

Income Tax Deduction for Timber Casualty Loss

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Timber damaged or destroyed by hurricane, fire, earthquake, ice, hail, tornado, high wind and other storms are “casualty losses” that may allow timberland owners to claim a deduction on their federal income tax returns. Yet the specific requirements on calculating the loss by the tax law and rules may result in low or no deductions being available in certain cases.

The cost of hiring professional forestry and/or appraisal services to establish the required tax data and records should be weighed with the potential tax savings before proceeding.

Determining the Amount of Casualty Loss

Deductible casualty loss for timber held for business or investment purpose is the smaller of the *adjusted basis of timber* and the *difference of the fair market value immediately before and after the casualty*. Salvage sale is reported separately.

An Example

A hurricane damaged your timber tract. Before the hurricane, the fair market value of the timber was \$10,000. But after the storm, the timber is worth only \$1,000. So the FMV loss of your timber is \$9,000 (\$10,000 - \$1,000). Assuming that the basis of the timber is 5,000. Then *the amount of casualty loss deduction is only \$5,000, not \$9,000.*

Calculating the Adjusted Basis

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The key for most cases is to figure out the “adjusted basis” of standing timber. Generally, the cost of a property is called “basis” in tax terms. “Adjusted basis” is the original basis reduced or added by adjustments over the term of ownership (such as new purchase or timber sale).

The original basis for:

- purchased timber property is the purchase price and related costs (such as legal fee and timber cruises).
- gifted timber property is the donor’s adjusted basis in most instances.

- inherited timber property is the *fair market value* (or alternative value if so elected) on the date of death (or alternative valuation date).

If you have not determined the basis of your timber at the time of acquisition, you may use the current volume, growth over the years, and timber price at the time of acquisition to establish it retroactively.

What You Need from Your Forester

To establish timber basis and appraise the fair market value loss of timber immediately before and after the casualty, consult a professional forester if necessary to determine the proper *timber volume* in thousand board feet, cords or tons and *timber prices*, as suggested by the IRS Timber Casualty Loss Audit Technique Guide.

“Single Identifiable Property” As the Measure

Treasury regulations requires that casualty loss is determined with respect to the “single identifiable property”. In the case of timber, it is normally the entire timber block owned by the taxpayer, not just the timber actually damaged or destroyed. For example, assume that you own 100 tons of hardwood sawtimber with a total basis of \$4,000 kept together in one place (account). A fire destroyed 20 tons. The adjusted basis for casualty loss determination in this case is \$4,000, not just \$800 (\$4,000 x 20 tons/100 tons).

Where to Report the Casualty Loss

All casualty losses are claimed first on Form 4684. For timber investment property, the loss is then entered into Schedule A of Form 1040. For timber business property, the loss is entered on Form 4797. Schedule D is used for gains if any (see below for salvage sale). Form T should also be prepared, although you may not be required to file (see filing instruction on who must file on Form T).

What If a Net Gain Is Realized

If you conduct a salvage sale, a taxable gain is realized when the salvage value exceeds the adjusted basis of damaged timber. But you may elect to postpone paying taxes on the gain if the proceeds is re-invested in timber such as forest planting, purchase of timberland and stock in the control of timber corporations.

Tax Pointers

Appraisal Fee and the Cost of Photo:

- Appraisal fees and the cost of taking photos are not part of the casualty loss deduction. They are part of deductible expenses claimed on itemized deductions (subject to 2% adjusted gross income limitation).

For property held for personal use:

- The casualty loss was further limited. The deduction, as calculated first as the smaller of the fair market value loss and

the adjusted basis, is then subject to \$100 reduction and 10% adjusted gross income limitation (aggregated with all casualties on personal property such as homes and autos) to get to the allowable casualty loss deduction.

- If you don't take itemized deduction, you will not be able to deduct a casualty loss on personal property.
- The \$100 reduction and the 10% adjusted gross income limitation were lifted for Hurricane Katrina, Rita, and Wilma, and Kansas storms taxpayers.

When to claim the loss:

- You can deduct a casualty loss only in the tax year in which the casualty occurred generally.
- However, for Presidentially declared disaster area, you may elect to apply the casualty loss in your prior year's tax return and thus avoid waiting to file the loss in the current year. But this should also be weighed with the current year's tax bracket and any expenses in amending prior year's tax return (if applicable).

Tips on Tax Records for Proof

- Gather information about the casualty (time, nature of the event and the area affected)
- Take photos as quickly as possible after the casualty
- Log the date, location and photographer
- Gather legal, insurance, and accounting papers from the court,

title company, the bank, or the insurance company to establish ownership and possible insurance claims if any

- Forest management records such as management plan
- Document hired services from professional foresters and/or appraisers

It is important that you have records that support your casualty loss deduction, but do not attach them to your return.

Recommended Readings

1. Forest Landowners' Guide to Federal Income Tax, Chapter 5 (Cost Considerations) and Chapter 6 (Income Considerations). You may purchase the 2001 edition from the U.S. Government Bookstore, First Union Plaza, Suite 120, 999 Peachtree Street, NE, Atlanta, GA 30309-3964. It's also available free

on-line by Google key words search using the book's title.

2. The IRS Timber Casualty Loss Audit Technique Guide, September 2005.

3. IRS publication 547, 548, 4492, 4492-A: These guides contain many casualty loss calculation examples,

which can be helpful for a general understanding of the casualty loss rules.

4. Tax Preparation Software. The software can be an effective tool for casualty loss calculation if you are interested in self-prepare your return, which can save your time over calculations and form selections.