



Timber Casualty Loss and Involuntary Conversion

Stephen Dicke

Central MS Research and Extension Center

**1320 Seven Springs Road Raymond, MS 39154
601-857-2284 steved@ext.msstate.edu**



#1 problem
is a very
low basis.

Tax treatment of
timber loss is the
same as all other
assets.
It may seem
unfair but its not.

What Qualities as a Casualty Loss?

- Sudden
- Unexpected and Unusual
- Natural or External forces
- Asset left unfit for use



Hurricane
Katrina –
August 29,
2005



Types of Losses

- **Casualty** – Deductible on IRS Form 4684 (Katrina damage - can file against 2004 taxes, 2005-2010)

- **Non-Casualty Business** –

- Deductible on IRS Form 4797
- Epidemic Southern Pine Beetle Damage
- Drought Disaster Seedling Loss

- **Normal** – Not Deductible
- Most Insects, all Diseases



To Claim a Casualty Loss

1. Identify the timber damaged or destroyed
2. Determine for entire timber acreage:
 - ✓ Fair Market Value Before the Loss
 - ✓ Fair Market Value After the Loss
(= Salvage Value for 100% loss)
3. Difference is FMV loss
4. Deduction is the lesser of FMV loss or basis.

**IRS
Form
4684**

SECTION B—Business and Income-Producing Property
