

# Tax considerations of natural disaster related timber losses and recovery

## Casualty loss deduction, salvage timber sales, and reforestation



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# Disclaimer

*The material and discussion in this presentation are NOT legal, tax, or accounting advice. The information is for educational purposes only.*



# Outline

- **Major timber tax provisions**
- **Post-disaster tax considerations**
  - timber casualty loss deduction
  - gain from salvage timber sales
  - reforestation tax incentives
  - state disaster relief grant



# Major forest-related federal income tax provisions

- Capital gain tax treatment of timber sale income
- Reforestation costs deduction and amortization
- Timber depletion
- Management expenses deduction
- Casualty loss deduction
- Cost-share payment exclusion
- Capital expenditure depreciation



# Tax considerations after a natural disaster

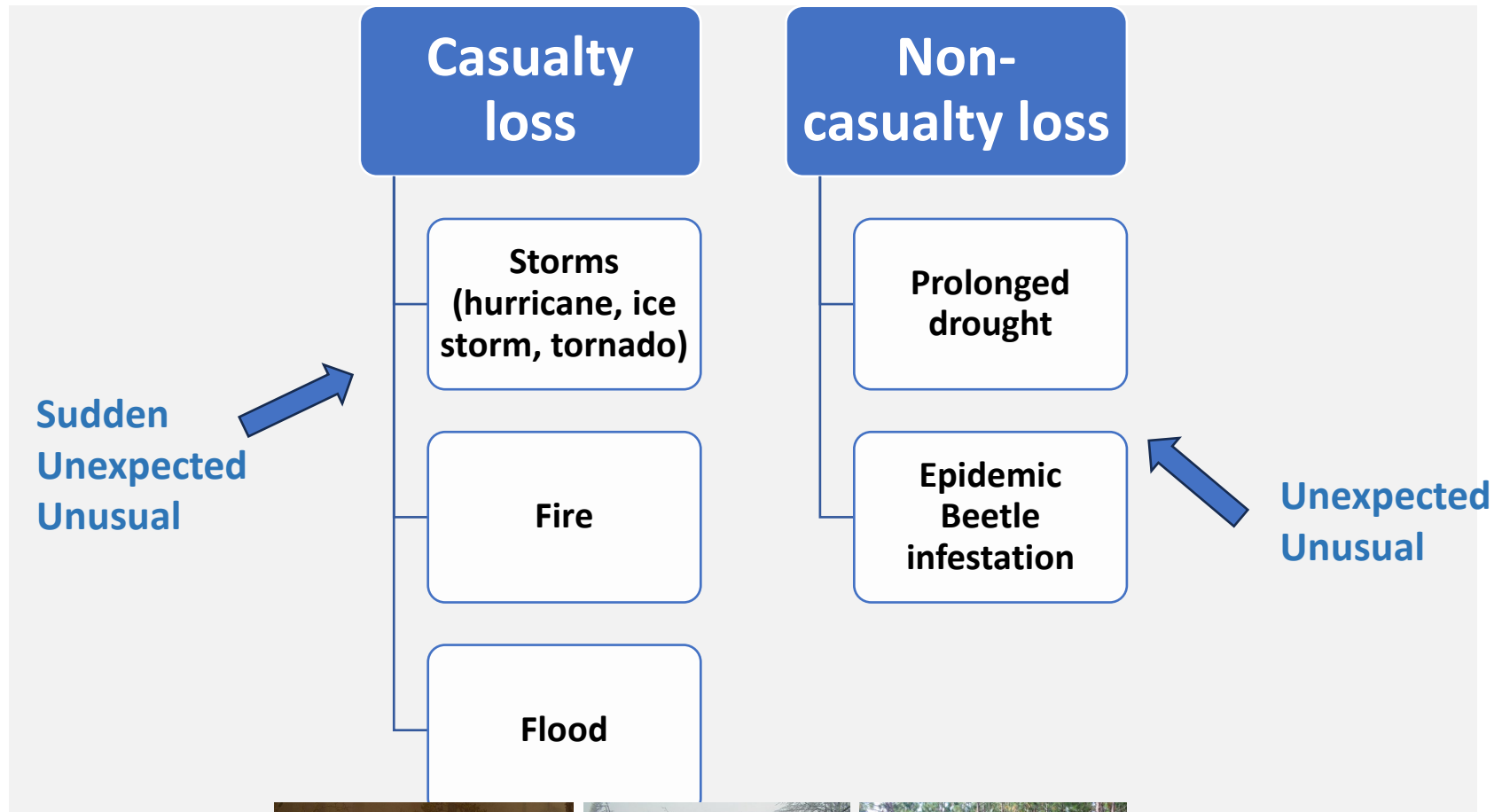


Timber casualty loss deduction

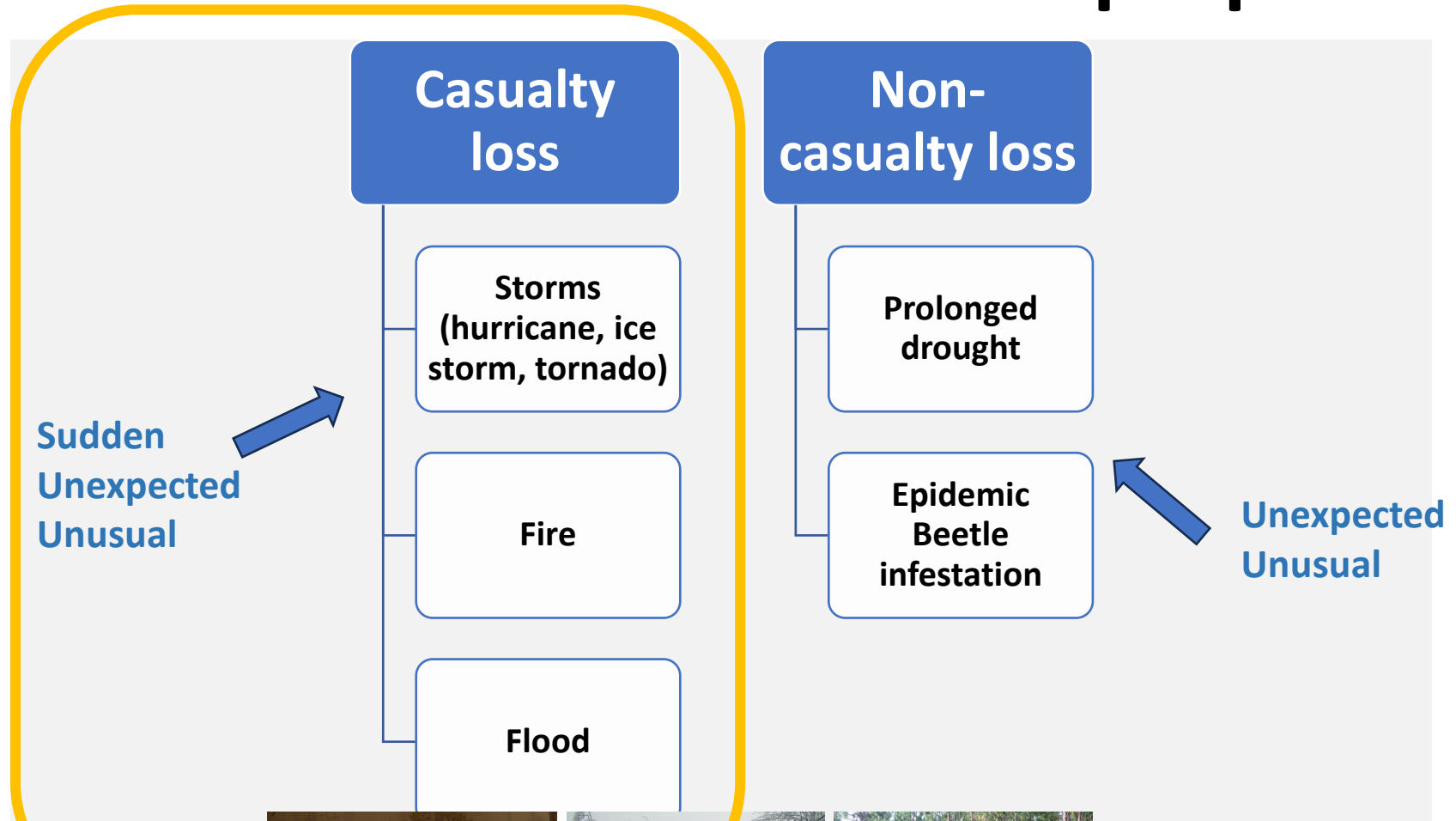
Salvage timber sales

Reforestation/restoration

