Tax Guide

Income Tax Deduction for Casualty Timber Loss

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Timber destroyed by Hurricane Rita in East Texas this year are "casualty losses" that may allow timberland owners to claim a deduction on their federal income tax return.

Determining The Amount Of Casualty Loss

Deductible casualty loss for timber held for business or investment purpose is the smaller of *the adjusted basis of timber for the timber block* and *the difference of the fair market value immediately before and after the loss*, reduced by salvage sale income.

Calculating The Adjusted Basis

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The key for most cases is to figure out "the adjusted basis." Generally, the cost of a property is called "basis" in tax terms. Adjusted basis is the original basis reduced or added by adjustments (such as new purchase or sale of part of timber).

The original basis for:

- purchased timber asset is the purchase price and related costs (such as legal fee and timber cruises).
- gifted timber asset is the donor's adjusted basis in most instances.
- inherited timber asset is the fair market value (or special use value if so elected) on the date of death or on the alternative valuation date.

Note unamortized reforestation cost is part of the original basis of timber.

If you didn't determine a basis of your timber at the time of acquisition, it's necessary to use the current volume before the storm, growth rate over the years, and timber price at the time of acquisition to get the best possible estimate.

What You Need From Your Forester

Here's what you need from your forester: fair market value of timber immediately before and after the storm. This usually requires timber volume in thousand board feet, cords or tons, and timber prices to establish the fair market value. Also, if you don't know your basis, you will need additional information such as timber price and volume estimate *at the time of acquisition or inheritance to set up the original basis for the timber.*

Basis Is For The "Single Identifiable Property"

Please keep in mind that the adjusted basis is typically *not* the value of timber. The adjusted basis is for the total "Single Identifiable Property" directly affected by the storm. For example, if you have $12,000 basis for your 80 acres of timberland where 17 acres were destroyed by the storm, your basis for casualty loss is $12,000 for the total block of timber when you keep track of the adjusted basis of them together.

Where To Report The Casualty Loss

All casualty losses are claimed first on Form 4684. Follow the instructions for this form and it will direct you to the proper reporting forms. Generally, if you hold timber for investment, after using Form 4684 for casualty loss calculation, the amount of loss is then entered into Schedule A of Form 1040. If your holding is business property, your casualty loss is then entered on Form 4797.

What If A Net Gain Is Realized

If you conduct a salvage sale, a net gain is realized when the salvage value exceeds the adjusted basis of damaged timber. You may postpone paying taxes on the gain realized from a salvage sale if you reinvest the proceeds in qualified replacement property.

Useful Tax Pointers

For timber property held for personal use:

- The casualty loss deduction is limited. The deduction, aggregating with all casualty deductions for one's home, is first reduced by $100 and then by an additional 10% of your "adjusted gross income" on Form 4684.
- Because of the 10% floor, you may be unable to deduct a casualty loss unless it is quite substantial.
- Also, if your income is high, your deduction is limited or eliminated.
- If you don't itemize your deductions, you will not be able to deduct a casualty loss.
- Appraisal fees and the cost of taking photos are not part of the casualty loss deduction. They are part of deductible expenses claimed on itemized deductions (subject to 2% AGI limitation).

For timber property held for business use:

- The entire casualty loss is deductible. It is not subject to any floor limitations.

When to claim the loss:

- You can deduct a casualty loss only in the tax year in which the casualty occurred.
- You may not file the loss in an amended return. "Use it or lose it."

Tips For Tax Records For Proof

- Take photos as quickly as possible after the casualty
- Log the date, location and photographer
- Gather newspaper articles about the hurricane (time, nature of the storm and area affected)
- Gather escrow papers from the title company or the bank
- Forest management records
- Photos of your property prior to the storm
- Hired service from professional foresters
- Court papers or legal documents are particularly useful for inherited and estate property.

It is important that you have records that will prove your deduction, but do not attach them to your return.

Recommended Readings

1. Forest Landowners' Guide to Federal Income Tax, Chapter 5 (Cost Considerations) and Chapter 6 (Income Considerations). You may purchase the 2001 edition from the U.S. Government Bookstore, First Union Plaza, Suite 120, 999 Peachtree Street, NE, Atlanta, GA 30309-3964. It's also available free on-line by Google key words search using the book's title.

2. National Timber Tax Website: www.timbertax.org

3. IRS publication 547: It contains many casualty loss examples. This guide is very useful for an in-depth understanding of the casualty loss rules.

4. Tax Software Turbo Tax Deluxe or Tax Cut or other tax software. The software is an effective tool for casualty loss deduction, especially if you are interested in doing your return by yourself. It can save time and frustration over calculations and form selections.