Part I Casualty or Theft Gain or Loss (Use a separate Part I for

19 Description of properties (show type, location, and date acquired for each prop
 aged from the same casualty or theft.
 Property A
 Property B
 Property C
 Property D

Timber Type, Legal Description, Date Acquired

	A
--	---

20	Basis			Cost or adjusted basis of each property.
21				Insurance or other reimbursement (whether or not you filed a claim). See the instructions for line 3.
22				Gain from casualty or theft. If line 21 is more than line 20, enter the difference here and on line 29 or line 34, column (c), except as provided in the instructions for line 33. Also, skip lines 23 through 27 for that column. See the instructions for line 4 if line 21 includes insurance or other reimbursement you did not claim, or you received payment for your loss in a later tax year.
23	FMV Befo			Fair market value before casualty or theft.
24	FMV After			Fair market value after casualty or theft.
25				Subtract line 24 from line 23.
26				Enter the smaller of line 20 or line 25.



FMV Before?

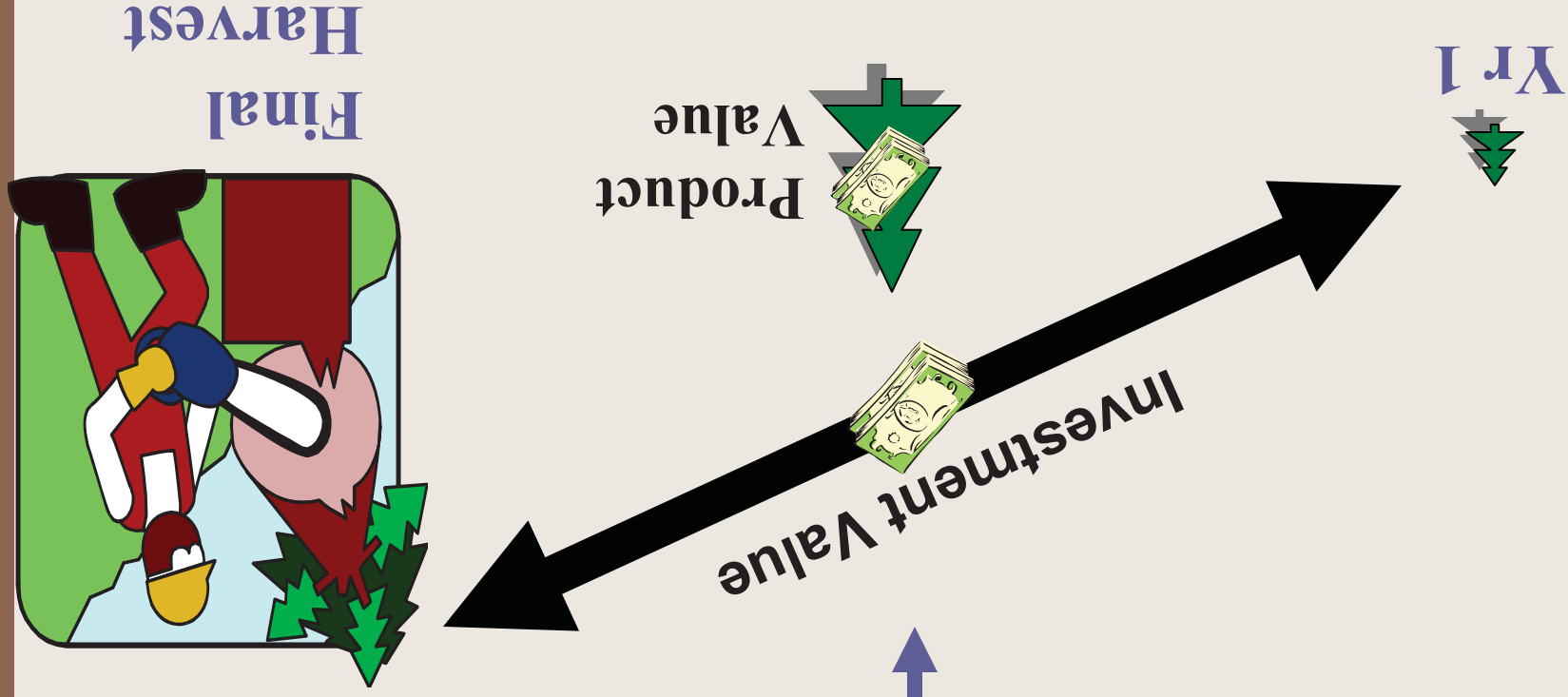
**For timber damaged,
estimate tons before
casualty.**

