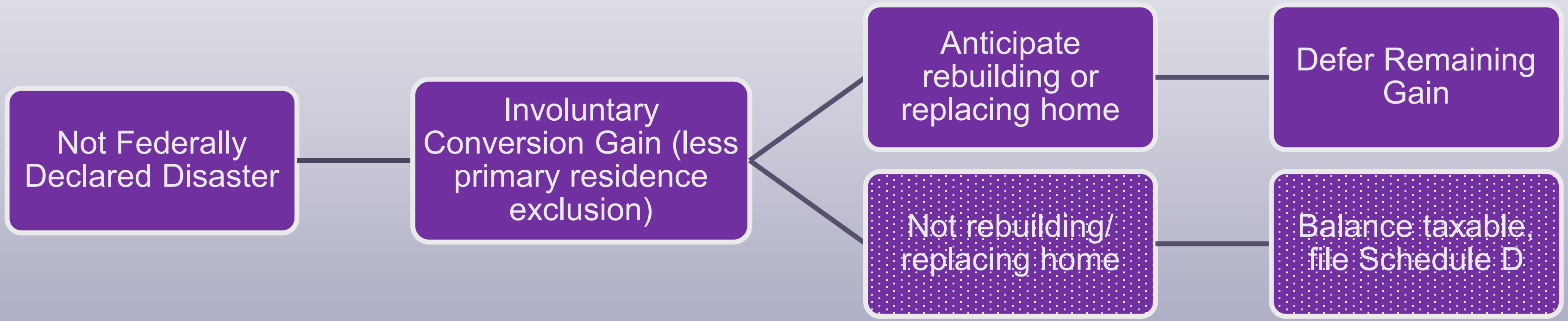
Do I have an Involuntary Conversion Gain?

- It is very possible, especially if your home was purchased many years ago and values have risen
- You can have a Gain, even if underinsured
- IRS regulations provide help to “offset” or “defer” Gains from “Involuntary Conversions”
- There are ways that you can reduce the taxable Gain while following the regulations

Qualified Federally Declared Disaster (DR) Involuntary Conversion Gain



NOT Federally Declared Disaster (DR) Involuntary Conversion Gain



If I have a Gain, can I defer it ?

- An Involuntary Conversion Gain may occur if payments/reimbursements exceed the Cost Basis of the property
- For personal, primary residences, it may be possible to utilize an Exclusion to offset the gain under sale of personal residence rules (IRC Section 121)
- It is possible to defer the Gain if reimbursements are reinvested in rebuilding home or to acquire a replacement home or homes within four years if in a Federal Disaster Declaration (DR) or 2 years if it is not a primary residence (runs from end of first year you have a Gain, NOT from date of fire)

What are the rules for using the primary residence Exclusion (IRC 121)?

- You may exclude up to $250,000 per individual or $500,000 per married couple of an Involuntary Conversion Gain on a personal use primary residence
  - "Complete Destruction"
  - "Unforeseen Circumstances"
  - "Modified" General Rules
- Must have been your personal residence 2 out of the last 5 years (pro-rata exclusion amount if less than 2 years)

Involuntary Conversion (IRC 121)

Principal residence was purchased for $150,000, with $25,000 subsequently spent on improvements. The home was destroyed and, instead of rebuilding, the taxpayer purchased a new home for $275,000 and retained the lot

Insurance proceeds	$ 800,000
Basis of principal residence destroyed	(175,000)
Realized gain	$ 625,000
Insurance proceeds	$ 800,000
Principal residence exclusion (MFJ)	(500,000)
Proceeds realized from involuntary conversion	$ 300,000

Proceeds realized from involuntary conversion	$ 300,000	
Basis of principal residence destroyed	(175,000)	
Realized gain on involuntary conversion	$ 125,000	(A)
Proceeds realized from involuntary conversion	$ 300,000	
Cost of new principal residence	(275,000)	
Recognized gain	$ 25,000	(B)
Deferred gain (A -B)	$ 100,000	
Cost of new principal residence	$ 275,000	
Less deferred gain	(100,000)	
Basis in replacement property	$ 175,000	

Gain of $25,000 is taxable in the year the last $25,000 of insurance proceeds is received

How long do you have to replace property to use the tax exclusions (IRC 121) on Involuntary Conversion Gain?

- Deadline is four (4) years for primary, personal residence in DR
- Deadline is two (2) years for all others
- Extensions may be available and must be filed

Note: Replacement period time limits of the 2 or 4 years from the date the *proceeds are received* must be followed or formally extended

Can I buy multiple properties to offset an Involuntary Conversion Gain?

