Determining Timber Casualty Loss

by Andrew Stainback

The ice storm that hit Kentucky in January 2009 was, according to some observers, the worst natural disaster in state history. The storm caused extensive damage to woodlands throughout the commonwealth. As a result, many woodland owners may be able to claim a casualty loss deduction from their federal income taxes due to damaged timber. Whether or not doing so is in the financial interest of a woodland owner depends on his or her individual circumstances.

This article highlights some of the basic issues involved in claiming a timber casualty loss that are useful in making such a decision. A consulting forester can normally help in quantifying the value of the destroyed or damaged timber and in other issues.

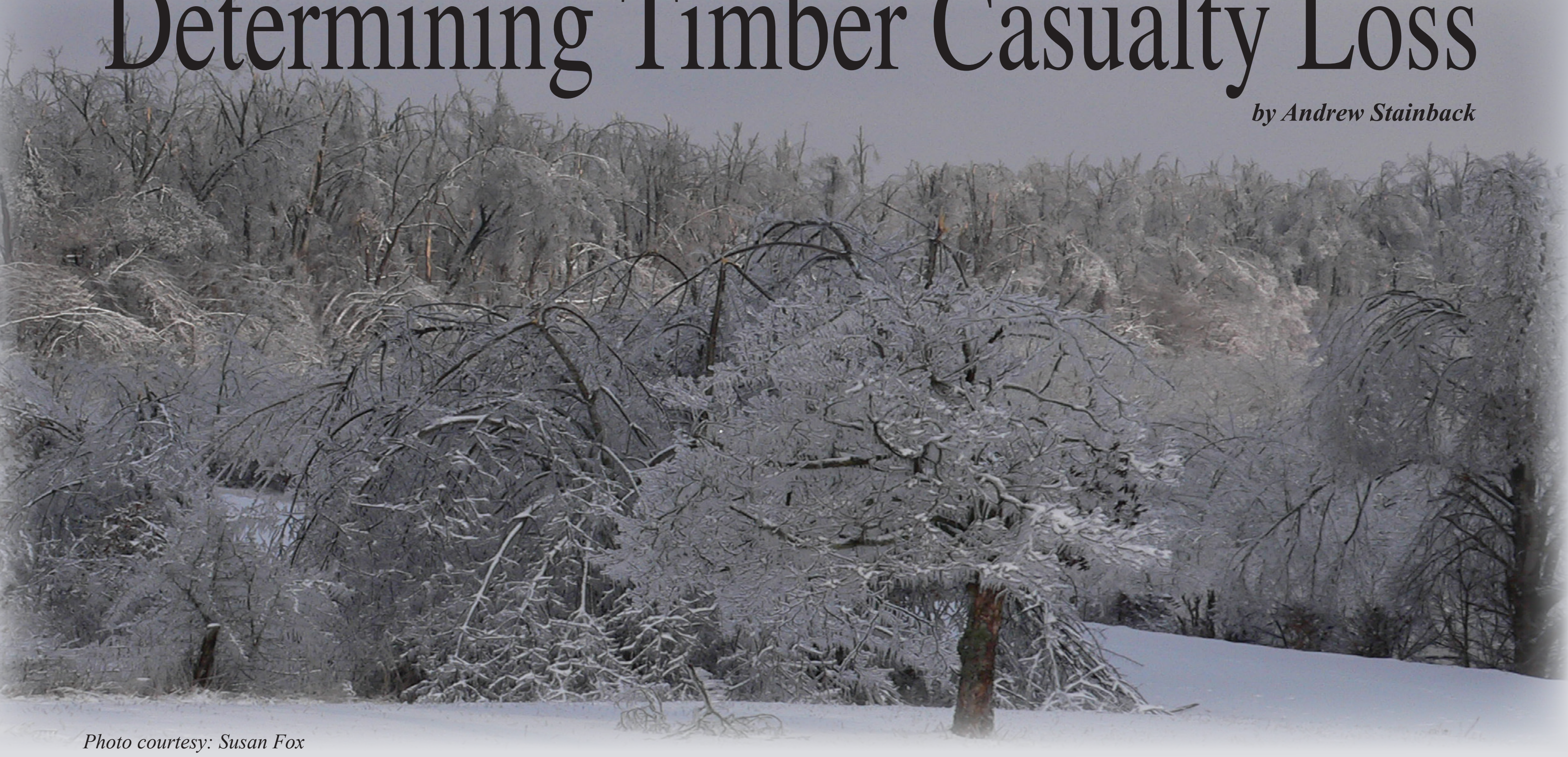

Photo courtesy: Susan Fox

Timber Casualty Loss

The Internal Revenue Service (IRS) allows two types of timber loss deductions—casualty and non-casualty. A casualty loss occurs when timber is damaged or destroyed from "any sudden, unexpected, and unusual event." Such events include ice storms, fire, hurricanes, tornadoes, floods, earthquakes, high winds, and certain human-caused events such as train derailments. Other types of losses such as timber theft, condemnation, or losses due to events that are unusual and unexpected but not sudden (i.e., insect outbreaks or droughts) may be deducted as a non-casualty loss under other tax provisions.

Current federal tax law allows a timber owner to deduct the lesser of two values:

- the fair market value loss, i.e., the market value of the timber damaged, or
- the adjusted capital basis of the timber, i.e., the value of the timber when ownership was taken.

In practice, this requires the documentation of the damaged or destroyed timber, determination of the fair market value of the timber just before and after the casualty, and the pre-casualty adjusted basis in the timber.

Determining Timber Basis

For most timber owners, the key issue is determining the adjusted basis of their timber. Basis is a tax concept to determine the "cost" of owning a capital asset such as timber. Separate accounts for basis are usually kept for timber, land, and other capital assets (i.e., barn, bridges, etc.). Most knowledgeable landowners who sell timber are familiar with the concept of timber basis because it is used to calculate the net profits of a sale for tax purposes. Original basis is the value of the timber when the timber was acquired through purchase, inheritance, or gift. The original timber basis includes the fair market value of the timber, including pre-merchantable timber and any costs associated with acquiring the timber such as surveying or legal fees. The original basis adjusted for timber removals or additions is termed the adjusted basis. However, the basis is not adjusted for timber growth. Basis is usually determined at the time the timber is acquired and adjusted over time for removals or additions through purchase or plantings. However, it is possible to determine the basis in timber retroactively using information on timber growth and timber prices at the time of acquisition. This will usually require the assistance of a consulting forester.

