Taxing Matters
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

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Disaster Insurance Help Libraries
uphelp.org/recovery/disaster-recovery-help

- State 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
Marshall Fire survivors

Please take a moment to complete our Marshall Fire One-Year Survey

www.uphelp.org/survey

When you complete our surveys, you help UP be an even more effective advocate for disaster survivors and a strong voice for fair insurance practices. Thank you!
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

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Schreiber and Schreiber, Certified Public Accountants

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Trapani, Certified Public Accountant
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- Frequently teaches courses for disaster-impacted households and businesses
- Partner, Schreiber and Schreiber, Certified Public Accountants
- Recognized by LCPA and AICPA for sharing his knowledge to help CPAs, businesses, and taxpayers through tax-related tasks following disasters
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John Trapani, CPA

- Licensed in California and Colorado
- Disaster survivor
- 30 years of disaster tax reporting
- For 30 years, presents educational seminars to fellow professional
- Has assisted hundreds of taxpayers report the tax reporting requirements of disasters for 30 years
- [www.trapanicpa.com](http://www.trapanicpa.com)
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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

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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

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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?
• Will my insurance company send me a tax document? (Question - Heather, NM)
• 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/
We reported our "net" insurance proceeds from loss of our home the 2020 Glass Fire in our 2020 tax return, after subtracting estimated rebuilding costs. We very much underestimated what our rebuilding costs would be and consequently paid capital gains on too much of our insurance payout. I am concerned about filing an amended return as I really don't want to be audited.

Although I have most receipts for the rebuilding, I do not have receipts for the cost of improvements we made on our home before it burned (as those records burned)- but we had a reasonable estimation of those costs to calculate the basis of our original home. Will the IRS want to see those receipts? They did not ask for them when we filed the return in 2020.
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

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 2022 losses, you have until October 15, 2023, to elect if you would like to claim the loss on an amended 2021 return or simply claim the loss on your 2022 return assuming the loss is settled in 2022
Question – Lynn, CA

We were a total loss in the 2020 Caldor Fire. Our insurance issued us 2 checks in Oct and Nov of 2021. We were not cleared by Cal OES to rebuild until Aug 2022. We decided not to rebuild.

When are capital gains taxes due to IRS and Franchise Tax? Since we weren’t notified until Aug 2022 that we could rebuild, does that change the date when capital gains taxes are due?

If we were to buy a replacement, by what date do we have to do it by?
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:


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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 – the Tax Code has been 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

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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 2022 return (already extended by IRS for your disaster to May 15th, 2023 for taxpayers in 2022 disaster 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 of all conversations, information
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

• If you have an adjuster’s report/scope of loss, make sure the details are correct (room dimensions, SF, finishes, fixtures)

• Include home improvements, additions and enhancements. Improvements also include landscaping, trees, other structures, not just remodeling

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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](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 these as if these were paid for the Real Property replacement, which has the net effect of negating some deferred Gain from Real Property 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.fema.gov/disasters/disaster-declarations)

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

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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
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
Our accountant wants to know the "basis" for our lost home. It was owner-built over a 20-year period (1970 to 1990) paying cash as we went. How do we figure "basis" in our case? We are spending 100% of settlement monies and more to rebuild a home equivalent to what we lost.
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?
## Form 4684 Scenarios

<table>
<thead>
<tr>
<th>Case:</th>
<th>A1</th>
<th>A2</th>
<th>A3</th>
<th>A4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cost Basis</strong></td>
<td>2</td>
<td>176</td>
<td>176</td>
<td>176</td>
</tr>
<tr>
<td><strong>Insurance</strong></td>
<td>3</td>
<td>30</td>
<td>150</td>
<td>150</td>
</tr>
<tr>
<td><strong>Gain</strong></td>
<td>4</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Value before loss</strong></td>
<td>5</td>
<td>130</td>
<td>130</td>
<td>300</td>
</tr>
<tr>
<td><strong>Value after loss</strong></td>
<td>6</td>
<td>0</td>
<td>0</td>
<td>120</td>
</tr>
<tr>
<td><strong>Loss – (Economic)</strong></td>
<td>7</td>
<td>130</td>
<td>130</td>
<td>180</td>
</tr>
<tr>
<td>Line 5 less line 6</td>
<td>8</td>
<td>130</td>
<td>130</td>
<td>176</td>
</tr>
<tr>
<td><strong>Loss – smaller of line 2 or line 7</strong></td>
<td>9</td>
<td>100</td>
<td>-0-</td>
<td>26</td>
</tr>
</tbody>
</table>

Subtract line 3 from line 8, if zero or less, enter zero - LOSS
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 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

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Cost or other basis of each property</td>
<td>421,801</td>
</tr>
<tr>
<td>3</td>
<td>Insurance or other reimbursement (whether or not you filed a claim) (see instructions)</td>
<td>103,555</td>
</tr>
<tr>
<td>4</td>
<td>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.</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Fair market value before casualty or theft</td>
<td>775,000</td>
</tr>
<tr>
<td>6</td>
<td>Fair market value after casualty or theft</td>
<td>100,000</td>
</tr>
<tr>
<td>7</td>
<td>Subtract line 6 from line 5</td>
<td>675,000</td>
</tr>
<tr>
<td>8</td>
<td>Enter the smaller of line 2 or line 7</td>
<td>421,801</td>
</tr>
<tr>
<td>9</td>
<td>Subtract line 3 from line 8. If zero or less, enter -0-</td>
<td>318,246</td>
</tr>
<tr>
<td>10</td>
<td>Casualty or theft loss. Add the amounts on line 9 in columns A through</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Enter the smaller of line 10 or 0100</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** If line 2 is more than line 3, skip line 4.
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
  - Question – Karen, CO where to find qualified appraisers
- 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)
What to know about reporting