# Not all disaster-related timber losses are treated the same for tax purposes



# Not all disaster-related timber losses are treated the same for tax purposes



# Category of forest holding is key



**Hobby/personal use**



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**Investment**



**Business**

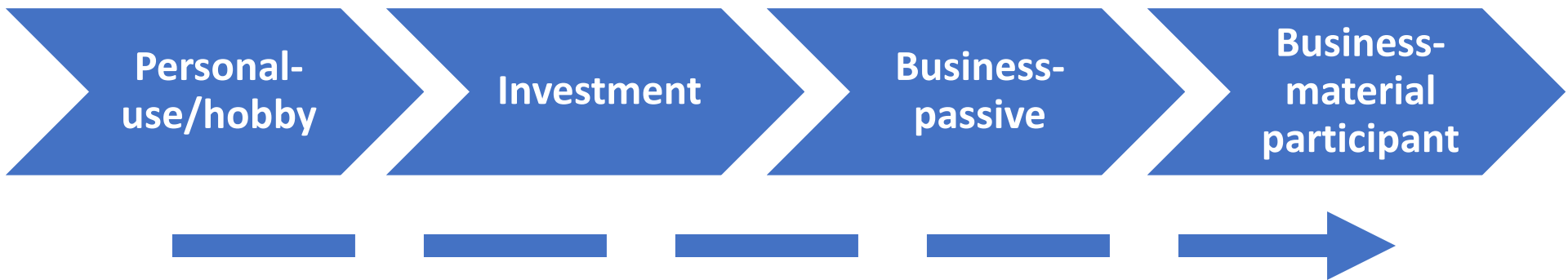
**Material participation**



**Passive activity**



**“For profit” activities (investment or business) receive larger tax benefit.**



- More favorable deductions
- Better tax treatments
- Stricter recordkeeping requirements

# General rules

- Timber casualty losses may be deductible
- A block approach should be used
- Deduction is limited to adjusted timber basis
- Casualty loss can offset ordinary income (carry over)
- Timber casualty loss deduction and timber salvage sale are two separate events
- Salvage sales could result in taxable gain
- The gain can be deferred
- Special rules apply to the federal disaster areas
- Reforestation tax incentives are available



# Single Identifiable Property (SIP)

- Timber casualty loss should be determined by reference to Single Identifiable Property damaged or destroyed
- The block used to keep track of timber basis
- Not the damaged or destroyed trees only
- An operation unit, a logging unit, or established by geographical/political boundaries
- Qualified timber property (QTP) under section 194 is acceptable



# Determine timber casualty loss

Deductible casualty loss is **the lesser of:**

- **Decrease in fair market value (FMV) of the block due to the casualty**
- **Adjusted timber basis of the block**



Not just the portion that was damaged or destroyed



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# Deductible timber casualty loss

- **Timber holding for investment or business**
- **Timber holding for personal use**
  - Limited to federally or state declared disaster only
  - Further reduced by \$100 and 10% of adjusted gross income (AGI)
  - “Qualified disaster”: reduced by \$500 only, can also claim standard deduction



# Example

Joe owns a **100-ac** loblolly pine tract in Appling county, GA. He keeps all timber in one block for depletion purpose. Timber basis is \$50,000. Hurricane Helene destroyed **30 acres** of the trees on the property. A consulting forester estimated that the FMV of the 100-ac property decreased from \$200,000 to \$140,000 (\$60,000 decrease). How much can he claim as a timber casualty loss?

