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From Ashes to Opportunity

Understanding Unique Tax Opportunities Within Federally Declared Disasters

By Steven Higgins, Financial Advisor, Registered Principal

As a local financial advisor with friends and clients that experienced loss as a result of the Marshall Fire,
I was motivated to seek opportunities to help people maximize their resources as the daunting expense of recovery threatened the financial security and goals for so many.

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My effort to find solutions revealed a significant opportunity with respect to the laws designed to assist those experiencing loss due to a federally declared disaster, like the Boulder County fires of 2021.

The IRS provides guidance for dealing with regular losses such as theft, water damage, fire, etc.

However, the rules change with respect to losses incurred during events that are declared by the President to be Federal Disasters.

THE MARSHALL FIRE IS SUCH AN EVENT.

> "By strategically utilizing the loss as a result of a federally declared disaster, a person may be able to offset income and tax associated with a ROTH IRA Conversion." *

On January 1, 2022, President Biden approved the Major Disaster Declaration for Colorado providing federal assistance for damage resulting from straight line winds and wildfires.

In addition to authorizing federal financial assistance, the declaration made it possible for those affected to utilize the qualifying disaster loss provisions outlined in IRS Publication 547, Casualties, Disasters, and Thefts. Important changes with respect to accounting for losses as a result of a federally declared disaster are the removal of the cap on the amount of losses that can be claimed and the absence of the requirement that losses must exceed 7.5% of a person's adjusted gross income.

Each situation is unique and I understand that there has been a lot of trauma experienced by families.

***My intention is to raise awareness about an opportunity, not to give broad tax advice.**

When an event is declared a Federal Disaster, the IRS provides an alternative set of rules with respect to how tax payers account for losses that result from the disaster. These rules provide additional financial relief for those affected. With thoughtful planning, individuals and families can takes steps to save significant money on taxes, as well as strengthen the tax efficiency of their assets for years to come.

The following is an overview of some of the opportunities that may serve as a benefit for people affected by the Boulder County fires of 2021. Every situation is unique and I recommend that each person consult professional advisors to determine what is best for themselves.

On December 30th, 2021, the wind blew relentlessly across the Marshall Mesa in Boulder County. The hurricane-force wind exacerbated the abnormally dry conditions that winter. The fire started east of the open space, and as the gusts encouraged the spread of the fire, the tragedy of the Marshall Fire began to unfold.

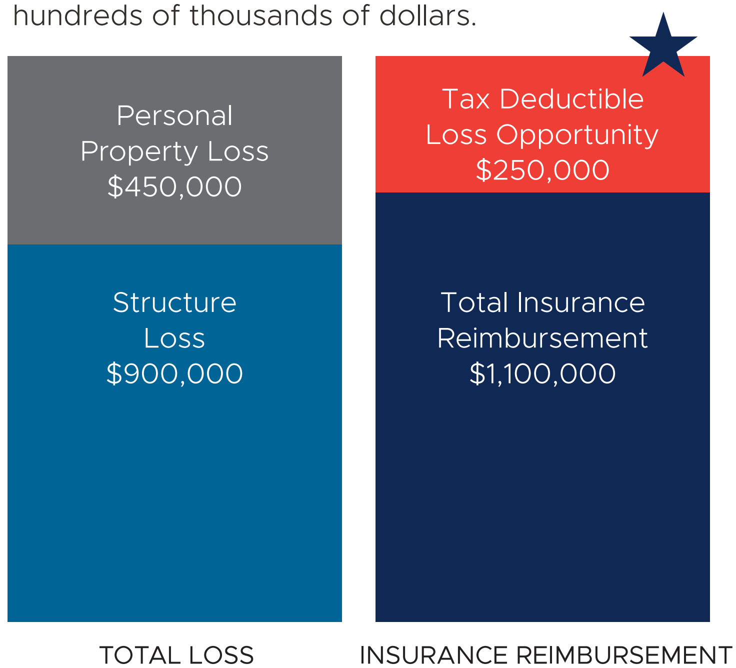
By days end more than a thousand homes were completely destroyed. The entirety of families' shelter, safety, and belongings were – almost instantly – lost. By sunrise the following morning, snow flakes began to fall on the still smoldering embers and as the year was coming to close, the challenge of recovering from a disaster of such magnitude was just beginning. There were countless frustrations lying ahead for so many families and even now, as newly built homes in various stages of completion line the streets of neighborhoods once engulfed by flames, hurdles remain as those affected fight and negotiate with insurance companies to be made whole.

So, in that spirit, the following are highlights of what may be an opportunity for you, your family, or a neighbor.

• Losses in excess of insurance reimbursements can be deducted against ordinary income.

