

Income Tax Deduction on Timber and Landscape Trees Loss from Casualty

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Timber or landscape trees destroyed by the hurricane, fire, earthquake, ice, hail, tornado, and other storms are “casualty losses” that may allow the property owners to take a deduction on their federal income tax returns. The key for most cases is to figure out the “adjusted basis” of the timber.

The “Adjusted Basis” of Timber

Generally, the cost or the measure of your investment in the property you own is the property’s basis. The original basis is defined as follows: 1) for purchased timber property, it is the purchase price and related costs (such as legal fee and timber cruises); 2) for gifted timber property, it is the donor’s adjusted basis in most instances; 3) for inherited timber property, it is the fair market value (or alternative value if so elected) on the date of death (or alternative valuation date). The “*adjusted basis*” of a property is the original basis reduced or added by adjustments over the term of ownership (e.g., new purchase increases your timber basis while timber sale decreases your timber basis).

If you have not determined your timber basis at the time of acquisition, you may use the current timber volume, timber growth over the years, and the timber value at the time of acquisition to retroactively establish it. Establishing timber basis often takes time and forestry expertise plus the tax knowledge. The benefit of setting up your timber basis is that it allows a deduction from timber sale and casualty loss.

Tax Deduction Rules for Casualty Loss

For Timber Held for Personal Use. A personal-use timber property is defined as one that is held primarily for personal enjoyment (vs. income production from the timber). The amount of personal casualty loss is subject to these deduction limits: first, the deductible casualty loss is the lesser of the fair market value loss or the property’s adjusted basis. Insurance or other reimbursement you received reduce the casualty loss. Second, an individual can take casualty loss when the amount of loss exceeds \$100 per casualty. Next, the deductible amount of loss is limited to the sum of the amount of personal casualty gains plus the amount of personal casualty losses for the tax year that exceeds 10 percent of adjusted gross income (AGI). Finally, casualty loss deduction is claimed under “itemized deductions” on Schedule A.

Example 1: Mr. Thompson owned timber primarily for personal use, not for profit. In 2017, his timber was completely destroyed by the hurricane. The adjusted basis of his timber is \$10,000. The fair market value of the timber immediately before the loss is \$9,100. The taxpayer’s adjusted gross income for the year is \$40,000. His casualty loss deduction is \$5,000 ($\$9,100 - \$100 - 10\% \times \$40,000$). He claim the deduction as “itemized deduction”.

Note for taxpayers impacted by Hurricane Harvey, Irma and Maria, Congress passed special tax law on September 29, 2017 to provide tax relief. The 10 percent AGI reduction and the “itemized deduction” requirements for personal casualty loss are eliminated.

For Timber Held as Investment or Business. Deductible casualty loss for timber held mainly for business or investment purposes is the smaller of the adjusted basis of timber and the difference of the fair market value immediately before and after the casualty. Salvage sale is reported separately.

Example 2: A fire damaged Mrs. Smith's woodland tract. Before the fire, the fair market value of the timber was \$10,000. But after the fire, the timber is worth only \$1,000. So the fair market value loss of her timber is \$9,000 (\$10,000 - \$1,000). Assuming your timber basis is 5,000, the amount of casualty loss deduction is only \$5,000, not \$9,000.

Casualty losses are reported first on Form 4684. For timber investment property, the loss is then entered into Schedule A of Form 1040. For timber business property, the loss is entered on Form 4797.

In general, you can deduct a casualty loss only in the tax year in which the casualty occurred. However, for federally declared disaster area, you may elect to apply the casualty loss in your prior year's tax return. Compare your current year and last year's tax bracket and any expenses for amending the prior year's tax return.

"Single Identified Property". Treasury regulations require that casualty loss is determined with respect to the "single identifiable property". This can be the "timber block" (even if only a portion of it is actually damaged) if you keep the timber tax records (account) together for the block.

Example 3: Mrs. Smith own a timber property that contains 1000 MBF of pine sawtimber (\$9,000 basis) on it. She kept the property in one account. A tornado destroyed 300 MBF. The adjusted basis for the casualty loss purpose is \$9,000, not just \$2,700 ($\$9,000 / 1000 \text{ MBF} \times 300 \text{ MBF}$). But the loss valuation must also be appraised for the entire tract or block, which may cost more.

Gain from Salvage Sale. A taxable gain may result if the salvage sale exceeds the adjusted basis of the timber and related selling expenses. But you may elect to postpone paying taxes on the gain if the proceeds is re-invested in timber such as planting trees, purchase of timberland and stock (at least 80%) of the timber corporations.

Consult Your Forester. To establish the timber basis and appraise the fair market value loss of the timber immediately before and after the casualty, you may need to consult a professional forester to determine the relevant timber volume in thousand board feet, cords or tons and the value of timber.

Special Rules for Landscape Trees Casualty. Generally casualty loss of trees in the private residence is measured based on the entire property, that is, the land, the improvement (house), and trees. In other words, the measure of the casualty loss is based on the tree loss that contributes to the overall decrease in the fair market value of the entire property immediately before and after the casualty. Personal-use property casualty loss rules discussed earlier apply in calculating the deductions from the loss of landscape trees and/or residence.

Example 4: Mr. Walter purchased his house at \$110,000 five years ago. He spent \$10,000 planting landscape trees and shrubs in the yard. Before the fire, the fair market value of his residence

including the shrubs and landscape trees has appreciated to be \$150,000. After the fire destroyed the trees, the fair market value of the entire property decreased to be \$130,000. The insurance paid him \$5,000. The loss deduction from the tree casualty is not \$10,000, the cost of the planting of these trees, but rather it is determined as follows: the fair market value loss of the entire property immediately before and after the fire is \$20,000 (\$150,000 - \$130,000). The adjusted basis of the house is \$110,000 (purchase cost). The tentative deductible casualty loss is \$14,900 (\$20,000 - \$5,000 insurance - \$100 per casualty). The tentative loss amount must be reduced by 10 percent of AGI as this loss is a personal casualty loss. Thus, if Mr. Walter's adjusted gross income were \$60,000, the deduction for the casualty loss would be \$8,900 (\$14,900 - \$6,000 (10% of \$60,000 adjusted gross income)).

Proof of Loss and Tax Records. It is important that you have records to support your casualty loss deduction, but do not attach them to your return. Document information about the casualty (time, nature of the event and the area affected). Carefully prepare the appraisals from the hired services by professional foresters and/or appraisers.

Overall, the tax laws provide a deduction for the loss of timber and landscape trees caused by casualty. Because of the complicated restrictions on the casualty loss calculation, if the timber basis is low or zero, there may be little or no deductions in the end. So it makes sense to weigh the cost of appraisal against the potential tax savings.