The **lesser** of:

- (a) timber basis (\$50,000) or
  - (b) decrease in FMV (\$60,000)
- is \$50,000

SIP is the 100-ac block



# Competent appraisal

- Registered consulting forester
- Document and analysis
- Loss due to physical damage

# What is timber basis?

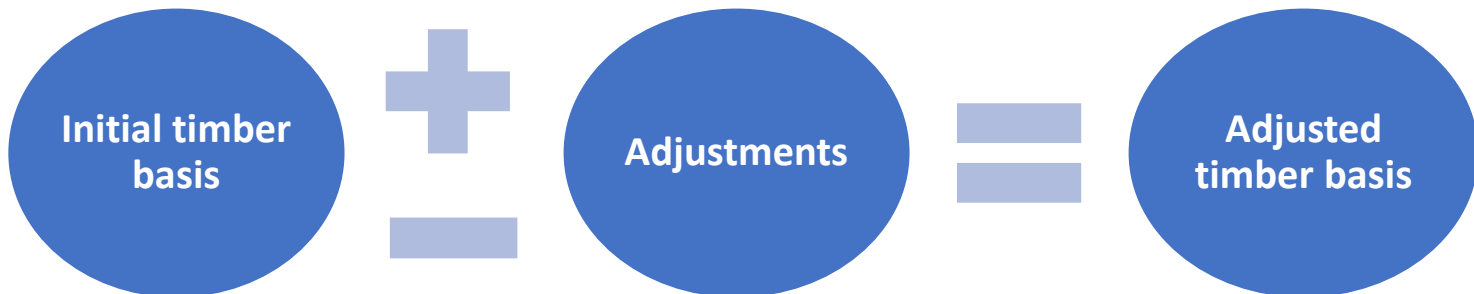
- Basis is the book value of your investment in timber
- Initial basis varies depending upon how the property was acquired
- Basis increases as more money is invested into the timber
- Basis decreases as timber is depleted
- Adjusted basis is the remainder



# What is your timber basis?



- Book value of your investment in timber
- Starts with initial basis
- Adjust over time
  - increase when having more investment
  - decrease when selling/having a loss
- Adjusted basis



# 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”**

# What if basis hasn't been established

- Reconstruct retroactively (ungrow timber)
- Back to the day when it was acquired
- Timber volume and value back then
- Using average timber growth rate or growth yield model
- If too costly, zero basis



# Casualty loss deduction

- Can offset ordinary income
- Carry over unused casualty loss until used up (no time limit)
- Investors have to itemize deductions (Schedule A)

# Casualty loss deduction and salvage sales

- Separate events
- Can claim loss first, then salvage timber
- Make reasonable efforts to salvage damaged timber
- Document attempts to salvage:
  - Phone calls to consultants, loggers, potential buyers
  - Contacts



# What if there is a gain?

- Salvage sale is an involuntary conversion
- Could result in a gain if the salvage revenue is greater than the adjusted basis
- **Two options:**
  - pay tax on the gain, or
  - defer the gain by purchasing qualifying replacement property



# Qualifying replacement property

- Reforestation costs
- Timber
- Replacement timberland
- Controlling stock in timber corporation