FMV Before = tonnage x price before casualty

Timber Product	\$/ton before Katrina 8/28/05
Pine Sawtimber	41.88
Pine CNS	23.35
Pine Pulpwood	8.07
Hardwood Sawtimber	22.98
Hardwood Pulpwood	7.49

SE MS Average Source: Forest2Market

Product value is fine for mature timber –
What is the **FMV** of an Immature Stand?



Final
Harvest

$$\text{FMV} = \text{Investment Value} > \text{Product Value}$$



**Precommercial
Timber Value**

Product Value of 17-yr-old pine plantation = \$800/ac

Investment Value of 17-yr-old Pine Plantation
Current Age = 17 years / 35 yr rotation
Estimated FMV of Timber = \$1268.25

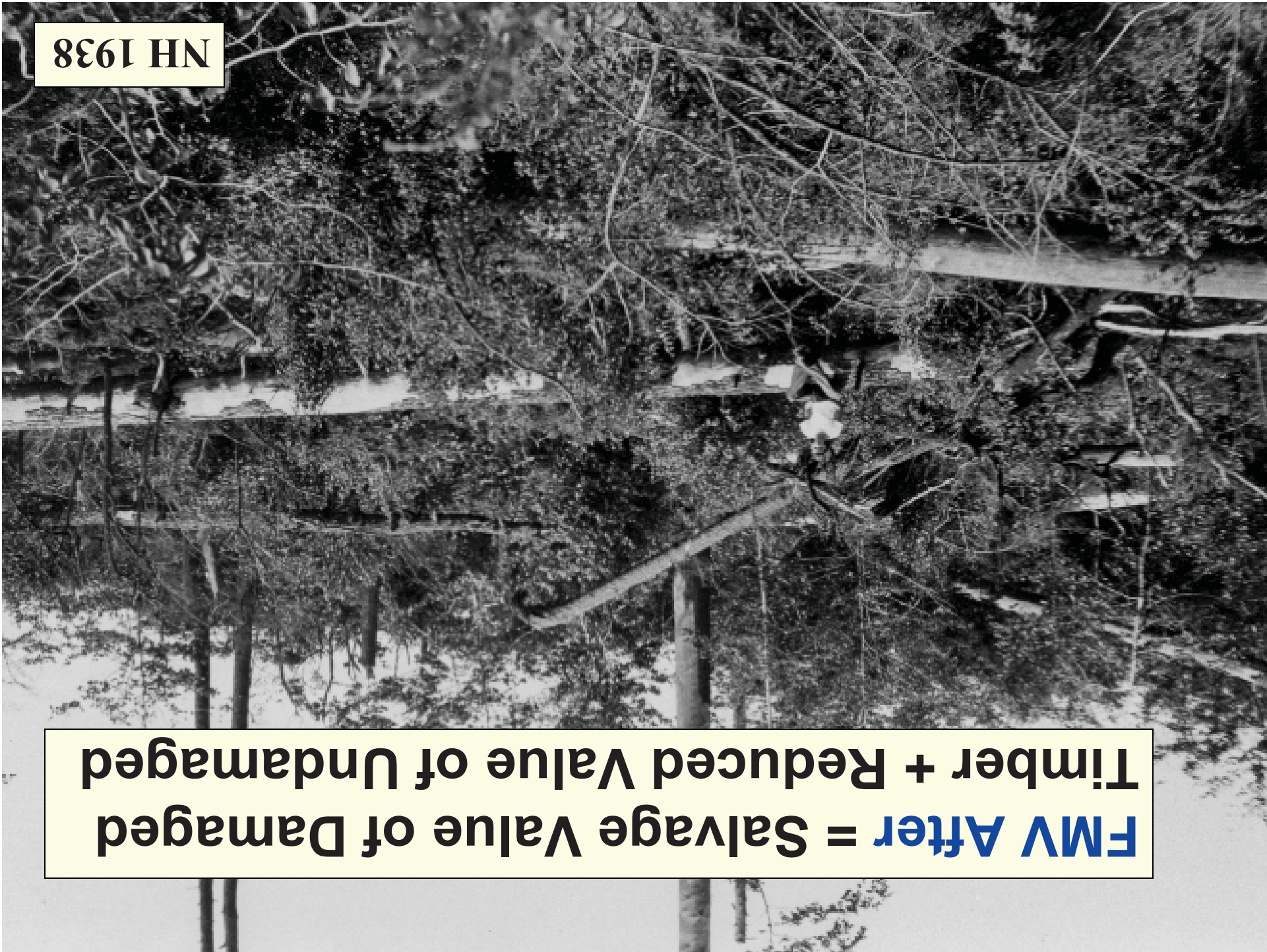
Estimated Value of Land = \$1000.00
Total Estimated Value = \$2268.25

**MORAL: Product value
underestimated FMV by \$446/ac**

FORVAL online www.cfr.msstate.edu/forval/

NH 1938

**FMV After = Salvage Value of Damaged
Timber + Reduced Value of Undamaged**



Reduced FMV After = tonnage x price
\$/ton after Katrina 8/30/05

Reported	-\$20/ton Bill Stuart	50% less Bob Daniels	Timber Product	Pine Sawtimber	20.94	21.88	12-28
			Pine CNS	Pine CNS	11.67	3.35	0,6
			Pine Pulpwood	Pine Pulpwood	4.03	0	0,2,4
			Hardwood Sawtimber	Hardwood Sawtimber	11.49		
			Hardwood Pulpwood	Hardwood Pulpwood	3.74		

Natchez Trace near Port Gibson 1996



BASIS?

