

Taxation Issues associated with the Sand & King Fires

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DISCLAIMER

Today's discussion is educational, NOT legal or accounting advice, since the facts and circumstances of each taxpayer's individual situation need to be taken into consideration for an exact application of the tax law.

Civics 101

- **Legislation – Congress** writes and the President signs into law the Internal Revenue Code or IRC. (Title 26 of U.S. Codes)
- **Administration** – The IRS interprets the Code through regulations, revenue rulings, private letter rulings, technical advice memoranda, et al.
- **The Courts** – Cases may be brought by taxpayers in either Tax Court, District Court, or the Court of Claims.

Taxpayers may initiate court actions after audit or after they have exhausted all other means of issue resolution with the IRS.

Ownership Purposes

Why do you own the property?

- Are you in the *trade or business* of buying and selling timber?
- Are you holding the property primarily for *investment* purposes?
- Do you use the property primarily for *personal use*?

Ownership Purposes (cont.)

Your ownership purpose is important as it can affect the amount and type of tax you pay as well as the deductions you can take.

Keeping Records

- Management information/plans including photos
- Accounting records
 - Shoebox, journal, journal with accounts
- Form T – Timber (available at www.IRS.gov)

These are important because they help you to document your ownership activities and income and expenses.

Form T Forest Activities Schedule

Form T (Timber) <small>(Rev. December 2005)</small> Department of the Treasury Internal Revenue Service	Forest Activities Schedule ▶ Attach to your tax return. ▶ See separate instructions. For tax year ending 20	OMB No. 1545-0007 Attachment Sequence No. 117																																													
Name(s) as shown on return		Identifying number																																													
Part I Acquisitions																																															
1 Name of block and title of account																																															
2 Location of property (by legal subdivisions or map surveys)																																															
3a Name and address of seller or person from whom property was acquired		b Date acquired																																													
4 Amount paid: a In cash b In interest-bearing notes c In non-interest-bearing notes																																															
5a Amount of other consideration b Explain the nature of other consideration and how you determined the amount shown on line 5a.																																															
6 Legal expenses																																															
7 Cruising, surveying, and other acquisition expenses																																															
8 Total cost or other basis of property. Add lines 4a through 7																																															
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<small>For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 16717G Form T (Timber) (Rev. 12-2005)</small>																																															

IRC Code Sections that May Affect You

- Casualty losses, thefts, condemnations - IRC § 165
- Involuntary Conversions - IRC § 1033
- Reforestation - IRC § 194
- Cost-share payments - IRC § 126

Casualty Losses and do you have one?

Regulation §1.165-7. **Casualty losses.** - (a) In general. - (1) **Allowance of deduction.** . . . any loss arising from **fire, storm,** . . . or other casualty is allowable as a deduction under section 165(a) for the taxable year in which the loss is sustained.

The manner of determining the amount of a casualty loss allowable as a deduction . . . is the same whether the loss has been incurred in a trade or business or in any transaction entered into for profit, or whether it has been a loss of property not connected with a trade or business and not incurred in any transaction entered into for profit.

Concept of Basis

Basis is the accounting term for what did something cost.

Can be adjusted for depreciation, depletion, or additional capital expenditures.

Why is basis or adjusted cost important for Casualty Losses?

The Potential Bad News

- Casualty losses are limited to the lower of ***the adjusted basis of the property*** or the ***decrease in fair market value*** caused by the casualty.
- Concept of Single Identifiable Property (SIP)
- Usually, insect attacks that kill trees are not considered to be a casualty loss.

Casualty Losses cont.

- Death of trees and seedlings from drought generally not qualified as a casualty loss.

How to calculate a Casualty Loss

- For smaller tracts, where all the timber is damaged, multiply the Adjusted Depletion rate of the timber times the lost timber volume. Larger SIP's use the change in Fair Market Value FMV before and after the casualty. **Both approaches are subject to the adjusted basis limitation!**
- Field Directive on Timber Casualty Losses -- April 2004.