While regular losses are capped and must exceed 7.5% of a person's adjusted gross income, this is not the case with losses that are incurred as a result of a federally declared disaster. The loss would be roughly calculated by adding the total loss of property (your home + personal property) and then subtracting the amount of insurance proceeds received.

Because of the recent increase in home values and post pandemic inflation driving up replacement and building costs, many people found themselves to be significantly under insured. For the Boulder County fires, it is common for the gap between total property losses and insurance proceeds to be in the hundreds of thousands of dollars.



*Hypothetical Loss Experience.
Individual experience and outcomes are unique and will be variable.

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• The IRS guidance states that a tax filer can claim the loss in the year that it is reasonably believed that there will be no more insurance reimbursements expected.

The timing of your claim should be discussed with your tax preparer. For many, their homes are nearing completion and insurance claims and settlements have been completed. With final clarity on the gap between losses and reimbursement, it is likely that 2024 will be the appropriate year to claim the disaster loss for many. If the appropriate year to claim the loss was a previous year, it may be well worth it to amend a previous year's tax return.

• If your losses as result of a declared disaster exceed your income in the year in which you claim the loss, you are able to carry the Net Operating Loss forward to subsequent years.

Keep in mind, this loss offsets ordinary income. It is not a capital loss.

• Proper financial and tax planning can help you make the most of your losses.

This is where a person can really make a difference for their financial future.

*By strategically utilizing the loss as a result of a federally declared disaster, a person may be able to offset income and tax associated with a **ROTH IRA Conversion.** A **Roth IRA Conversion** is the practice of converting assets accumulated in a traditional IRA, 401(k), or similar retirement account to a ROTH IRA. In a traditional IRA, the assets are accumulated pre-tax, grow tax free, and are taxed at ordinary income rates in retirement. In a ROTH IRA, the assets are accumulated after-tax, grow tax free, and are withdrawn tax-free in retirement. So, if a person can use their losses in excess of their insurance reimbursements to off-set the tax consequences of converting traditional IRA assets to ROTH IRA assets, they may be able to save hundreds of thousands of dollars in taxes and drastically improve the tax efficiency of their retirement income for the rest of their lives.

*This does not constitute a blanket recommendation. As with all recommendations, a persons individual goals and tax circumstances vary and individualized, professional advice is recommended. Contributions to a traditional IRA may be tax deductible in the contribution year, with current income tax due at withdrawal. Withdrawals prior to age 59 ½ may result in a 10% IRS penalty tax in addition to current income tax.

• Work with a qualified professional.

There is care that needs to be taken if you are considering this strategy. Timing is important and I absolutely recommend you seek the counsel of a tax professional.

If we can be of help to you, we would gladly work along side your tax preparer to consider this strategy. If you need a recommendation for a tax preparer, we can proved a referral. Tax planning is a core element of our service at Higgins and Schmidt Wealth Strategies, however we are not tax prepares. We believe working as a team with partner professionals is in the best interest of our clients and I hope we are able to help you make the most of what has been a very challenging situation. Federally declared disasters are not common and there is little in the way expertise on the matter in our community.

Please be thoughtful when considering advice.

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Steven Higgins
Financial Advisor, Principal

Allison Schmidt,
Financial Advisor, CFP®, CPA

Higgins & Schmidt Wealth Strategies is an SEC Registered Investment Advisory firm located in Denver.

My partner, Allison and I founded our firm in 2010.

Allison and I each have over 20 years of experience in our industry and have grown our team of professionals to serve individuals and families in the areas of financial planning, tax planning, and investment management.

We take great care to uphold our fiduciary responsibility and provide for an elevated client experience. At the core of our commitment to our clients is the care we take to understand their unique circumstances.

This event is an example of the level of care the we promise.

The Marshall Fire of 2021 was a disaster in so many ways and we felt compelled to help our affected clients move forward the best way possible.

We hope the work we have done for some can be extended to others and if we can even slightly lessen the financial burden assumed because of this tragedy, we would be well rewarded.

Next Steps

I encourage you to explore whether you can benefit from this strategy. Too many people are missing out on a major aspect of federal assistance provide for by the declaration of a federal disaster.

If you feel that you might be able to benefit from this opportunity, reach out to set up a time to discuss your personal situation. You may contact our Client Service Associate, Alexis Miley at **alexis@hswscolorado.com** or call 720-287-0918.

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We hope the information we provide leads to improved outcomes and if it's appropriate, we would appreciate the opportunity to be of service.

We look forward to meeting you.

Higgins & Schmidt Wealth Strategies
1934 Market Street Denver, CO 80202
HSWSColorado.com