Initial Basis

- ☺ **Inherit**
- ☺ **Purchase**
- Receive as Gift
- Regenerate

Retroactive Basis

- Stand Table Projection
best for > 10 yrs

- Growth and Yield Models
best for > 20 yrs

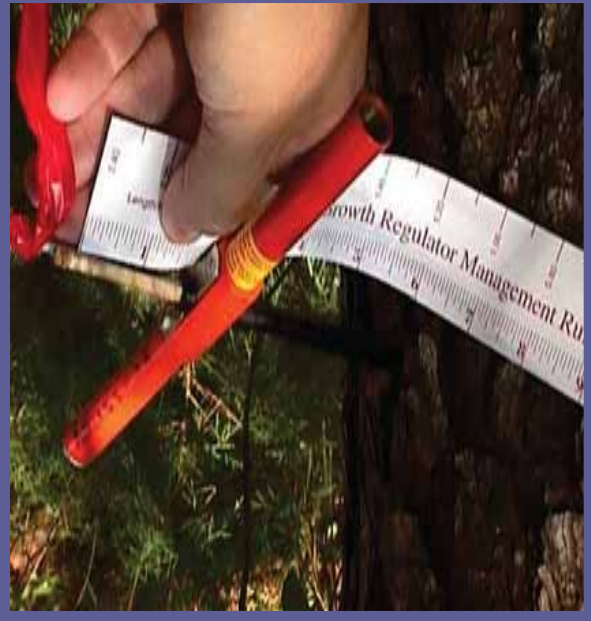
- Average growth rates

Pine = 4%

Oak = 5% (SWAGS)

Models: Texas Forest Service tfsfrd.tamu.edu

MSU Forestry www.cfr.msstate.edu/fwrc/software



Basic Model is a Table

Yield from Loblolly Pine Plantations							Age
Site Index Base Age 50							
65	70	75	80	85	90	95	
39	44	49	57	65	75	86	
42	49	55	62	73	83	96	
47	55	62	70	81	94	107	
52	60	68	78	88	101	117	
56	65	73	83	96	109	125	
60	68	78	91	104	117	135	
65	73	83	96	109	125	146	
68	78	88	101	117	135	153	
73	83	94	109	125	140	161	
75	86	99	114	130	148	169	
81	91	104	120	135	156	179	
83	94	109	125	143	164	187	
86	99	112	130	148	169	192	
88	101	117	135	153	177	200	
94	107	122	138	158	182	208	
96	109	125	143	164	187	216	

Adapted from Virginia Division of Forestry Occ. Report # 21

Residual Method (the method of last resort)
Timber Basis = Purchase Price – Land Value



**What's my
basis?**

Retroactive Basis Determination for Inherited Land and Timber.

Elliot Slash inherited 80 acres of timberland from his mother 10 years ago. The estate was never settled.

This year, a forestry consultant provided the following information: current sawtimber tonnage is 5,000 tons. Growth in the past averaged 3 tons/acre/year. Timber prices 10 years ago were \$25/ton. Comparable bare land 10 years ago was valued at **\$600/acre**.

Retroactive Basis Calculations:

Initial FMV = values 10 years ago

Initial FMV Land = \$600/acre × 80 acres = \$48,000

Initial Tons = Present Tons – 10 Years Growth

= 5,000 tons - (3 tons × 80 ac. × 10 yrs) =
= 5,000 tons - 2,400 tons = 2,600 tons

Initial FMV Timber = \$25/ton × 2,600 tons = \$65,000

Establishing retroactive basis. IRS Form T-Part I Acquisitions.

Note: Best time to establish basis is when property is acquired!

3a Name and address of seller or person from whom property was acquired Elliot Slash inherited 80 acres in 1995		b Date acquired Inherited	
4 Amount paid: a In cash b In interest-bearing notes. c In non-interest-bearing notes.			
5a Amount of other consideration		113,000	
b Explain the nature of other consideration and how you determined the amount shown on line 5a. Fair Market Value at the time Elliot's mother died in 1995. The title was never transferred to Elliot Slash until 2005, thus the need to establish FMV in 1995 retroactively.			
6 Legal expenses			
7 Cruising, surveying, and other acquisition expenses			
8 Total cost or other basis of property. Add lines 4a through 7			
9 Allocation of total cost or other basis on books:		Unit	Number of units
a Forested land		Acre	80 acres
b Other unimproved land		Acre	\$600 per acre
c Improved land (describe)		Acre	Total cost or other basis
d Merchantable timber. Estimate the quantity of merchantable timber present on the acquisition date (see Regulations section		Pine Sawtimber	Cost or other basis per unit 2,600 tons \$25 per ton
			65,000

