TAX CONSIDERATIONS FOR FORESTS AFFECTED BY NATURAL DISASTERS

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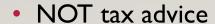
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INTRODUCTION

Tax law is very complex

Often hinges on details

Always changing





AGENDA

- Casualty loss
- Basis
- Gains
- Financial assistance
- Reforestation



DEFINING CASUALTY LOSS

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, SPB kill in 9 days

NOT A CASUALTY LOSS

Normal timber loss (not deductible)

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

DEDUCTIBLE TIMBER CASUALTY LOSS

- Timber holding for investment or business
- Timber holding for personal use

PERSONAL-USE CASUALTY LOSSES

- Home, household, personal vehicles
- Federally declared disaster area
 - No declaration = no allowable loss
- Subtract \$100 and 10% of AGI

DETERMINE TIMBER CASUALTY LOSSES

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

WHAT IS BASIS?

• A measure of an owner's investment in a capital asset

- Very important for sales or loss situations
 - Will reduce your taxable gain!

DETERMINATION OF BASIS

Depends on how property is acquired

- Purchase
- Inheritance
- Gift
- Exchange

PURCHASED PROPERTY

Total amount paid

• Includes attorney fees, commissions, sales taxes

Not indexed

PROPERTY RECEIVED THROUGH INHERITANCE

- Basis equal to fair market value
- At date of death or alternate valuation date
- Results in a "stepped-up" basis
- If special use valuation is elected, that value is used



HOW DO I FIGURE OUT MY BASIS IF IT WAS NEVER DONE??

- Called a retroactive basis determination
- Same method as if figured at time of acquisition, just requires research
- Will need to determine timber prices
- Volume estimation

WAIT!

 Adjusted basis: original basis minus depletion, depreciation, losses plus capital improvement costs or additions to asset

CASUALTY LOSS DEDUCTION

- Usually taken in year of loss but may go back a year
- Multiple owners, allocate by ownership
- Provide proof of ownership, loss, basis
- Can trigger a NOL
 - complex, consult a tax preparer
- Must take into account salvage and insurance proceeds

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

INSURANCE

IF YOU EXPECT TO BE REIMBURSED FOR PART OR ALL OF YOUR LOSS

- 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.
- Correct on following tax return if less or more than expected

IF YOU RECEIVE AN INSURANCE OR OTHER TYPE OF REIMBURSEMENT

 Subtract the reimbursement when you figure your loss

SALVAGE

- 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

QUALIFYING REPLACEMENT PROPERTY

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

Within 2 years

TREATMENT OF EXPENSES

 Deduct the costs of determining a casualty or theft (appraisal, cruise, photos, incidental costs) as operating expenses

Landowners holding timber as an <u>investment</u> capitalize the expenses

Landowners holding timber for use in a <u>trade</u> <u>or business</u>, use Form 1040, Schedule C or F

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

TYPES OF INCOME

- Ordinary income
 - Example: wages
- Capital Gains
 - Lower rates
 - Current 0, 15 & 20%
 - No self-employment tax (15.3%!)
 - Can be offset completely by capital losses

HOW INCOME IS TAXED

- How long timber is held:
 - Must be held for more than one year
 - For gift, donor & donee's time counted
 - No holding period if inherited

RECOVERING TIMBER BASIS

Done through depletion

Adjusted basis ÷ total volume of timber

Calculated for each account

REFORESTATION

Afforestation or reforestation

- Site prep, seed or seedlings, brush & weed control
- Natural and artificial regeneration



REFORESTATION TAX INCENTIVES

- Outright deduction of expenses up to \$10K
 - Per qualified timber property
 - Per tax year

Remainder amortized over 8 tax years

EXAMPLE REFORESTATION

- Landowner spends \$25,000 on reforestation activities in 2023
 - Deduct \$10,000 on 2023 return
 - \$15,000 will be amortized
 - Can have another \$10,000 deduction on new reforestation in 2024
 - Recapture provisions for amortization
 - 10 years, gain on disposition

TAX STRATEGY!!!

Reforestation incentive available each tax year

Forestry operations often naturally staggered

Take advantage of staggering operations

NOTES ON REFORESTATION INCENTIVE

On timely filed return

Must include cost share income

No carryover of unused deduction

• Recapture provisions!

UTILIZING THE REFORESTATION INCENTIVE §194

 Investors take deduction on Schedule 1 of 1040, businesses on Schedule C or F (file Form 4562 depreciation and amortization)

Can not be made on amended return!

CASUALTY LOSS LEGISLATION

- Disaster Reforestation Act
- Proposed, in Senate Finance Committee
- Improved tax deductions

Stay tuned!

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!

RESOURCES

- Forest Landowner's Guide to the Federal Income Tax, Ag Handbook
 731
- Hardwood Timber Industry Audit Technique Guide, online IRS guide
- Timber Casualty Loss Audit Technique Guide, online IRS guide
- Woodland Steward Forestry Tax Series 2022 https://forestrywebinars.net/webinars

QUESTIONS

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