UT Extension
W261

Renewable Resource Notes

When a Tornado Strikes: Steps to Claim a Timber Casualty Loss

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Risk is inherent to long-term investments. Perhaps no risk is more greatly feared by timberland owners than a direct tornado strike. Damage is normally so devastating that the decrease in timber value reaches 70 to 100 percent loss. Landowners are often left confused about how to proceed. The following steps are suggested to help in salvaging damaged timber and in maximizing IRS tax deductions via timber casualty loss.

First, locate your tax records on timber costs ("basis"). If your timber basis is low or zero, it may not be worth the expenses of hiring a professional forester to appraise the loss. **The tax law limits the casualty loss deduction to your timber basis**. If you have a timber basis, you should document and keep as evidence the tornado casualty with newspaper articles and photographs. An attempt must also be made to salvage the damaged timber by contacting professional foresters and loggers. Begin by salvaging the better stands of timber first. Understand that salvage logging is often difficult and unsuccessful, with logger interest very low due to a number of constraints, including harvest dangers, slow logging production and unseen quality defects in the wood.

The next action is to attempt to claim a *casualty loss*. The IRS recognizes a casualty loss as the "actual loss of tangible or measurable property, which is evidenced by a closed and complete transaction, fixed by identifiable events, and actually sustained during the taxable year." The casualty must be a natural or other external force, acting in a sudden, unexpected and unusual manner. Therefore, tornados and fires qualify; diseases and drought normally don't. (There are exceptions where, for example, Southern pine beetle killed trees in nine days and this qualified for casualty loss, Revenue Ruling 79-174.) The amount deductible as a casualty loss is the lesser of: 1) the decrease in fair market value of the timber as a result of the casualty or 2) the adjusted tax basis in the timber, *less* any salvage revenue.

Arriving at the **decrease in fair market value** (FMV) requires an inventory and appraisal normally conducted by a professional forester. Essentially it's the difference between the timber value directly prior to and directly following the casualty. Foresters can estimate these values. If salvage income was realized from the damaged timber, this must be included in the calculation. Logging tickets and receipts should be saved to aid the forester in estimating the decrease in FMV.

Arriving at the **adjusted tax basis** is normally more challenging (Refer to Tankersley, L. 2004. *Setting up the Books*. University of Tennessee Extension PB 1691). Essentially, the tax basis is the investment value or the amount invested in a capital asset. When the property is sold, or when there is a loss, or the property (the timber) is used up (logged), the basis is depleted by deductions to gross income on tax returns. The original tax basis varies according to how the property was acquired, whether purchased, inherited or gifted. In cases of purchased property, the basis is the total acquisition cost of the timber. With inherited property, the basis can be stepped-up to the FMV at the time of the donor's death. When property is gifted, the recipient obtains the donor's basis (generally). With most ownerships, the basis exists, but was never allocated at the time of land acquisition. In other words, a forester did not appraise the timber. In such cases, a forester can make a current inventory of the timber, then adjust the current volume and value back to the time of acquisition and arrive at the original basis. If timber has been logged between the time of acquisition and the casualty, the basis would then be adjusted down to reflect the depleted trees.

Once the decrease in FMV and the basis are known, casualty loss can be figured. It is the lesser of these two. Normally if the casualty is extensive, the decrease in FMV will exceed the basis and a landowner will not be able to recapture the full loss from the tornado. If the basis is zero, the casualty loss is zero. Situations where the basis might be zero (or negligently low) might include:

- timberland that was acquired many years ago that has grown considerably (i.e., timber value was insignificant at the time of acquisition);
- Timber that had naturally regenerated after acquisition (for instance, after a clearcut or after a field was abandoned) with no owner investment in the new trees;
- Reforested land where costs were recovered through tax credits, deductions or government cost-sharing;
- Property that was gifted and the transferor's basis was low or zero;
- The basis account has already been fully depleted from prior timber sales.

Casualty losses are reported on IRS Form 4684. If a casualty loss can't be claimed, and salvage revenue was received from stumpage sale, the income can be reported as a capital gain. If salvage revenue exceeds the basis adjusted for casualty loss, this excess is a taxable capital gain. However, you can defer the income or even postpone the taxable gains being currently taxed by reinvesting the gains in timber/tree planting projects. Salvage sales are treated separately from the casualty loss (See tax court case: Westvaco Corp. versus United States, 639 F.2d 700 [Ct. Cl. 1980] for separate treatment as precedent, from national Timber Tax website).

Claiming a casualty loss is a complicated process. Unless landowners have considerable knowledge of timber inventory and appraisal, they should work with experienced foresters and tax accountants. Finally, it is good business to have timber appraised shortly after acquisition, to establish a tax basis, thereby making the process described here much easier. For more information, refer to the National Timber Tax website – www.timbertax.org.

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http://utextension.tennessee.edu/

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