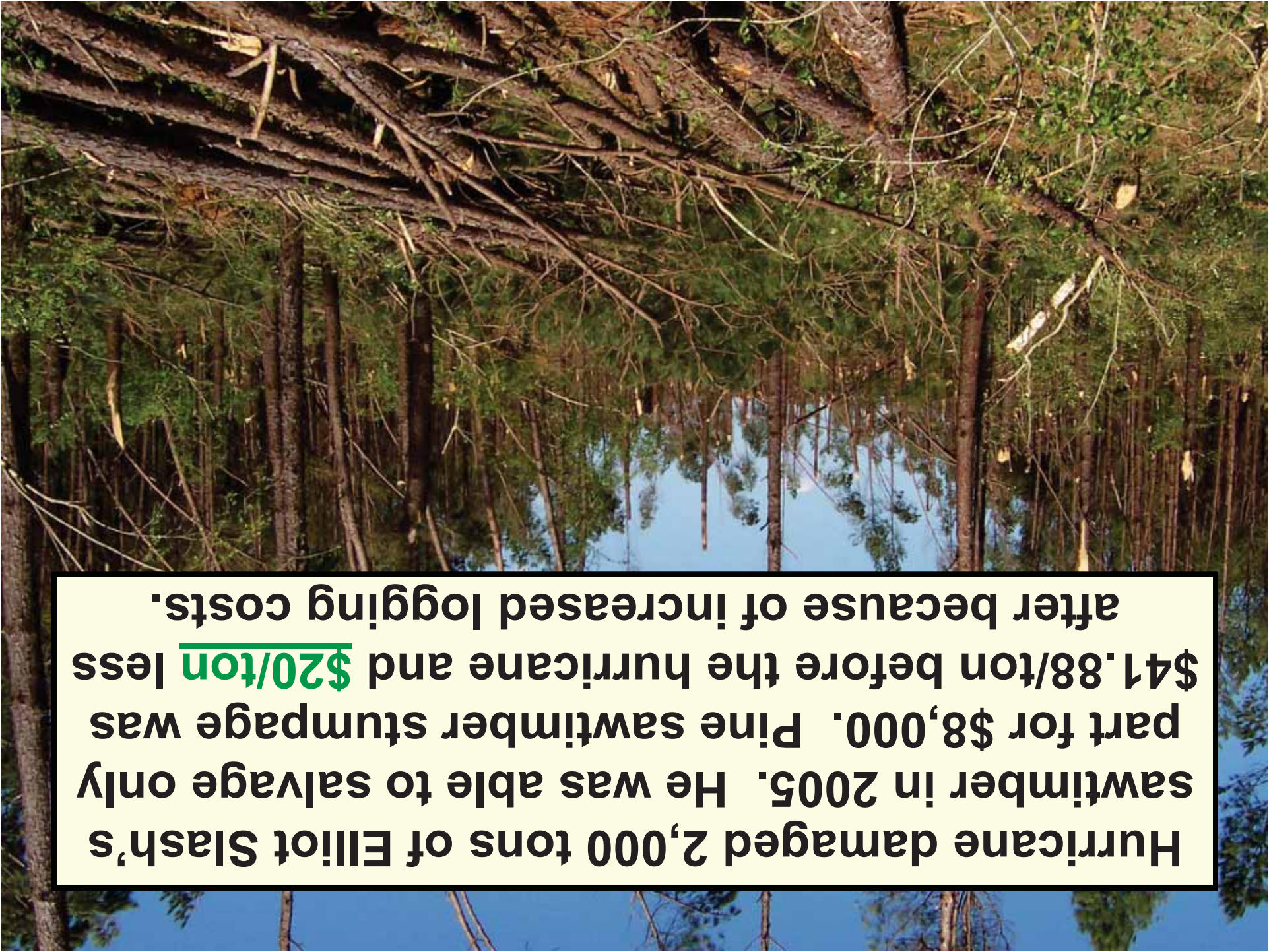
Updating Elliot Slash's timber account for 2005. IRS Form T – Part II Timber Depletion.

