



Casualty Loss and Involuntary Conversions Applicable to Timberland Owners

By John Merrill and Steve Chapman

Georgia's forest landowners may have suffered some damage and/or loss of trees due to storms.

The Georgia Forestry Commission would like to review some of the Internal Revenue Service rules, regulations and or Revenue Rulings pertaining to Casualty Losses.

The reporting of casualty losses is a two step process resulting from the changes which have evolved from recent court cases:

Step one involves determining the difference in value between the value of the timber before the casualty and the value afterwards, as determined by a qualified appraisal.

Step two involves the salvage of the damaged timber. The salvage may result in a gain, which is an Involuntary Conversion that may be deferred. (3)

Determining A Casualty Loss

"As a general rule, all losses – including those that technically are not casualty losses – that are uncompensated by insurance or otherwise – are deductible from income in the year sustained. In the case of individuals, however, this general rule is limited so as to apply in only three situations:

- a. When the loss is incurred in a trade or business.
- b. When the loss is incurred in any transaction entered into for profit (investment, as opposed to a trade or business).
- c. When the loss, while not connected with a trade or business, or investment is the result of fire, storm, shipwreck, or other casualty, or from theft—" (2)

Every reasonable effort should be made to salvage the affected timber. (1)

Generally, if your timber is damaged or destroyed by fire or other casualty, your deductible loss is the diminution in value, limited by the allowable basis in the timber damaged or destroyed, less any insurance or other compensation received. Determine your gain or loss from the salvage cutting, sale, or other disposal as you would for timber sales in general. (1)

Generally, a deduction for a loss to a taxpayer's single identifiable property is expressed in terms of the number of timber units damaged or destroyed. The units of measurement used should be those utilized to maintain your timber accounts, such as board feet, cords, cubic feet or other units. The number of units of timber damaged or destroyed must be established by fair and reasonable measurement to justify a deduction. (1) When using weight as a form of selling timber IN GEORGIA, the only legal unit of measure is "tons".

The amount of the deductible loss is the lesser of;

1. The decrease in the fair market value of the "single identifiable property" or
2. The adjusted basis of the "single identifiable property"

less any insurance proceeds or other compensation received. If your timber has no basis, you will not have a deductible loss. (1)

Salvage is separately accounted for. In other words, it is not subtracted from the loss deduction; rather, it is treated as a

timber sale. This position by the Internal Revenue Service is the result of three separate court cases whereby the Court of Federal Claims held that the casualty loss and the subsequent sale of salvaged timber are separate events, and need not be combined and set off for tax purposes. (5)

Destruction of a premerchantable stand or plantation from a casualty may result in a deductible loss if;

1. You keep a separate account for the stand in your records, and
2. You have costs allocated to the account.

A loss arising from a casualty generally is deducted in the year in which the casualty occurs. This is true even if you have not yet settled a reimbursement claim or have not received an agreed-upon insurance settlement or other compensation. If a claim for reimbursement has been made and you think you will recover all or part of the loss, reduce the reported loss by the amount you expect to recover, even though you have not yet received payment by the time the tax return for the year of the casualty is due. (1)

Involuntary Conversion

It is possible that a landowner could have a gain resulting from the salvage operations. This can be considered an Involuntary Conversion and therefore the gains would qualify to be postponed.

To defer any gains realized, you must use the proceeds (amount realized) to purchase qualifying replacement property. The purchase of qualifying replacement property includes the purchase of replacement timber sites; the cost of seeds and seedlings; your costs to plant trees or sow seed on sites; and the cost

of purchasing a controlling stock interest or ownership of a corporation owning timber, timberland, or both. Restoration work to repair damage, clean and clear drainage systems, or replace culverts, fences, gates and roads is also considered qualifying replacement property. (1)

If you elect to defer reporting the gain, you must file a statement with your tax return stating that the election is being made and include all the pertinent information concerning the conversion and the replacement property. If you make the election, but do not spend all of the compensation, reimbursement, or proceeds on qualifying replacement property, you must report the difference as income. (1)

Casualty Loss For Yard Trees (4)

The process of determining casualty losses from yard trees is somewhat more complicated and due to the process required by the IRS, will generally be worthwhile for only those property owners who have received significant and therefore large dollar amounts of damage.

You must start with the lesser of:

The decrease in fair-market value of your property caused by the loss

OR

The basis of the property (usually its cost)

(Appraisal fees and other costs of determining your loss do not add to the loss, but can be taken as itemized deductions on Form 1040, Schedule A.)

Subtract any insurance or other reimbursement you receive for the damage. (If the reimbursement is more than the loss, you may have a taxable gain.)

Combine all losses caused by the same event and deduct \$100.

Combine all losses from all events during the year and subtract 10 percent of your adjusted gross income from Form 1040, line 33.

The amount left is your deduction. Use Form 4684, Section A to calculate the deduction.

Landowners are encouraged to consult with their forestry tax specialist if they have significant timber losses due to storms. The process mentioned above can be confusing for a landowner who has never claimed a loss in the past.

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- (1) Ag Handbook 718 - Forest Landowner's Guide to the Federal Income Tax updated for Revenue Ruling 99-56.
 - (2) Timber and the Federal Income Tax, course notes by Harry L. Haney, Jr., PhD. and William C. Siegel, J.D.
 - (3) Comments added by Harry L. Haney, Jr. PhD.
 - (4) Summarized information from "Understanding Loss Deductions For Yard Trees", by Dr. John Greene, Forest Economist, USDA Forest Service Southern Research Station, New Orleans, LA.
 - (5) Comments added by Linda Wang, National Timber Taxation Specialist, USDA Forest Service