



Income tax deductions for hurricane-damaged timber losses

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Photo credit: E. Benton UGA-WFSNR

The impact of Hurricane Michael was immediate and devastating. Many forest landowners suffered catastrophic or severe timber losses, and have done (or plan to do) a timber salvage. There are a few special federal income tax provisions available for forest landowners affected by the disaster:

- 1) Forest landowners who suffered timber loss caused by a disaster like this may be able to deduct some of the casualty loss on their federal income tax.
- 2) The general rule is landowners may deduct a casualty loss in the year it occurs. But, landowners of affected timber located in the federally declared disaster area¹ have the option of claiming casualty loss on an amended tax return for the 2017 tax year to recoup their losses sooner. Considering 2017 ordinary income tax rates are generally higher than rates for 2018 for most taxpayers, it could result in greater tax savings.
- 3) Salvaged timber will likely be sold at a discounted price due to both actual damage and a flood of timber into local markets after the disaster. Nevertheless, a salvage sale may result in a taxable capital gain. Landowners may postpone tax on the capital gain by claiming an involuntary conversion and purchasing a qualifying replacement property.

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¹ Georgia Counties: Appling, Atkinson, Bacon, Baker, Ben Hill, Berrien, Bleckley, Brooks, Bulloch, Burke, Calhoun, Candler, Chattahoochee, Clay, Coffee, Colquitt, Cook, Crawford, Crisp, Decatur, Dodge, Dooly, Dougherty, Early, Echols, Emanuel, Evans, Glascock, Grady, Hancock, Houston, Irwin, Jeff Davis, Jefferson, Jenkins, Johnson, Jones, Laurens, Lee, Macon, Marion, Miller, Mitchell, Montgomery, Peach, Pulaski, Putnam, Quitman, Randolph, Schley, Screven, Seminole, Stewart, Sumter, Tattall, Telfair, Terrell, Thomas, Tift, Toombs, Treutlen, Turner, Twiggs, Washington, Webster, Wheeler, Wilcox, Wilkinson, and Worth (see Figure 1).

The deductible casualty loss is the lesser of either:

- adjusted basis of timber before loss, **or**
- decrease in fair market value (FMV) of timber due to the casualty.

Therefore, if the adjusted timber basis is zero, landowners would not be able to deduct any casualty loss, regardless of the actual timber losses.

This publication provides steps to help landowners in determining and reporting timber casualty loss and reporting gains from salvage timber sale. Although this publication is prepared in the context of Hurricane Michael, most of the general principles are also applicable to timber losses due to other casualty events (e.g., fire, flood, storm, etc.).

Additionally, the Georgia General Assembly approved a special income tax credit incentive on November 17th, 2018 for forest landowners suffering timber losses due to Hurricane Michael. The bill is known as HB 4EX (Hurricane Relief Bill). Please visit our website for a publication on this topic.

Step 1. Identify type of your timber holding

Depending upon the purpose of timber holding and the level of management activities, your timber holding may be classified into one of the following three tax classifications:

1) Personal-use property. If you hold timber mainly for personal enjoyment and do not expect income from the property, your timber holding may be classified as for personal use.

2) Investment property. If you expect to generate profit from either a timber sale or appreciation of the property (including land and timber), but your management activity does not rise to the level of a timber business, your timber holding may be classified as an investment.

3) Business property. If your primary purpose of holding timber is to make a profit and you regularly and continuously engage in your timber operation, your timber holding may be classified as a business.

Compared to holding timber for profit (either as for investment or for business), holding timber for personal use is subject to more restricted rules for casualty loss deduction (see Step 5). Maintaining a proof of profit motive is critical for landowners holding timber as an investment.

Step 2. Identify affected timber “block”

To claim a casualty loss, you need to identify the Single Identifiable Property (SIP) damaged or destroyed by the disaster. For management or accounting purposes, you may have divided your timberland into several blocks and maintained timber tax records (timber value and volume accounts) for the depletion block (or SIP). Assessment of timber casualty loss is based on the whole SIP even if only a portion of the SIP may be damaged by the disaster. This block approach normally gives landowners more favorable tax treatment.