10	Name of block and title of account ▶	Quantity (a)	Cost or other basis (b)
	Elliot Slash 80 Acres inherited in 1995		
11	Estimated quantity of timber and cost or other basis returnable through depletion at end of the preceding tax year	2,600 tons	\$65,000
12	Increase or decrease of quantity of timber required by way of correction		
13a	Addition for growth (number of years covered ▶ 10 yrs)	2,400 tons	
b	Transfers from premerchutable timber account.		
c	Transfers from deferred reforestation account		
14	Timber acquired during tax year		
15	Addition to capital during tax year		
16	Total at end of tax year, before depletion. Add lines 11 through 15	5,000 tons	\$65,000
17	Unit rate returnable through depletion, or basis of sales or losses. Divide line 16, column (b), by line 16, column (a)		\$13 per ton

Depletion Unit for Salvage

**Timber
Basis**





Hurricane damaged 2,000 tons of Elliot Slash's sawtimber in 2005. He was able to salvage only part for \$8,000. Pine sawtimber stumpage was \$41.88/ton before the hurricane and \$20/ton less after because of increased logging costs.

$$\text{FMV Before} = 5,000 \text{ tons} \times \$41.88 = \$209,400$$

FMV After = salvage + undamaged

$$\text{Salvage value of 2,000 tons damaged} = \$8,000$$

$$\text{Value of undamaged} = 3,000 \text{ tons} \times \$21.88 = \$65,640$$

$$\text{FMV After} = \$73,640$$

$$\text{FMV LOSS} = \text{FMV before} - \text{FMV after} = \$209,400 - \$73,640$$

$$\text{FMV Loss} = \$135,760$$

$$\text{Basis} = \$65,000$$

the lesser amount is

Elliot Slash's Deductible Loss

**IRS Form
4684 for
Elliott Slash**

SECTION B—Business and Income-Producing Property

Part I Casualty or Theft Gain or Loss (Use a separate Part I for e

19 Description of properties (show type, location, and date acquired for each prop

aged from the same casualty or theft.

Property A

Hurricane Damage to Elliott Slash's 80 acres

Property B

Property C

Property D

A	

20	Cost or adjusted basis of each property.	65,000
21	Insurance or other reimbursement (whether or not you filed a claim). See the instructions for line 3.	No Salvage Income Here
22	Gain from casualty or theft. If line 21 is more than line 20, enter the difference here and on line 29 or line 34, column (c), except as provided in the instructions for line 33. Also, skip lines 23 through 27 for that column. See the instructions for line 4 if line 21 includes insurance or other reimbursement you did not claim, or you received payment for your loss in a later tax year.	
23	Fair market value before casualty or theft.	209,400
24	Fair market value after casualty or theft.	73,640
25	Subtract line 24 from line 23.	135,760
26	Enter the smaller of line 20 or line 25.	65,000
27	Subtract line 21 from line 26. If zero or less, enter -0-	65,000

Cost or adjusted basis of each property.

Insurance or other reimbursement (whether or not you filed a claim). See the instructions for line 3.

Note: If line 20 is more than line 21, skip line 22.

Gain from casualty or theft. If line 21 is more than line 20, enter the difference here and on line 29 or line 34, column (c), except as provided in the instructions for line 33. Also, skip lines 23 through 27 for that column. See the instructions for line 4 if line 21 includes insurance or other reimbursement you did not claim, or you received payment for your loss in a later tax year.

Fair market value **before** casualty or theft.

Fair market value **after** casualty or theft.

Subtract line 24 from line 23.

Enter the **smaller** of line 20 or line 25.

Note: If the property was totally destroyed by casualty or lost from theft, enter on line 26 the amount from line 20.

Subtract line 21 from line 26. If zero or less, enter -0-

Elliott Slash reports \$8,000 salvage. IRS Form 4797

1 Enter the gross proceeds from sales or exchanges reported to you for 2004 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions).

1	8,000
---	-------

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)

(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
2 Salvage Sale of 2,000 tons	Inherited	9/30/05	8,000		- Consultant fee	
					See attached	
					explaining	
					Involuntary	
3 Gain, if any, from Form 4684, line 39						
					Conversion	3

Elliott Slash claims involuntary conversion so taxable income = 0
Rep. Bo Eaton: MS tax on Salvage = \$0

Salvage Following Casualty

Options:

1. Pay tax on net income (gain-depletion) or:
2. Defer tax on entire gain until replacement property sold.

- a) Reforestation
- b) Replacement timber sites
- c) Reforestation on replacement sites
- d) Controlling stock in timber corporation (80% control is required and is not likely)

– Reinvest within 2 years following year of disposition unless a condemnation or presidential declared disaster then you have an additional year

