

Coping with Losses from Nature and Chance



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FORESTRY TAXES

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WEBINAR SERIES

Jan. 18 Seeing the Forest for the Trees: An Overview of Forestry Taxes

Jan. 25 Basics of Timber Basis: Re(setting) the Table:

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Disclaimer

- The material and discussion in this presentation are NOT legal or accounting advice. The information is for educational purposes only.
- The facts and circumstances of each taxpayer's individual situation need to be taken into consideration for exact application of the tax law.
- This presentation is an overview, for awareness raising, and omits various provisions and complexities that might affect certain people of all categories.



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Disclaimer

Tax law is very complex

Often hinges on details
always changing

This presentation is NOT TAX ADVICE



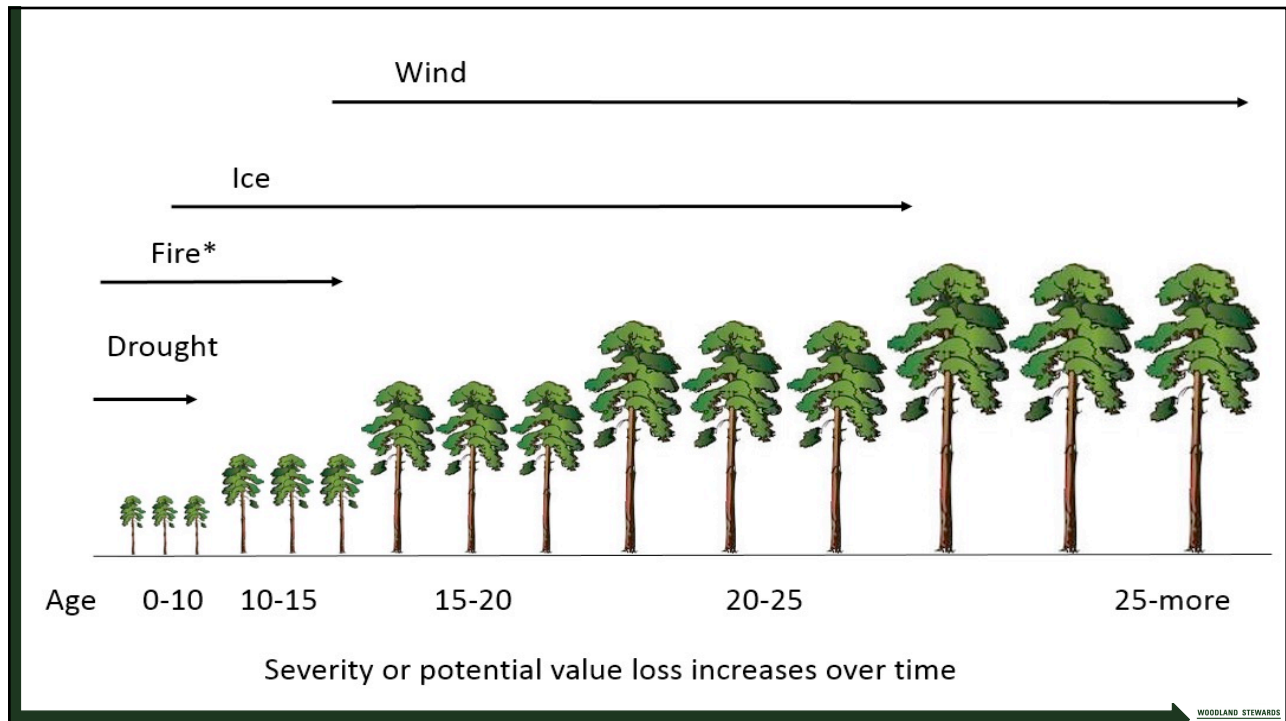
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Outline

1. Defining casualty loss
2. General rules for timber
3. Determination of deduction
4. Reporting timber casualty loss
5. Treatment of casualty-related income
6. Theft & non-casualty losses



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Defining casualty loss

A timber casualty loss is the damage, destruction, or loss of timber resulting from an identifiable event that is:

Sudden	Unexpected	Unusual
swift, not gradual or progressive	unintended, unanticipated	not a typical day-to-day occurrence

Fire, hurricane, tornado, storm, earthquake, volcanic eruption, auto crash, timber killed by SPB in 9 days



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What timber casualty loss is **not**

Normal timber loss (not deductible)

- Expected mortality (seedling death, normal levels of insect/disease infestation, low rainfall, crowding etc.)
- Improper planting/management

Non-casualty timber loss (deductible)