Department
of the
Treasury
Internal
Revenue
Service

Publication 547
Cat. No. 15090K

Casualties, Disasters, and Thefts

For use in preparing
2012 Returns



Get forms and other information
faster and easier by:
Internet IRS.gov

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Reminders

Future developments. For the latest information about developments related to Publication 547, such as legislation enacted after it was published, go to www.irs.gov/pub547.

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

This publication explains the tax treatment of casualties, thefts, and losses on deposits. A casualty occurs when your property is damaged as a result of a disaster such as a storm, fire, car accident, or similar event. A theft occurs when someone steals your property. A loss on deposits occurs when your financial institution becomes insolvent or bankrupt.

This publication discusses the following topics.

- Definitions of a casualty, theft, and loss on deposits.
- How to figure the amount of your gain or loss.
- How to treat insurance and other reimbursements you receive.
- The deduction limits.
- When and how to report a casualty or theft.
- The special rules for disaster area losses.

IRS Publication 547

The screenshot shows a web browser window with the URL <http://apps.irs.gov/app/picklist/list/formsPublic>. The page title is "Forms and Publications (PDF)".

Instructions:

1. Enter a term in the Find Box.
2. Select a category (column heading) in the drop down.
3. Click Find.

Tips:

- Click on the product number in each row to view/download.
- Click on column heading to sort the list.
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Results: 1 - 1 of 1 files Show per page: [25](#) [50](#) [100](#) [200](#) « Previous | 1 | Next »

Product Number	Title	Revision Date	Posted Date
Inst 4684	Instructions for Form 4684, Casualties and Thefts	2012	10/05/2012

« Previous | 1 | Next »

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Example of a search at www.irs.gov for forms, publications, and other documents.

2012

Instructions for Form 4684



Casualties and Thefts

Section references are to the Internal Revenue Code unless otherwise noted.

General Instructions

Future Developments

For the latest information about developments related to Form 4684 and its instructions, such as legislation enacted after they were published, go to www.irs.gov/form4684.

Purpose of Form

Use Form 4684 to report gains and losses from casualties and thefts. Attach Form 4684 to your tax return.

Losses You Can Deduct

You can deduct losses of property from fire, storm, shipwreck, or other casualty, or theft (for example, larceny, embezzlement, and robbery).

If your property is covered by insurance, you must file a timely insurance claim for reimbursement of your loss. Otherwise, you cannot deduct the loss as a casualty or theft loss. However, the part of the loss that is not covered by insurance is still deductible.

Related expenses. The related expenses you have due to a casualty or theft, such as expenses for the treatment of personal injuries or for the rental of a car, are not deductible as casualty or theft losses.

Costs for protection against future casualties are not deductible but should be capitalized as permanent improvements. An example would be the cost of a levee to stop flooding.

Losses You Cannot Deduct

- Money or property misplaced or lost.
- Breakage of china, glassware, furniture, and similar items under normal conditions.
- Progressive damage to property (buildings, clothes, trees, etc.) caused by termites, moths, other insects, or disease.

Gain on Reimbursement

If the amount you receive in insurance or other reimbursement is more than the cost or other basis of the property, you have a gain. If you have a gain, you may have to pay tax on it, or you may be able to postpone the gain.

Do not report the gain on damaged, destroyed, or stolen property if you receive property that is similar or related to it in service or use. Your basis in the new

property is the same as your basis in the old property.

Any tangible replacement property held for use in a trade or business is treated as similar or related in service or use to property held for use in a trade or business or for investment if:

- The property you are replacing was damaged or destroyed in a disaster, and
- The area in which the property was damaged or destroyed was declared by the President of the United States to warrant federal assistance because of that disaster.

Generally, you must recognize the gain if you receive unlike property or money as reimbursement. But you generally can choose to postpone all or part of the gain if, within 2 years of the end of the first tax year in which any part of the gain is realized, you purchase:

- Property similar or related in service or use to the damaged, destroyed, or stolen property, or
- A controlling interest (at least 80%) in a corporation owning such property.