Electing to Defer Tax

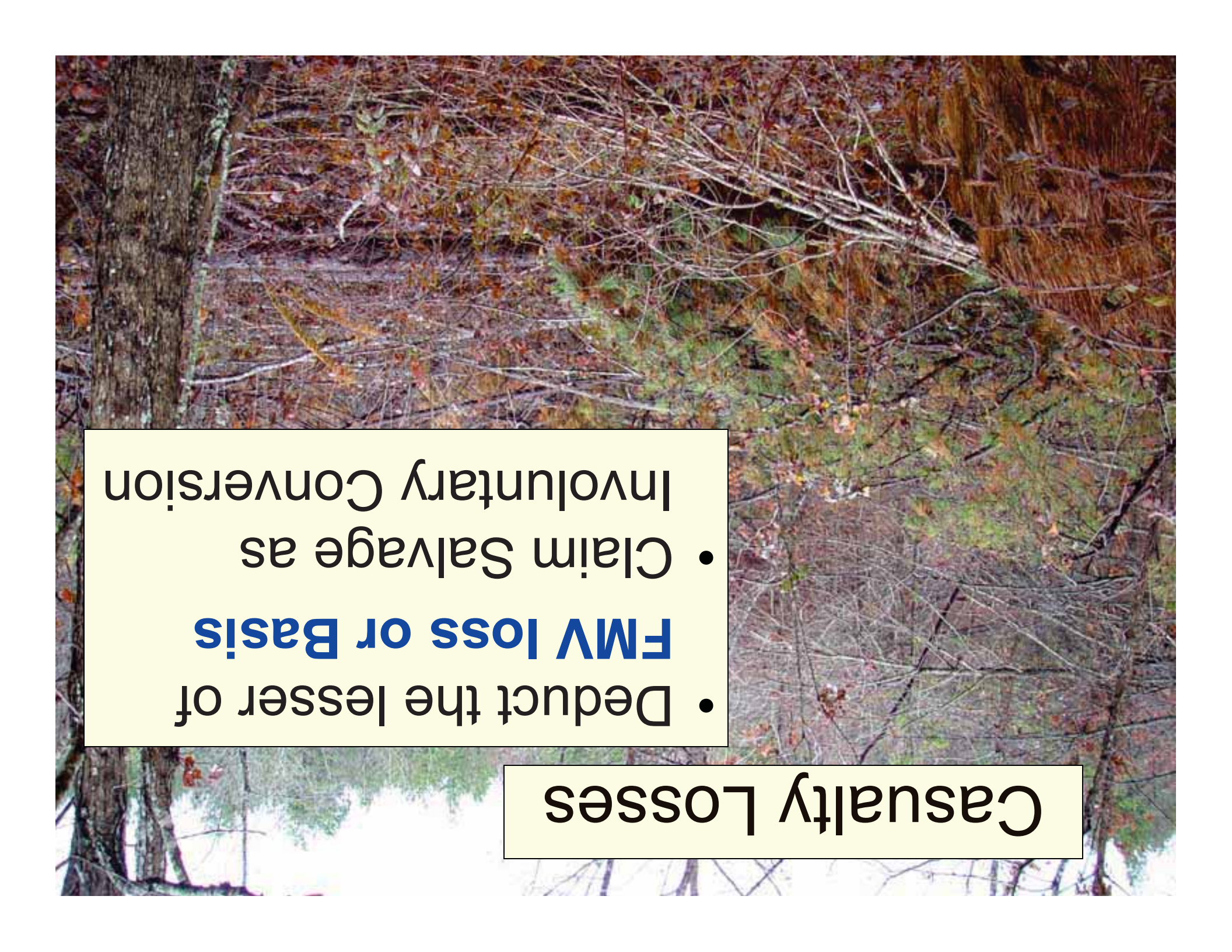
1. Attach Election to Form 4797

- Details of involuntary conversion
- Compensation received
- Determination of gain
- Plans for replacement

2. Report Purchase of Replacement

Property by Dec 31, 2008

New property basis = cost - postponed gain



Casualty Losses

- Deduct the lesser of **FMV loss or Basis**
- Claim Salvage as Involuntary Conversion