- Buying multiple, smaller properties
- There is no limit on the number of “replacement properties” to avoid an Involuntary Conversion Gain
- Must be “similar or related”
  - Any personal use real estate generally qualifies
- Acquisition of “replacement contents” (not necessarily identical) also counts
- Replacement period time limits must be followed or formally extended

If I sell my lot, will the proceeds be taxable?

The sale of the residual land can, in most cases, be treated the same as if it is proceeds received from insurance

It will likely be substantially all Gain

If the $250,000/$500,000 Exclusion has not been fully used prior to the sale, it can be applied to the land sale, but only if the sale is closed within 2 years of the date of the loss

Reporting an Involuntary Conversion Deferred Gain

- Reporting Is required annually detailing the overall and current status of the reimbursement process, the replacement / reinvestment process as well as other data and information

- Accuracy and completeness of this reporting is the key to communicating with the IRS and state tax offices in order to meet all requirements. No pre-printed form is provided by the IRS

- Reports are part of the regular income tax return and are included starting in the year of the loss and end upon the completion of the replacement process

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OTHER CONSIDERATIONS

What are your circumstances?

Rental property?

Second home?

Number of replacement properties?

Trust?

Lot sale?

Lawsuit settlement?

Divorce or death?

Change of use?

Business loss and taxes?

Which payments MAY be taxable by IRS?

For those impacted by a disaster loss regardless of disaster declaration, taxable reimbursements will include:

- Unemployment compensation
- Payments for real estate are treated the same as if they are proceeds paid by the insurance company
- Some ALE insurance proceeds, if used to purchase an asset rather than to pay for temporary living expenses
- Some insurance proceeds related to contents, also contents in a second home, even if a DR
- Lawsuit proceeds, depends on what proceeds are for, the written terms of the settlement/disposition of the lawsuit are what determines whether proceeds are taxable. This is a complex analysis beyond the basics of the Webinar

Which payments are not considered taxable by the IRS?

For those impacted by a disaster loss regardless of declaration, non-taxable reimbursements may include:

- Payments for ALE (to the extent they are being used to pay for temporary living expenses), including insurance proceeds and FEMA payments
- Payments from social welfare agencies, charitable organizations, and in-kind services such as free meals, medical supplies, and shelters
- FEMA payments under authority of Code Section 139

Tax treatment of funds for ALE

- In all cases, including a DR, insurance proceeds for ALE and other funds received for temporary rent are not taxable to the extent that they are used toward actual temporary/additional living costs (expenses incurred after the event, not part of the disaster itself)
- Not part of “Casualty Loss” calculations
- Excess ALE insurance proceeds are taxable in the year taxpayer no longer incurs additional living costs
- Out of pocket payments for ALE that insurance did not cover are not deductible

HOWEVER,…

Purchase of a temporary home/RV (Real Property) with ALE proceeds

The purchase of temporary housing is not considered an Additional Living Expense (ALE). The acquisition of a Capital Asset (Real Property) results in remaining ALE proceeds becoming taxable

- The temporary residence may be treated as part of the replacement property. This will spread the deferred gain over more properties. If you reside in the temporary residence for at least two years and sell it to move into the permanent home, you can apply the $250,000/$500,000 Exclusion, eliminating allocated deferred gain
- Once you move into the Capital Asset you purchased as a temporary residence, you are no longer incurring temporary living costs/ALE since you are living in your Capital Asset. Whatever is left over becomes taxable at that point
- What if I do a lease/purchase agreement, or buy a temporary home through my business and lease it to myself?

What about legal / litigation proceeds?

- Depends on what proceeds are for, the written terms of the settlement/disposition of the lawsuit are what determines whether proceeds are taxable
  - Generally, non-physical injury claims that align with Real Property, ALE, and Contents should be treated in same manner as insurance reimbursements, so could be considered taxable (goes into your calculations for loss/gain)
  - Emotional distress and personal loss of income are taxable (on the gross amount, before legal fees; may be a state deduction for legal fees, no federal starting in 2018)
  - Compensation for medical care and bodily injury are not taxable
  - Rental property loss of income, you can deduct the legal fees as ordinary, necessary business expense (like mortgage interest)

It can take years for these actions to play out to a final outcome

Are business-related losses taxed differently than personal losses?

Gain on Involuntary Conversion calculation is similar to personal property with the following differences:

- Land is not included (unless land is sold due to it no longer being economically viable to owner)
- For complete destruction, no appraisals are needed
- No exclusion on Gain available
- Deduction not limited by 10% of AGI and $100
- Only consider adjusted basis in computing Gain or loss, not change in FMV
- Loss must be substantiated, similar to individual losses
  - inventory

Can I defer a Gain for a business Involuntary Conversion?

