Tax implications of Hurricane Michael related timber casualty losses



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Outline

- Federal income taxes
- casualty loss deduction
- gain from salvage sale
- Georgia state timber tax credit
- -Federal tax implications of the tax credit

Timber casualty losses: federal income tax aspect

- Deductions are available to owners with profit motive
- A block approach should be used
- Deductions are limited to timber's adjusted basis
- Casualty loss deduction and timber salvage sale are two separate events
- Salvage sale could result in taxable gain
- The gain can be deferred

Purpose of timber holding matters

- Personal use: not for producing income
- Investment: for profit (income or property appreciation) and occasional timber sales
- Business: for profit, activity is more frequent and regular

"For profit" activities in general receive better tax treatment

Single Identifiable Property (SIP)

- Timber casualty loss shall be determined by reference to single identifiable property damaged or destroyed
- The block used to keep track of timber basis
- An operation unit, a logging unit, or established by geographical/political boundaries
- Qualified timber property (QTP) is acceptable

Determine timber casualty losses

Casualty loss shall be the lesser of:

- Decrease in fair market value (FMV) of the block due to the event
- Adjusted timber basis of the block

Not just the proportion that was actually damaged



What is timber basis?

- Basis is the book value of your investment in timber
- Initial basis varies depending upon how the property was acquired
- Basis is adjusted up as more money is invested into the timber
- Basis is adjusted down as timber is depleted
- Adjusted basis is the remainder

How to determine initial timber basis?

Depend on how the property is acquired:

- Purchase—Total costs of acquisition
- Inheritance—Property's fair market value on the date the decedent died "stepped-up basis"
- Gift—Normally donor's basis, plus gift tax paid

"carryover basis"

Deductible timber casualty loss

Timber holding for investment or business

- Timber holding for personal use
 - Limited to Presidentially Declared Disaster Areas only
 - Further reduced by \$100 and 10% of adjusted gross income (AGI)

Salvage is required

- Landowners must make reasonable efforts to salvage damaged timber before claiming a casualty loss
- If it is not salvageable, document attempts to salvage:
 - Phone calls to consultants, loggers, potential buyers
 - Contacts

What if there is a gain?

- If timber is damaged and the owner receives payment, the transaction is called an involuntary conversion
- If the salvage income is greater than the adjusted basis, there will be a gain
- The owner can elect:
 - pay tax on the gain, or
 - defer the gain by purchasing qualifying replacement property

Qualifying replacement property

- Reforestation costs
- Timber
- Replacement timberland
- Reforestation on replacement property
- Controlling stock in timber corporation

Within 2 years



When can a casualty loss be deducted?

- Claim in year of casualty
- For *federally declared disaster areas*, the deduction can be taken on amended tax return for the last year (by Oct. 15, 2019)
- Landowners affected by Hurricane Michael have two options

Reporting timber casualty loss

- Report the loss on Form 4684
- Then:
 - Business timber owners go to Form 4797
 - Investors go to Form 1040, Schedule A, "Other Itemized Deductions"
 - Landowners holding timber for personal use go to Form 1040, Schedule A

To postpone recognition of Gains

- Attach a statement to your tax return
- Describe conversion and replacement property
- State that you elect to postpone recognition of the gain
- Your basis in the replacement property is:
 - Acquisition costs deferred gain
- The gain will be recognized when you sell the property in the future



Treatment of expenses

- Deduct the costs of determining a casualty or theft (appraisal, cruise, photos, incidental costs) as operating expenses
 - Landowners holding timber as an investment capitalize the expenses
 - Landowners holding timber for use in a trade or business, use Form 1040, Schedule C or F

Georgia income tax credit for timber growers affected by Hurricane Michael

- HB 4EX (Hurricane relief bill)
- Disaster area: 28 counties
- Eligible timber property: timber held for profit
- Tax credit: 100% of timber casualty loss, but no more than \$400/ac
- Refundable, transferable

Georgia timber tax credit

- Claim the credit:
- Received preapproval from DOR
- Reported the replanting of timber in a quantity projected to yield at maturity at least 90% of timber losses via Georgia Tax Center
- -Claim it on tax return
- \$200 million in total
- All tax credits shall be claimed by 2024

Georgia timber tax credit

- Excludible from federal income for original recipient
- If it is sold, the net gain is taxable as capital gain
- The purchaser should report the difference between face value as capital gain when he uses the credit

IRS Chief Counsel Advice CCA 201147024

Cost-share payment

- Financial assistance received from government agencies for tree planting, insect control, thinning etc.
- Generally, you are required to include costshare payment into your income
- Under IRC Section 126, certain government cost-share payments may be excluded from gross income

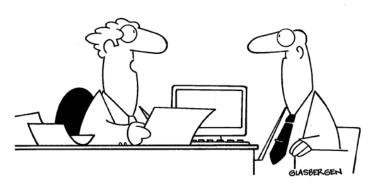
Excludable cost-share programs (Federal)

- Forest Health Protection Program (e.g. Southern Pine Beetle Program-SPB)
- Conservation Reserve Program (CRP) (annual rental payment **not** qualified)
- Environmental Quality Incentives Program (EQIP)
- Wildlife Habitat Incentives Program (WHIP)
- Wetlands Reserve Program

Excludable amount

"...the present fair market value of the right to receive annual income from the affected acreage of the greater of 10 percent of the prior average annual income from the affected acreage or \$2.50 times the number of affected acres..."

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26 CFR § 16A.126-1

Excludable amount

- **Step 1:** 10% × Average annual income from the affected acreage in the past 3 years
- **Step 2.** \$2.5/ac × affected acreage
- Step 3. The larger number from Step 1 and 2 Farm Credit Bank interest rate
- Step 4. The smaller of the number from Step 3 and cost-share payment received

