

Include Casualty Loss Provisions in Forest Management Plans

*Brandon Hatchett and Ben Jackson
Graduate Student and Professor
Warnell School of Forestry and Natural Resources*

Every forest landowner should have a management plan for his or her timber, and hopefully most everyone does. It is vital that a provision for casualty and non-casualty losses be included in this plan. Investing in timberland has its own unique set of risks, and the possible destruction, theft, or condemnation of your timber and property are significant ones.

Concerning casualty losses specifically, there are few legal applications to relieve the pain of such an event, and in the worst cases your only relief may be a cost efficient attempt at timber salvage. Unfortunately, options for dealing with a casualty loss often are discussed only after the fact. But, you should be familiar with and plan for these issues prior to their occurrence so you can be ready for financial and management recovery plus other related implications.

Things to consider concern the ways the timber loss situation can be handled regarding financial recovery, salvage, taxation, new stand establishment, and insurance coverage. Every situation is unique and some may require the consultation of experienced forestry, legal and tax professionals. But, basic knowledge of the concepts and proper preparation can benefit any landowner or investor.

For tax purposes, sudden natural catastrophes that affect timber are handled the same under a timber casualty loss. One important factor is to determine if it is worth the

In compliance with federal law, including the provisions of Title IX of the Education Amendments of 1972, Title VI of the Civil Rights Act of 1964, Sections 503 and 504 of the Rehabilitation Act of 1973, and the Americans with Disabilities Act of 1990, the University of Georgia does not discriminate on the basis of race, sex, religion, color, national or ethnic origin, age, disability, or military service in its administration of educational policies, programs, or activities; its admissions policies; scholarship and loan programs; athletic or other University-administered programs; or employment. In addition, the University does not discriminate on the basis of sexual orientation consistent with the University non-discrimination policy. Inquiries or complaints should be directed to the director of the Equal Opportunity Office, Peabody Hall, 290 South Jackson Street, University of Georgia, Athens, GA 30602. Telephone 706-542-7912 (V/TDD). Fax 706-542-2822. AN EQUAL OPPORTUNITY / AFFIRMATIVE ACTION INSTITUTION.

effort to go through a casualty loss process. The costs can easily outweigh the benefits of dealing with a small number of tree casualties (1).

Your land and timber holdings should have separate accounts and be allocated their separate basis values. Remember, you cannot use your land basis to increase the casualty loss of the timber (1). When determining the loss amount, you have to look at the Single Identifiable Property (SIP). The standard is any unit of property that has an identifiable adjusted basis and that is reasonable and logical and identifiable in relation to the area affected by the casualty (3). The block approach generally allows for a larger casualty loss deduction, but because of this, the next time you harvest timber from the block, your adjusted basis in the timber harvested will likely be lower than under the earlier Revenue Rulings, and your taxable income higher (3).

For example, if you have two tracts but only one basis account, then your deductible loss on one of these tracts would be based on this one single combined account. If you have two tracts with separate basis accounts, then the loss would be allocated towards its respected account without affecting the other.

If you have multiple properties, then it is reasonable to have different accounts for each. If you have a large tract, then consider the following statement by the IRS. "If the property or block being valued includes several distinct tracts that are noncontiguous and contain different types of timber, subdivision may be appropriate. If a party suggests subdivision, however, "...the taxpayer must establish that there existed a reasonable probability that the land would be so used in the reasonably near future. Absent the evidence that subdivision would be expected or reasonable, the property should be valued as a whole" (3).

A natural subdivision would be for pre-merchantable timber and merchantable timber. It is usually to your advantage to use the entire block as the SIP. This usually results in the change in Fair Market Value (FMV) value being less than the Basis. This means keeping all of your merchantable timber in one account. You should compare the results of different combinations of approaches before you make a decision, because the IRS will likely not allow you to change the method used after the casualty event has happened (4). It is possible to have a tax deduction on your pre-merchantable timber. To take advantage of this, you need to have a separate account for this pre-merchantable timber and have costs allocated towards it, i.e. planting and reforestation costs (4).

The first thing you should be familiar with is **Basis and FMV** when attempting a casualty loss deduction on your taxes. Basis is usually the cost of the property, in this case timber, used for taxation purposes. The **Adjusted Basis** value is basically the Basis value adjusted over time due to change in ownership, investment, timber sale, and other actions. FMV is the current market value of the timber. The amount that is tax deductible is the lesser value of the Adjusted Basis or the change in FMV. The casualty loss is deductible up to the Basis. This means if there is no basis on the timber, then

there cannot be any tax-deductible loss, because it is impossible to determine which of the change in FMV or the adjusted basis value on the SIP is smaller (4).

It is important to note that the way you acquire property does have an effect on the way Basis is determined (3). **Purchased** timber property is the purchase price and related costs. **Gifted** timber property is usually the donor's adjusted basis. For **inherited** property, the basis is the FMV and the date of death, or alternate valuation date (5). This being said this, having records of your basis points, possibly is the most important consideration when wanting to attempt a casualty loss deduction.

The IRS separates forest landowners into **three categories**: hobby owners, investors, and business owners. Each group has its different taxation parameters. Taxation is based on how you use and manage your land, as well as how involved you are with management of it. You must assess your situation and goals for the property and determine which describes you best. There is not a significant difference among category each in how a casualty loss is handled, except when it comes to the actual forms to complete and send in to the IRS. For separate ownership in a limited liability company (LLC), the loss will pass to each member according to how the ownership is divided.

If you do not have any basis records for your timber, it is possible to do a retroactive basis determination. Dr. Linda Wang, Tax Specialist with the USDA Forest Service says "It is important to weigh the cost of hiring professional forestry and/or appraisal services to establish the required tax records against the potential tax savings before proceeding." Dr. Debbie Gaddis, former Extension Forestry Specialist at Mississippi State University supports this by stating, "That it is a general rule to hire a forester to estimate basis only if fees are less than 15 percent of the expected value of the basis.

Finally, ea reasonable effort should be made to salvage the affected timber. If you are not able to salvage the timber after making a bona fide attempt to do so and you claim a loss deduction, you should keep a record of your efforts in order to show that the timber was not salvageable (2).

Citations:

1. Gaddis, D. A. and S. G. Dicke. 2010. Frequently asked questions about timber casualty losses. Publication 2619. Mississippi State University, Extension Service. <http://msucares.com/pubs/publications/p2619.html>.
2. Haney, H. J., W. L. Hoover, W. C. Siegel, and J. L. Greene. 2001. Forest landowners' guide to the federal income tax. USDA Forest Service, Agriculture Handbook No. 718. 157 p. <http://www.timbertax.org/publications/aghandbook/>.

3. Internal Revenue Service. 2011. Timber casualty loss audit techniques guide.
http://www.irs.gov/businesses/small/article/0,,id=238854,00.html#_Toc290643113.
4. National Timber Tax Website. 2011. Section 1033 – Involuntary Conversions.
<http://www.timbertax.org/research/irc/sub/sections/sec1033/>.
5. Wang, L. 2011. Income tax deduction for timber casualty loss.
<http://www.timbertax.org/publications/Timber%20Casualty%20Loss%20Tax%20Deduction-2011-2.pdf>

Have Questions? Contact Ben Jackson at bjack@uga.edu or 706-542-9051

Disclaimer: This material is not legal, tax and accounting advice. Any U.S. federal tax advice contained here is not intended or written to be used for the purpose of avoiding penalties under federal tax laws, or promoting, marketing or recommending to another party any transaction or matter addressed herein.