- If the Gain results from proceeds in excess of Cost Basis for your business, you treat the reimbursements as sales proceeds
- You have two years after realizing a Gain to reinvest in a property similar or related in service, or use in repairs/rebuilding the damaged/destroyed property

Note: Federal Disaster Declaration matters

Tax implications from losing a "second home"

- For vacation/second homes, no Exclusion available. You have 2 years to replace beginning calendar year when the total proceeds exceed the Cost Basis of the property; if you have good reasons, you can ask the IRS for an extension, one year at a time
- Combine the land, landscaping, building improvements, building itself – all one integral unit/one number
- Unlike primary residence, Contents proceeds are subject to regular recovery rules (have to determine Cost Basis and document insurance proceeds)

Tax implications from losing a rental property

- Rentals are considered investment property
- No loss of rental income, you just don't pay taxes on the rental income you didn't receive
- If not insured, most likely have a Casualty Loss
- Have rental property's depreciation schedule from previous tax returns to use in tax calculations –
  - identify items lost (since land is not lost, not part of Casualty Loss)
  - Landscaping, building – becomes basis for determining Loss
- Loss is simply adjusted basis of property at time of disaster (potentially skip before/after appraisals)

What about timber / lumber losses?

If land was zoned Timber Production, the value of the trees (for lumber) most likely had increased. However, homeowners insurance will not cover the timber loss (not insured in policy)

- Need to determine appraised value of property overall (which includes the trees) before and after disaster
- Cost to remove trees post-fire cannot be calculated into the Cost Basis

What about taxes and partial loss?

- Since primary residence itself was not destroyed, $250,000/$500,000 Exclusion not available
- If insurance proceeds were reasonable, it may still be less than Cost Basis so you probably don't have an Involuntary Conversion Gain
- Do you have a Casualty Loss?   It depends, start w/your Cost Basis and insurance proceeds
  - Example: Other structures/guest home destroyed:
    - Cost Basis for entire property pre-disaster - $775,000
    - Insurance proceeds for structure destroyed – $103,000
    - Cost Basis post-disaster - $575,000
    - $200,000 decrease, potential “Loss”
    - Subtract insurance proceeds ($103,000) from decrease in Cost Basis ($200,00) for Casualty Loss of $97,000

What about debris removal?

- While insurance proceeds may be paid directly to FEMA (if part of govt coordinated program), debris removal payments will be reported as your claim proceeds; it also becomes money you spent/replacement cost
- If sale lot, net proceeds after commission will be taxable and you can subtract the expenses you incurred (treated as investment in the lot) off the net sale of lot
- Sale of lot may or may not be covered under 121 exclusion

Do I want/need professional help?

- Adhering to time limits, allowances established by the Tax Code, and reporting are extremely important to protect your resources
- Failing to report a disaster loss event on a tax return could result in totally avoidable penalties and loss of valuable tax opportunities
- It is difficult to correctly calculate and successfully claim a “Casualty Loss” / Reporting an ”Involuntary Conversion” is even mor difficult
- Changing rules and complexity often make it wise to seek advice from a qualified, vetted expert

➢ **https://uphelp.org/recovery/professional-help-directory/**

➢ **https://uphelp.org/claim-guidance-publications/hiring-professional-help-for-an-insurance-claim/**

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Stay informed – Sign UP

To be added to our mailing list for notices of future events and updated guidance:

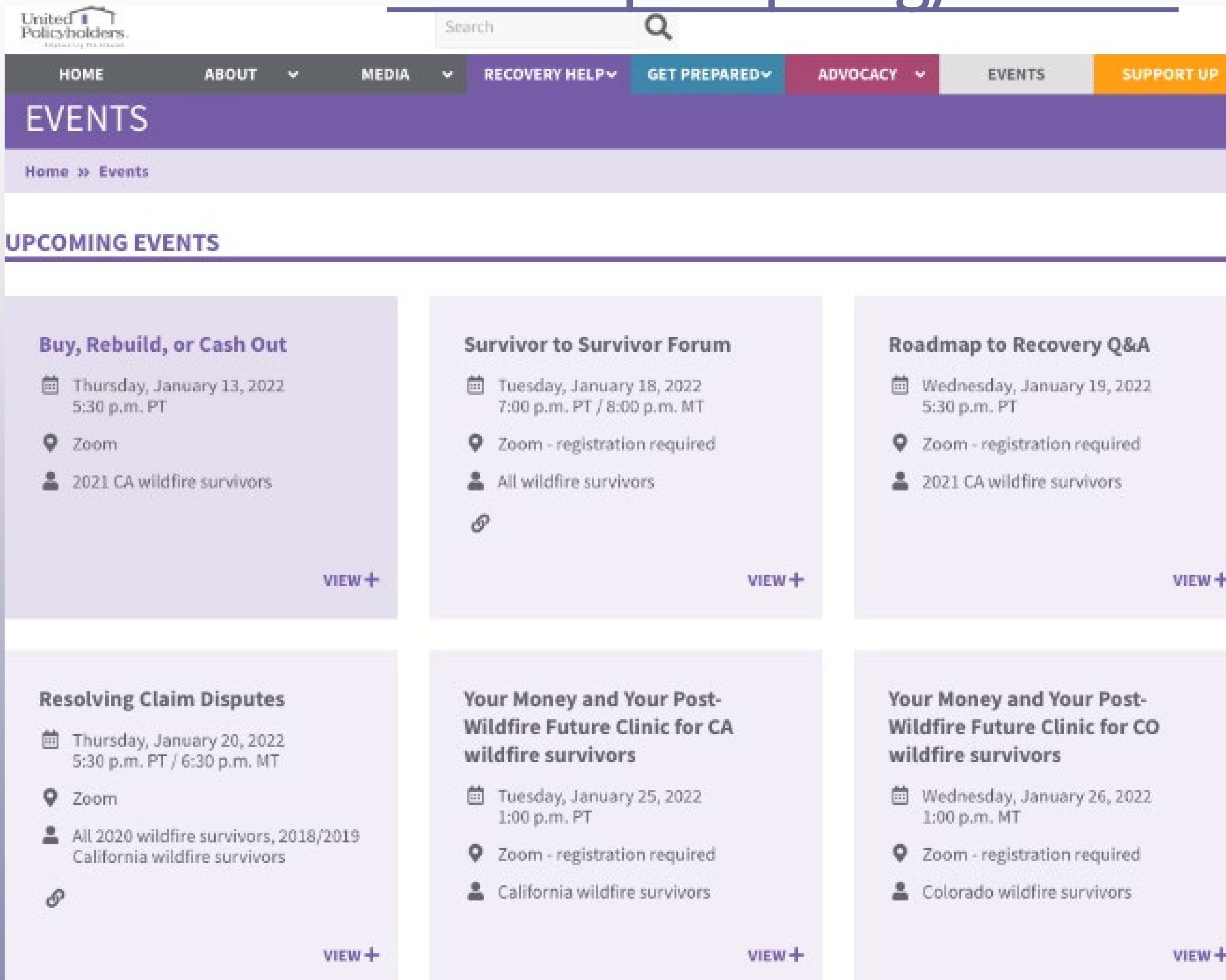
- Encourage friends to sign up: **www.uphelp.org/signup**
- To request a copy of today's slides or video, email: **info@uphelp.org**

Stay connected to other disaster survivors – S2S Forums

- Great source of information about:
  - Insurance and rebuilding
  - Negotiation and financial strategies
  - Referrals and warnings re: professionals
- Important source of emotional support
  - No one else understands your challenges and emotions like another survivor

➢ Find upcoming Survivor 2 Survivor Forums and register at: http://www.uphelp.org/events

Upcoming Roadmap to Recovery® events
www.uphelp.org/events



Register for upcoming events. View recordings of past events and related resources

Upcoming Roadmap to Recovery® Events

Survivor to Survivor Forums
Tuesday, March 1, 8:00 p.m. MT (*www.uphelp.org/mar1*)
and
Tuesday, March 15, 8:00 p.m. MT (*www.uphelp.org/mar15*)

Roadmap to Recovery® Q&A for CO 2021 wildfire survivors
Wednesday, March 2, 6:00 p.m. MT
Register: www.uphelp.org/mar2 (submit your question: www.uphelp.org/r2rhelp_marshall)

Dealing with Underinsurance for CO and CA 2021 wildfire survivors
Wednesday, March 9, 5:00 p.m. PT / 6:00 p.m. MT
Register: www.uphelp.org/mar9

Collecting Every Dime for 2020 wildfire survivors
Wednesday, March 16, 5:00 p.m. PT / 6:00 p.m. MT
Register: www.uphelp.org/mar9

Navigating Your Contents Claim for CO 2021 wildfire survivors
Wednesday, March 30, 6:00 p.m. MT
Register: www.uphelp.org/mar30

www.uphelp.org/events
Register for upcoming events. View recordings of past events and related resources.

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