**Within 2 years**



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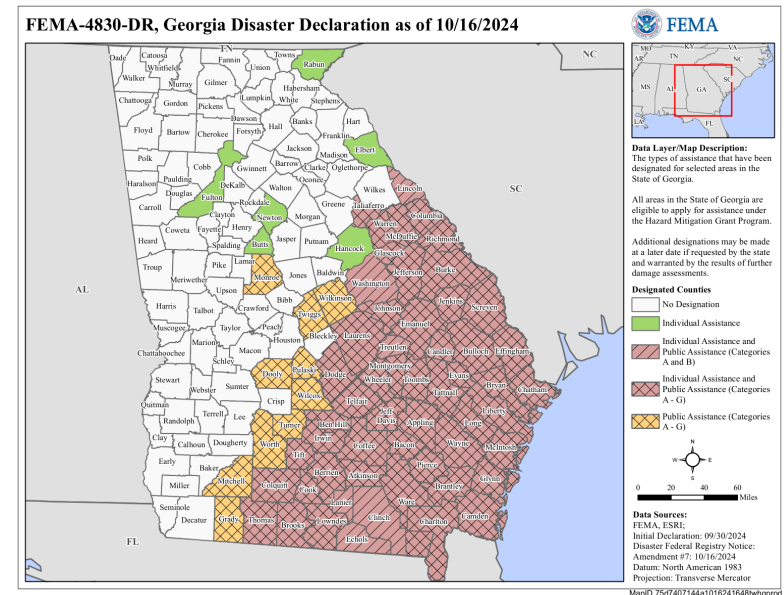
# Special rule for federal disaster areas (for-profit timber holding only)

- Any tangible replacement property for productive use in a business is considered similar in use



# When to deduct a casualty loss

- Claim in the year of casualty
- For ***federally declared disaster areas***, the deduction can be taken on amended tax return for the last year
- Benefits
  - cash
  - tax saving



# Report timber casualty loss

- Report the loss on Form 4684
- Then:
  - Business timber owners go to Form 4797, then Schedule 1
  - Investors go to Form 1040, Schedule A, “Other Itemized Deductions”
  - Landowners holding timber for personal use go to Form 1040, Schedule A

Form **4684**  
Department of the Treasury  
Internal Revenue Service  
Name(s) shown on tax return

**Casualties and Thefts**  
Attach to your tax return.  
Use a separate Form 4684 for each casualty or theft.  
Go to [www.irs.gov/Form4684](http://www.irs.gov/Form4684) for instructions and the latest information.

OMB No. 1545-0177

**2023**  
Attachment  
Sequence No. **26**

Identifying number

# Postpone recognition of gains

- **Attach a statement to the tax return**
  - Describe the conversion and replacement property
  - State that you elect to postpone recognition of the gain
- **Use the proceeds to buy replacement property**
- **Your basis in the replacement property is:**

Acquisition costs – deferred gain
- **Recognize the gain when the property is sold in the future**



# Treatment of appraisal costs

- Deduct the costs of appraisal as operating expenses
  - Landowners holding timber for use in a trade or business, use Form 1040, Schedule C or F
  - Landowners holding timber as an investment capitalize the expenses



# State disaster relief payment

- Compensation for timber loss
- Taxable income (ordinary)
- Can defer the income by purchasing replacement property



# Record-keeping

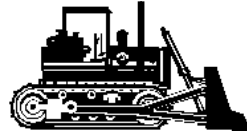
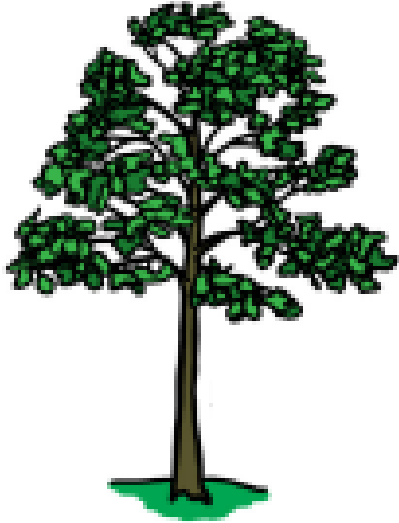
- Photos of the property and damage
- Timber accounting records
- Forest management records
- Proof of property ownership
- Previous tax returns



