Post-Fire Timber Tax Issues

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Post-Fire Timber Loss

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<5> Records

Loss Deduction

- The timbers lost from fire fall under “casualty loss” deduction for tax purpose
- Treasury Regulations apply
Casualty Loss Amount

- The smaller of:
  - FMV decrease or
  - adjusted basis
  of your timber property

An Example

John’s 80-acre timber was destroyed by fire.
FMV Prior: $50,000
FMV After: $5,000
$45,000
Adjusted basis: $24,000

Insurance or Salvage Value

- Generally the casualty loss must be reduced by insurance, salvage value or other compensation received
Timber Salvage Sale

- Exception:
  Court case allowed timber salvage sale as a separate event

FMV Decrease

- Defined as: the FMV immediately before the casualty reduced by the FMV of the property immediately after the casualty

The Adjusted Basis

- Key to casualty loss deduction
  - Generally, it is the cost of property, adjusted by changes
Original Basis: *Purchased Property*

- The total original basis is:
  - the *purchase price* plus
  - acquisition *costs*

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Original Basis: *Purchased Property*

- The original basis must be *allocated* between land and timber *based on its share of FMV*

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Original Basis: *Inherited Property*

- Generally *the fair market value* of timber on the *date of the decedent’s death*
Original Basis: Gifted Property

- Generally donor’s adjusted basis carries over to the donee:
  - the lower of the donor’s basis or the FMV if a loss on subsequent disposition

Original Basis: Gifted Property

- If gift tax is paid:
  - gift taxes paid increase the basis for the donee

Original Basis: Reforested Property

- The cost of reforestation:
  - Site Preparation
  - Seedling
  - Hired Labor
  - Transportation
Establishing Basis

- Retroactively documenting basis is OK
- Typically a forester is needed for timber volume estimate

Property Unit

- Hotly debated:
  - Basis for the *entire* timber acreage or *specific* units destroyed?

An Example

- A fire damaged 10% of a timber stand.
  The adjusted basis of the entire stand is $50,000.
  Use $50,000 as basis for casualty loss calculation?
Property Unit

- If the record for the entire stand was kept together, court cases and the IRS accepted using the basis for the entire stand for casualty loss!

IRS Audit Area #1

- Basis verification
  - Form T (Part II) or
  - Timber tax records

Audit Area #2

- FMV Loss Examination
  - To be consistent, FMV loss valuation should be performed for the entire stand
Capital Loss Disallowed

- Deducting the FMV loss of timber as capital loss is disallowed

Taxable Gains?

- If salvage sale proceeds exceed sales expenses and adjusted basis, you have a taxable gain.

An Example

- FMV loss: $50,000
  Adjusted basis: $45,000
  Casualty loss: $45,000

  If Salvage sale of $4,000, then taxable gain: $4,000
Taxes may be deferred

- when the sale proceeds are used to purchase qualifying replacement property

Replacement Property

- Reforestation
- Acquiring new timberland
- Cost of purchasing stock of timber corporation (80%)

Records

- Substantiate your loss with solid records.