- Result of an unusual and unexpected event, but not sudden
- (Timber losses due to severe drought, tree mortality due to SPB outbreak)



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General rules

- Deductions are available to owners with profit motive
- A block approach should be used
- Deductions are limited to lesser of timber's decrease in FMV or adjusted basis
- Casualty loss deduction and timber salvage sale are two separate events



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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



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Determine timber casualty loss

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



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Timber casualty loss – an example



Joe purchased a **50-acre** loblolly pine tract in 2010. Right after the purchase, he allocated **\$5,000** to the timber basis account. Last year, trees on **20 acres** of the property were completely destroyed by a fire. A consulting forester estimated that there were **800 cords** of pulpwood at \$25/cord on the **whole 50-acre** property prior to the fire. How much can he claim as casualty loss for the year?

Fair Market Value before the fire:	\$20,000
<i>50 acres x 800 cords x \$25/cord</i>	
FMV after the fire:	\$12,000
<i>20 acres destroyed x 320 cords x \$25</i>	
Decrease:	\$8,000

**Single
identifiable
property or
"block"**



He can deduct \$5,000 as casualty loss.

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Deductible timber casualty loss

- **Timber held for investment or business**
 - **Income-producing property**
- **Timber held for personal use**
 - Limited to Presidentially Declared Disaster Areas only
 - Further reduced by \$100 and 10% of adjusted gross income (AGI)



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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 previous year



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Reporting timber casualty loss

- Report the loss on Form 4684, then:

Business owners: Form 4797

Investors: Form 1040, Schedule A, "Other Itemized Deductions"

Personal use: Form 1040, Schedule A, line 15



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Insurance

If you expect to be reimbursed for part or all of your loss

you must subtract the expected reimbursement when you calculate your loss. You must reduce your loss even if you don't receive payment until a later tax year.

If you receive an insurance or other type of reimbursement,

you must **subtract the reimbursement** when you figure your loss.

Correct on following tax return
if less or more than expected



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Casualty loss and salvage

- Separate events (OK to claim loss first, salvage later)
- Landowners make proper adjustment for salvage value
- Not required to salvage



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What if there is a gain?

If the owner receives salvage income, can call the transaction an involuntary conversion

Salvage income > adjusted timber basis = gain

The owner can:

- pay tax on the gain, or
- defer the gain by purchasing qualifying replacement property



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Qualifying replacement property

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

Within 2 years



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To postpone recognition of gains

1. Attach a statement to your tax return
 - ✓ Describe conversion and replacement property
 - ✓ State that you elect to postpone recognition of the gain
2. Your basis in the replacement property is:

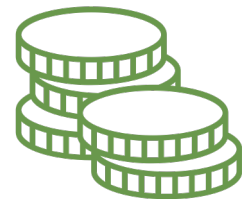
Acquisition costs – deferred gain
3. The gain will be recognized when you sell the property in the future



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Treatment of expenses

Costs of determining a casualty or theft (appraisal, cruise, photos, incidental costs) are not part of the casualty loss



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



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Timber casualty loss summary

- Block approach
- Casualty loss deduction is limited to lesser of decrease in FMV or adjusted timber basis
- Casualty loss and salvage are separate events
- Salvage sale/insurance could result in taxable gain
- Taxes can be deferred by claiming an involuntary conversion and purchasing qualified replacement property



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Theft loss

- Loss is determined just like a casualty loss
- Theft loss is deducted in the year the theft is discovered
- Personal theft loss must be in Presidential-declared disaster area



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Noncasualty timber loss

Loss of timber resulting from an unusual and unexpected event (not necessary to be sudden)

Can be gradual or progressive: insect attack, drought, or a combination of factors

Mostly a business deduction:
Investors can not deduct noncasualty losses

Reported on Form 4797 and netted with other Section 1231 gains or losses



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Block grants/other compensation

For cleanup:

treat as ordinary income and then handle the expenses as previously discussed

Loss compensation:

considered income to taxpayer, will be either ordinary or capital depending on eligibility

- May result in gain or loss depending on basis
- May purchase replacement property and defer gain



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End notes

- ✓ Keep excellent records to substantiate treatment
- ✓ Make decisions based on objectives and consider biological, financial and legal factors
- ✓ This is complicated, good advisors are key
- ✓ PLAN!



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Resources

- Forest landowner's guide to the federal income tax, Ag Handbook 731 (currently in revision)
- Tax Tips for Forest Landowners for the 2021 Tax Year
- Timbertax.org
- Audit technique guides

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