Determining the Allowable Deduction

The allowed deduction is the lesser of the adjusted basis for the timber or the reduction in the fair market value of the timber due to the casualty. If the timber is owned as personal property instead of investment or business property, an additional $100 and 10% of adjusted gross income is subtracted from the deduction. The National Disaster Relief Act of 2008 made several changes. It increased the $100 reduction to $500 for 2009 for any one declaring a personal property casualty loss. It remains $100 for losses claimed in 2008 or 2010. The 10% rule and the requirement that deductions be itemized is also removed for personal use property losses attributable to a federally declared national disaster that occurred in 2008 or 2009. If a salvage sell is conducted and the salvage value exceeds the adjusted basis, the gain is taxable, and no deduction is allowed. Costs incurred in filing for the casualty loss or determining the amount of the loss are not deductible.

It is important to gather pertinent information about the nature of the casualty such as time of occurrence and impacted area. Photographs of the timber damage or loss can also be useful. Any available documents such as forest management records, ownership deeds, insurance claims, or paperwork related to appraisal or forest consulting should be gathered and made easily accessible. Such documents do not need to be submitted when taxes are filed but can be essential in case of an audit. A casualty loss is generally claimed in the year that the casualty occurs. However, in a presidentially declared disaster area, a casualty loss can be claimed on the previous year's taxes (this applies to the January 2009 ice storm in Kentucky).

Filing for a Timber Casualty Loss Deduction

A timber casualty should first be reported on IRS form 4684 for casualty and loss. If the loss or destroyed timber is owned as an investment or personal use, the casualty should also be reported on IRS form 1040 schedule A. If owned as a business, it should be reported on IRS form 4797 instead of form 1040. Finally, the IRS form T should be prepared. If you do not sell timber frequently, this form usually does not need to be filed. Consult the IRS instructions for filing form T to determine if filing is necessary.

Conclusion

Whether or not deducting a casualty loss is in the financial interest of an individual woodland owner depends on his or her individual tax circumstances and the nature and extent of the casualty loss. The cost of filing for a casualty deduction, such as the cost of hiring a professional forester or obtaining appraisals, along with the expected tax savings, are important to consider before making a decision to file. It is highly recommended that anyone considering declaring a casualty loss consult IRS Publication 547: Casualties, Disasters, and Thefts (reference below) before filing.

References and Suggested Reading:

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