# Reforestation

- **Tax incentives are available for reforestation**
- **Reforestation expenses are the direct costs of planting or seeding for forestation**
  - ✓ Site preparation costs
  - ✓ Consulting forester fee related to reforestation
  - ✓ Hired labor
  - ✓ Vegetation control to establish trees
  - ✓ Rent for tools/equipment
  - ✓ Depreciation of equipment used in reforestation

# Reforestation Costs



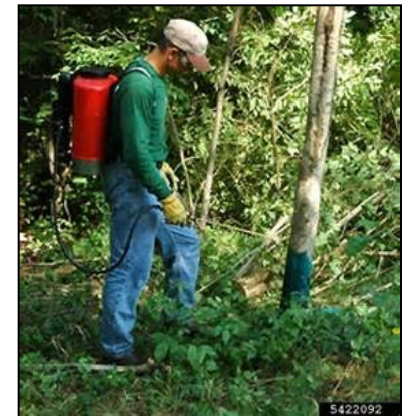
Pre-Harvest Site Prep

Harvest

Site Preparation

Planting

Post-Planting Site Prep



Credit: Stephen Dicke



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# Reforestation (cont.)



- IRS allows outright up to \$10,000 expensing and an 84-month amortization
- This applies to per qualified timber property (QTP) per year
- Proper planning over years can maximize the tax benefits
- Individuals, estates, partnerships, and corporations are eligible
- Trusts are not eligible for the expensing deduction but they are eligible for the amortization

# Ways to maximize tax benefits

- Divide into multiple QTPs
- Divide reforestation operation into two years
- Use cost-share programs to bring down costs

## But...

- Should base your forest management decisions on silvicultural, financial and planning implications, not just tax effects



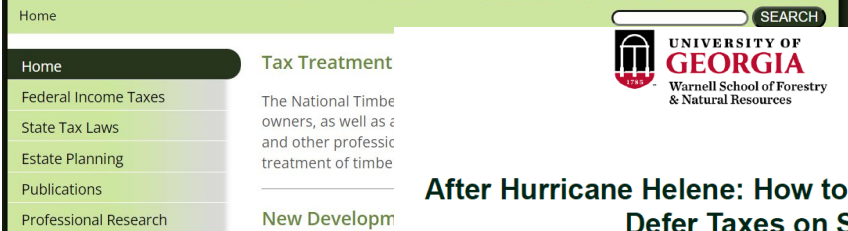
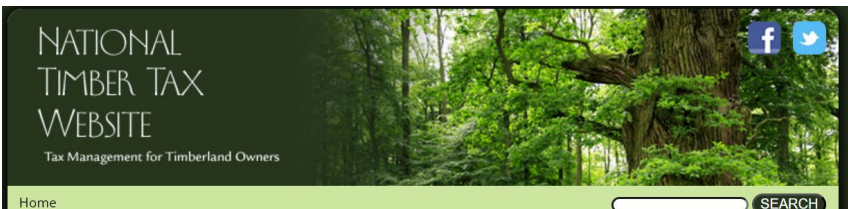
# Sources of information

- National timber tax website
- UGA extension publication
- Webinar



## National Timber Tax - Education Series

The USDA Forest Service's National Timber Tax Education Series is a webinar based education series for timberland owners, as well as a reference for accountants, attorneys, consulting foresters and other professionals regarding the tax treatment of timber related activities.



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Harley Langdale Jr.  
Center for Forest Business  
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## After Hurricane Helene: How to Claim Timber Casualty Losses and Defer Taxes on Salvage Timber Sales

Yanshu Li, E. David Dickens, and David C. Clabo

October 18<sup>th</sup>, 2024



- **Method for determining loss.** Timber casualty losses should generally be determined using the timber depletion block approach, rather than simply adding up the value of the damaged or destroyed timber.
- **Deduction limit.** The deductible amount for timber casualty losses cannot exceed the adjusted basis of the affected timber depletion block. This amount is often lower than the retail value of the affected timber block.

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