• Gain on unscheduled property – Gain is not taxable and no tax reporting/disclosure necessary for primary personal residence in a federally declared disaster (DR)

• Proceeds on scheduled property is separate from unscheduled property and treated as if it were real property (added to cost basis of real property) and insurance proceeds get added to real property proceeds (treated as a single item of property)

• 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  Casuality Loss  File Form 4864
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

- Qualified Federally Declared Disaster
- Involuntary Conversion Gain (less primary residence exclusion)
  - Anticipate rebuilding or replacing home
  - Not rebuilding/replacing home
    - Defer Gain
    - Balance taxable, file Schedule D

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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 4 years (not from the event but end of first year you first realize a Gain) 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 disaster).

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Question – Lynn, CO

I plan to settle with my insurance company in 2023 with a replacement property. I will plan to sell my lot that is located in the 2021 Marshall Fire area. As it relates to tax exclusion $500k (filing joint) what should I do to maximize this tax benefit for dwelling and lot?
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)
Question – Barbara, CO

After losing our home of 23 years, we have decided to rebuild elsewhere. After reading Publication 547, I understand that - because we are in a Federally Declared Disaster Area - we can postpone paying taxes on the gain of our burned home if we build a home that is greater in value than our burned home's cost basis (insurance proceeds + what we sell the land for).

Once we declare a replacement home, we cannot substitute a later home to again postpone gain. Is this correct?
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.

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

Involuntary Conversion (IRC 121)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insurance proceeds</td>
<td>$800,000</td>
</tr>
<tr>
<td>Basis of principal residence destroyed</td>
<td>(175,000)</td>
</tr>
<tr>
<td>Realized gain</td>
<td>$625,000</td>
</tr>
<tr>
<td>Proceeds realized from involuntary conversion</td>
<td>$300,000</td>
</tr>
<tr>
<td>Basis of principal residence destroyed</td>
<td>(175,000)</td>
</tr>
<tr>
<td>Realized gain on involuntary conversion</td>
<td>$125,000</td>
</tr>
<tr>
<td>Cost of new principal residence</td>
<td>(275,000)</td>
</tr>
<tr>
<td>Recognized gain</td>
<td>$25,000</td>
</tr>
<tr>
<td>Deferred gain (A - B)</td>
<td>$100,000</td>
</tr>
<tr>
<td>Cost of new principal residence</td>
<td>$275,000</td>
</tr>
<tr>
<td>Less deferred gain</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Basis in replacement property</td>
<td>$175,000</td>
</tr>
</tbody>
</table>
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:** not from the event but end of first year you first realize a Gain

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

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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
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?

These requires complex analysis and depends on what type of litigation. It can take years for these actions to play out to a final outcome

- 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)
Is the reporting business-related losses different than personal losses?

There is a different standard for qualified replacement property for business 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)

• No exclusion on Gain available

• Deduction not limited by 10% of AGI and $100

• Loss must be substantiated, similar to individual losses
  – Providing an inventory
  – Cost basis will be based on your depreciation schedule, computed up through the date or your event
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 proceeds to be reinvested.
- You have two years after realizing a Gain to reinvest or use in repairs/rebuilding the damaged/destroyed property.

Note: Federal Disaster Declaration allows a more lenient determination of qualified replacement property.
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)
The Caldor Fire in CA destroyed 177 cabins on Forest Service land and the FS is not expected to decide on rebuilding or not rebuilding until this summer, almost two years after the actual fire. Anyone with insurance who got a payout greater than the cost basis of their cabin will be subjected to capital gains at the end of this year (2 years plus the rest of the tax year since the fire) because of this delay and the short building season (May/June through October/November). By definition of the special use permits with the FS, these cannot be primary homes.

The tax code, 1033, talks about an extension of some sort, and since the government is actually preventing us from rebuilding it seems they should grant an extension. The question is how does one go about getting an extension?
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 with 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

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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

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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 more 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/recovery/professional-help-directory/)
Question, Tawnya, CO

I have a casualty gain to defer. I will not owe money from the gain because I will spend it all on my new build and it is less than $500k, so I can do a 1033 election. What is the worst thing that can happen if I file my own taxes?
We have not been able to find a good CPA versed in Federally Declared Disaster Area tax law. My plan is to file for an extension, and then after April 15, hopefully then I can find the right CPA to take me on. What's the best strategy if we cannot get a good CPA?

NOTE: We thought we had a good CPA last year, but after paying a bundle, she was terrible!
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To be added to our mailing list for notices of future events and updated guidance:

- Encourage friends to sign up: [www.uphelp.org/signup](http://www.uphelp.org/signup)
- To request a copy of today’s slides or video, email: [info@uphelp.org](mailto: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
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Wildfire resources and insurance information

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CALL US AT: 1 800 927 4357

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Contents Pricing Party for wildfire survivors

📅 Saturday, January 21, 2023
10:00 a.m. PT

📍 Zoom

👥 All wildfire survivors

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Register for upcoming events.
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Ask an Expert Forum
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• Write in your questions.
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