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 cost-share 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**…"

"Of course it's impossible to figure out.
That's why it's called the tax *code!*"

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.** $\dfrac{\text{The larger number from Step 1 and 2}}{\text{Farm Credit Bank interest rate}}$

- **Step 4.** The smaller of the number from Step 3 and cost-share payment received