Timber Casualty Losses

Tennessee Department of Agriculture, Division of Forestry

Timber lost by fire, storm, theft, and in some cases drought may be fully deductible from adjusted gross income. This includes investors and passive participants as well as active participants.

Fire, storm and theft are called "casualty losses". Casualty losses must be abnormal, unusual and unexpected. Similar losses, called non-casualty losses, may also be deductible if they are unusual and abnormal, but not unexpected. Non-casualty loss might result from a southern pine beetle epidemic or death of seedlings because of drought. Losses resulting from ordinary circumstances are not deductible.

Your deductible loss is the lesser of the fair market value (FMV) and the basis of the timber suffering the loss, which the IRS calls the "single identifiable property" (SIP). It is to your advantage to use the entire stand of timber as the SIP. This affords the greatest chance of claiming the full Fair Market Value as a loss. It may be necessary to get a cruise to get a sound estimate of changes to the timber basis and FMV due to loss and damage.

You can claim a loss of *unmerchantable* timber if you maintain separate accounts for plantation and timber, if you allocate "reasonable" costs to these accounts, and if the costs have not already been transferred to the timber account.

You must attempt a salvage and be able to prove it; keep a record of buyers contacted and their responses.

If you can't complete the salvage in time to report, go head and file based on an estimate; adjust the return for the year when the amount is finally determined.

You must subtract what you get from a salvage sale, even if you haven't received the money yet. Adjust later tax returns if the amount received is different than anticipated.

If you have capital gains for the year, you must follow the capital gains/losses netting procedure proscribed by the IRS to determine your final loss or gain for the year.

Report gains or losses from the incident just as you would a timber sale; report casualty losses on Form 4684, Section B and carry over to Form 4797, Sale of Business Property. Report non-casualty losses as a Section 1231involuntary conversion on Form 4797.

If your loss is not deductible, adjust your timber volume account but don't change the timber value account (cost basis) since you did not recover any basis.

In case of audit, provide added information on form 4748; it is a good idea to have this available ahead of time. Documentation is very important; it is advisable to take photos.

Tax payment can be postponed two years while you acquire replacement property; this includes reforesting.

See IRS Publication 547 (Sales and Other Dispositions) and 549 (Casualties, Disasters and Thefts) and IRS Code Section 1231, Involuntary Conversions.

This bulletin is educational in nature and is not intended to serve as specific advice on tax preparation.

Draft version 11-15-02