Example. Mrs. Smith owns 100 acres of timberland with a timber basis of \$9,000. She kept the property in one account. Hurricane Michael damaged 20 acres of the property. To determine deductible casualty loss, she needs to compare the timber basis of the whole 100 acres to the loss in FMV of the property (\$20,000). Mrs. Smith may deduct the lesser of these two numbers. Therefore, she will be able to deduct \$9,000.

Step 3. Determine adjusted basis of the timber

For each SIP damaged or destroyed by the disaster, you need to locate your tax and management cost records and determine the adjusted basis of the timber block. Timber basis is the amount of money you have invested in the portion of the timber. It starts from an original basis, which varies depending upon how you acquired the property. Then, the basis is adjusted over time. When you invest in the property, the basis increases. When you sell timber or lose timber due to casualty or other losses, the basis is reduced. The adjusted basis is the timber basis immediately before the disaster.

The original basis is determined as follows:

- **For purchased timber**, the original basis is the total acquisition costs of the whole property, including purchase price, legal and regulatory fees, timber cruise (if performed), surveying costs, and other qualified expenses related to the purchase. The total acquisition costs are then allocated proportionally among the land, timber and other assets based on the FMVs of these properties. The portion allocated to timber is the original timber basis. A timber cruise just prior to or within a year after the purchase can help estimate the original volume of timber products on the property or the acreage of pre-merchantable timber.
- **For inherited property**, the original basis is the FMV of the property on the date of the decedent's death (or the FMV on the alternate valuation date if elected). Because this normally results in a higher basis for the beneficiary, it is usually called a **stepped-up basis**.
- **For gifted property**, the original basis is the donor's basis in many instances. Since the basis is transferred to the recipient, it is normally called a **carryover basis**.

If no timber basis has been established, a retroactive approach could be used to create the basis. A professional forester can help estimate the volume and value of timber at the time when the property was acquired. The estimate would be based upon current timber stock, timber growth, and local/regional historical timber stumpage prices. Landowners, however, are advised to weigh the benefit and costs before hiring a professional to establish the basis.

Some common cases where the adjusted timber basis might be zero (or negligibly low) include:

- Timber naturally generated after acquisition with limited additional investment;
- Reforested land where the reforestation costs had been recovered in full through the expensing and the amortization rule;
- Timberland that was acquired many years (30+) ago and no thinning/harvest had been done since the acquisition;
- Timberland is received as a gift and the original basis was low.

FEMA-4400-DR, Georgia Disaster Declaration as of 11/15/2018

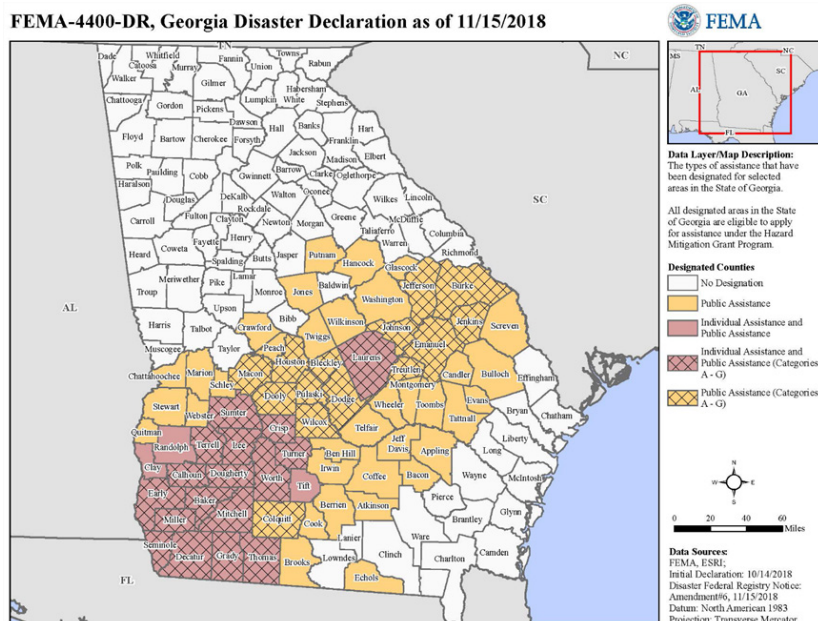


Figure 1. Federal Emergency Management Agency (FEMA) Georgia Disaster Declaration map

Step 4. Estimate decrease in fair market value (FMV) of timber

For each affected SIP, the difference in the FMVs of timber immediately before and after the disaster must be estimated. An appraisal requires help from a professional forester. The Georgia Forestry Commission maintains a directory of consulting foresters. Go to this website to locate a forester in your area: <http://www.gfc.state.ga.us/resources/directories/consulting-foresters/index.cfm>.

