Casualty Loss Deductions For Timber CLDFT101718

Forest landowners whose timber has been destroyed may be eligible to take a deduction for the loss on their federal income tax. The loss must be physical in nature and caused by an identifiable event or combination of events that has run its course. There are two types of losses from natural events.

Casualty losses are sudden, unexpected and unusual – as from a fire, tornado, storm, or hurricane. **Non-casualty losses** are not sudden but are unexpected and unusual – as from a severe insect attack, drought, or disease. Casualty and non-casualty loss deductions are available to all owners who hold timber to produce income as a business.

Allowed Deduction Losses may be deducted up to the adjusted basis of the timber lost. Basis is the cost of the timber on the property. It is either the cost allocated to the timber – not the land – when the tract was purchased, or the fair market value of the timber when the property was inherited, or the cost of reforestation when the tract was planted by the current owner. For casualty loss purposes, the IRS lets you use the basis of the 'single identifiable property,' which can be the number of board feet of timber, or the basis for all timber on a tract, or the basis for *all* timber owned by the landowner (not just the damaged timber).

Measuring Loss A deduction is allowed only if the damage renders the timber unfit for use, or results in it being sold for less value than it was appraised for prior to the storm. Claim as a loss the lesser of the difference in value before and after the casualty or the difference between the adjusted basis for the tract and the amount received from salvage, if the latter is less than basis. Reimbursements from insurance and other anticipated recovery must be deducted in computing the loss. In other words, basis less insurance equals casualty loss.

EXAMPLE 1: You own 50 acres of forestland carrying 200 MBF of young sawtimber. Your adjusted basis in the timber is $4000. A natural disaster damages 10 acres, destroying 25 MBF of timber, which was worth $6500 before the storm. You have no timber insurance and could not salvage. Your casualty loss deduction can be either the basis of the damaged tract (10/50 of $4000 or $800) or of the entire property ($4000), even though the timber was worth $6500.

Involuntary Conversion Income The salvage income from a casualty loss may be considered an 'involuntary conversion.' This income is considered capital gains and may be taxable. But if the salvage income is reinvested within two years into reforestation or the purchase of new timberland, the taxes owed are deferred until the new timber is sold.

EXAMPLE 2: You own 20 acres of natural regenerated pines, which had no basis. You were able to sell the timber, receiving $2000 in salvage value. The casualty loss would be the basis ($0). The timber salvage would be considered a $2000 capital gain. If you elect involuntary conversion and use that $2000 to site prepare and replant your trees, you will pay no taxes and the basis of the new stand will stay at $0. If you spend more than $2000 to replant, the basis will be the total cost less $2000. If you spend less than $2000, you will owe capital gains tax on the difference.

Document the Casualty Regardless of the use or intent for owning the property, it is necessary to document or show the type of casualty and when it occurred, and that you owned the property at the time of the damage. Photography is a very good way to document losses, and 'before and after' shots are especially useful in assisting appraisers with determination of fair market values. Keep newspaper clippings showing the existence of the disaster.

How to File Deduct a loss on your tax return for the year the loss occurs. Use Form 4684, Section B, to report either a casualty or non-casualty loss.

Amended Returns Casualty losses occurring from an event in an area declared eligible for federal assistance under the Disaster Relief and Emergency Assistance Act may be deducted on the return or amended return for the tax year immediately preceding the tax year in which the disaster happened, as well as during the tax year in which the event occurred. For a disaster occurring in 2018, one would have until April 15, 2019, to file an amended return for deducting losses on the 2017 tax year return.

For additional information on these and other tax matters, consultation with a certified public accountant or tax attorney is recommended. Timber tax information is also available at www.timbertax.org.

Source: *Forest Owner's Guide to the Federal Income Tax*, USDA Forest Service

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