

Income Tax Deductions for Storm-Damaged Timber

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After a disaster, one crucial question facing forest landowners is how to recover losses to timber from a tax perspective. This publication intro-duces forest landowners to the basic procedures used to claim income tax deductions for storm-damaged timber.

When a timber stand is storm-damaged, landowners may be able to recover the loss as a casualty loss on their federal income tax return as outlined in the Internal Revenue Code. To qualify as a casualty, the damage should cause the timber to be unfit for use. To claim a casualty loss, the loss of timber must be caused by an identifiable event that is sudden, unexpected and unusual. A sudden event is one that is swift, not gradual or progressive. An unexpected event is one that is ordinarily unantici-

pated and unintended. An unusual event is one that is not typical for the activity in which you were engaged. Ice storms, tornadoes, earthquakes, fires and floods are all examples of events that meet these criteria. Losses caused by natural mortality, drought, insects or diseases generally are not eligible for casualty loss deductions because they result from progressive deterioration not a sudden event.

The following information applies to losses of timber held for use in a trade or business or timber that is held for investment purposes. This information does not apply to personal-use property, such as the loss of yard trees. For information regarding the loss of yard trees or timber held for personal use (hobby), see IRS Publication No. 547, Casualties, Disasters, and Theft.

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Figure 1. Ice storm damage on a 15- to 20-year-old loblolly pine plantation in southern Arkansas.

Determine the Basis

The first thing you need to know when considering a casualty loss deduction is the “basis” or dollar value invested in the timber that was damaged. The maximum amount that can be deducted for a casualty loss is the adjusted basis for the portion of timber damaged. In other words, the amount deductible is limited to whatever you have invested in producing the timber minus any compensation received (insurance, etc.) for the timber. Neither the loss of future profits from your timber nor the fair market value of the timber is deductible. The following are some general guidelines for determining the basis in damaged timber:

Determining the Basis on Inherited Land

- The basis of inherited timber is the value of the timber at the time of the decedent’s death, or you may use the alternate valuation method to calculate the basis.

Determining the Basis on Purchased Land

- For timber that was growing on the land when it was purchased, the basis in the timber is a portion of the purchase price.
- A valuation of the bare land and standing timber at the time of purchase should be made, and the purchase price along with purchasing expenses (such as surveys, timber cruise to determine volume, etc.) should be proportionately allocated between the land and the timber to establish the basis for each asset.

Other Considerations

- Money spent to manage the timber after its establishment, purchase or inheritance can be added to the basis unless it is claimed as a deduction.
- If no money has been spent on the development or management of a stand, no basis can be determined.
- For pine plantations, the basis is usually the money spent for establishment, such as site preparation and tree planting. However, if you have claimed deductions for stand establishment, you may have already recovered the basis, and the remaining basis may be zero.
- If you have harvested or thinned trees from your property since the original basis was determined, then you must reduce your basis to reflect this harvesting. This figure is then called your adjusted basis.

Estimate the Damage

The second step in the process, if you are certain you have a basis, is to determine the amount of timber lost or damaged in terms of units (board

feet, cords, cubic feet, tons). You should use the same units to calculate the loss as you do in maintaining your timber account. Deductions are allowed only in instances when trees are so severely damaged that you must remove them and start over or when trees are destroyed. Limited damage due to natural mortality and normal losses from insects and diseases cannot be deducted, since these are risks inherent to growing timber for investment or business purposes.

A registered forester should be used to determine the amount of timber damaged. Contact your consulting forester to make this determination. If you do not have a forester, you may contact the Arkansas Forestry Commission for a list of consulting foresters who work in your area. You should also document the damage that occurred. Take photographs of the damage, and keep copies of reports from the registered forester who examines the damaged stand.

Salvage Requirement

The third step is to make a reasonable effort to market the damaged timber as salvage. In some cases, it will not be possible to sell the damaged timber, but you should document your efforts in order to show that the timber was not salvageable. Young stands with trees that have not reached marketable size typically have no salvage value.

Calculate the Loss

If a salvage sale is made, the gain from the sale must be subtracted from the adjusted basis before determining the amount of the casualty loss. Any insurance payments must be subtracted from the adjusted basis as well. The net loss from a casualty, such as ice storm damage, equals the adjusted basis of the damaged timber minus the proceeds of a salvage sale minus any payments (insurance, federal disaster relief, etc.) received. Appraisal, timber cruising and other expenses incurred in determining your loss are not part of the loss. These expenses may be deductible as management costs, or they may be “capitalized” (added to the basis of the timber). Casualty losses are normally deducted from ordinary income.

Postponing Gains From Involuntary Exchanges

Sometimes a salvage operation in damaged timber results in a taxable gain rather than a loss. This is possible when the money received from the salvage sale exceeds the adjusted basis of the damaged timber. When this happens, you may be able to postpone the taxes on the gain by treating it as an involuntary exchange. In order to postpone the

taxes on the gain, you must purchase qualifying replacement property. This includes the purchase of replacement timber sites, the cost of seed or seedlings and the cost of sowing the seed or planting the seedlings.

Get Professional Help

If you have a gain or a loss, good record keeping is important in determining the basis of your timber. You should consider consulting a registered forester to assist you in determining the basis in your timber and a certified public accountant or tax attorney to address your specific tax reporting needs.

Additional Resources

Internal Revenue Service
www.irs.gov

National Timber Tax Website
www.timbertax.org

Forest Landowners' Guide to Federal Income Tax, Agriculture Handbook 718, U.S. Dept. of Agriculture
http://www.srs.fs.usda.gov/pubs/misc/ah_718.pdf

Consulting Foresters for Private Landowners http://www.uaex.uada.edu/Other_Areas/publications/PDF/FSA-5019.pdf

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