Step 5. Determine deductible timber casualty loss

For timber held for investment or business, landowners need to compare the adjusted timber basis determined in Step 3 and the decrease in the FMV determined in Step 4. The IRS allows landowners to deduct whichever is the lesser of these two numbers.

For timber held for personal use, landowners are allowed to deduct the casualty loss only if the loss occurs in the federally declared disaster area¹ (see Figure 1) and is a result of the disaster. This is a temporary provision for tax years 2018 through 2025 brought by the tax reform law known as the 2017 Tax Cuts and Jobs Act (TCJA). The amount of personal casualty loss deduction is limited to the lesser of the FMV loss of the property or the adjusted basis of the property, further reduced by \$100 and 10 percent of your adjusted gross income (AGI). This is current as of February 5, 2019. Special tax laws may be passed later to provide additional tax relief. Please check the Outreach Website of UGA Warnell School of Forestry and Natural Resources for the most recent information on this (<https://www.warnell.uga.edu/outreach/publications>).

Example 1. Mr. York owns 200 acres of forestland (\$6,000 in timber basis) as an investor. Before the hurricane, the fair market value of the timber was \$20,000. After the hurricane, the timber is worth only \$2,000. The FMV of the timber decreased \$18,000. The amount of casualty loss deduction is limited to the basis of \$6,000.

Example 2. Mr. Thompson owns 200 acres of forestland (\$6,000 in timber basis) for personal enjoyment. The property was located in the Presidential Disaster Declaration Area and destroyed by the hurricane. The loss in FMVs of the timber was \$18,000. His adjusted gross income is \$40,000. His timber casualty loss deduction is first limited by the basis of \$6,000. His loss of \$6,000 is then reduced by \$100 and 10% of his AGI. The final allowable casualty loss deduction is \$1,900 [$\$6,000 - \$100 - (\$40,000 \times 10\%)$].

Step 6. Report timber casualty loss

- **For timber held as an investment**, casualty loss is reported first in Section B (Business and Income-producing Property) of Form 4684. The loss is then entered into Schedule A of Form 1040, line 16 as “Other Itemized Deductions”. For landowners electing to file an amended tax return for the 2017 tax year, the loss is then entered into Schedule A of Form 1040 as “Other Miscellaneous Deductions”.
- **For timber held for business purposes**, casualty loss is reported first in Section B (Business and Income-producing Property) of Form 4684. The loss is then entered on Form 4797, line 14 as “Net Gain or (Loss) from Form 4684” and net with other gains and losses. If it is a loss, the amount will be transferred to Schedule 1 of Form 1040, line 14 as “Other Gains or (Losses)”.
- **For timber held for personal use**, deductible casualty loss is reported first in Section A (Personal Use Property) of Form 4684. The loss is then entered into Schedule A as “Casualty and Theft Losses”.

Forest landowners who hold timber as in investment or for personal use may need to evaluate tax implications of itemizing or taking standard deductions based on their filing status.

Step 7. Tax treatment of income from salvage timber sale

If the payment of the timber salvage sale exceeds the sum of the adjusted basis of the sold timber and the sales expenses, landowners have the option of:

- Pay capital gain tax on the profit, **or**
- Postpone the tax by using the entire proceeds to purchase qualifying replacement property, within the allowable replacement period (starts from the date the property was damaged or destroyed and ends 2 years after the close of the first tax year in which any part of the gain is realized).

Qualifying replacement property includes timber, timberland, reforestation costs, and stocks of a corporation that owns timber or/and timberland (gain 80% or greater control of the corporation).

Tips for proving the loss

- Take photos as quickly as possible after the casualty, and log the date, location and photographer
- Gather newspaper articles about the event
- Gather documents showing that you owned the property (recorded and stamped warranty deed, recorded plat from county courthouse, and/or county tax map of property with map and parcel number)
- Forest management records
- Photos of your property prior to the disaster
- Hired service from professional foresters
- Court papers or legal documents are particularly useful for inherited property.
- Documents of your reasonable effort to salvage the affected timber.

Additional sources of information

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