The replacement period is 5 years, instead of 2 years, if the property was located in the:

- Hurricane Katrina disaster area (which includes the states of Alabama, Florida, Louisiana, and Mississippi) and that property was converted after August 24, 2005, as a result of Hurricane Katrina, but only if substantially all of the use of the replacement property is in that disaster area.
- Kansas disaster area (as defined in Pub. 4492-A, Information for Taxpayers Affected by the May 4, 2007, Kansas Storms and Tornadoes) and that property was converted after May 3, 2007, as a result of the storms or tornadoes, but only if substantially all of the use of the replacement property is in that disaster area.
- Midwestern disaster areas (as defined in Pub. 4492-B, Information for Affected Taxpayers in the Midwestern Disaster Areas) and that property was converted on or after the applicable disaster date as a result of severe storms, tornadoes, or flooding, but only if substantially all of the use of the replacement property is in those disaster areas.

To postpone all of the gain, the cost of the replacement property must be equal to or more than the reimbursement you received for your property. If the cost of the replacement property is less than the reimbursement received, you must recognize the gain to the extent the reimbursement exceeds the cost of the replacement property.

If the replacement property or stock is acquired from a related person, gain generally cannot be postponed by:

- Corporations (other than S corporations),
- Partnerships more than 50% owned by one or more corporations (other than S corporations), or
- All other taxpayers, unless the aggregate realized gains on the involuntarily converted property are \$100,000 or less for the tax year. This rule applies to partnerships and S corporations at both the entity and partner or shareholder level.

For details, see section 1033(i).

For details on how to postpone the gain, see Pub. 547, Casualties, Disasters, and Thefts.

If your main home was located in a disaster area and that home or any of its contents were damaged or destroyed due to the disaster, special rules apply. See [Gains Realized on Homes in Disaster Areas](#) later.

When To Deduct a Loss

Deduct the part of your casualty or theft loss that is not reimbursable in the tax year the casualty occurred or the theft was discovered. However, a disaster loss and a loss from deposits in insolvent or bankrupt financial institutions may be treated differently. See [Disaster Losses](#) and [Special Treatment for Losses on Deposits in Insolvent or Bankrupt Financial Institutions](#) later.

If you are not sure whether part of your casualty or theft loss will be reimbursed, do not deduct that part until the tax year when you become reasonably certain that it will not be reimbursed.

If you are reimbursed for a loss you deducted in an earlier year, include the reimbursement in your income in the year you received it, but only to the extent the deduction reduced your tax in an earlier year.

See Pub. 547 for special rules on when to deduct losses from casualties and thefts to leased property.

Disaster Losses

A disaster loss is a loss that occurred in an area determined by the President of the United States to warrant federal disaster assistance. It includes a major disaster or emergency declaration. A list of areas warranting public or individual assistance (or both) is available at the Federal Emergency Management Agency (FEMA) website at www.fema.gov.

Casualties and Thefts

Information about Form 4684 and its separate instructions is at www.irs.gov/form4684. Attach to your tax return. Use a separate Form 4684 for each casualty or theft.

Department of the Treasury Internal Revenue Service

Name(s) shown on tax return

Identifying number

SECTION A - Personal Use Property (Use this section to report casualties and thefts of property not used in a trade or business or for income-producing purposes.)

1 Description of properties (show type, location, and date acquired for each property). Use a separate line for each property lost or damaged from the same casualty or theft.

Property A
Property B
Property C
Property D

2 Cost or other basis of each property

3 Insurance or other reimbursement (whether or not you filed a claim) (see instructions)

Note: If line 2 is more than line 3, skip line 4.

4 Gain from casualty or theft. If line 3 is more than line 2, enter the difference here and skip lines 5 through 9 for that column. See instructions if line 3 includes insurance or other reimbursement you did not claim, or you received payment for your loss in a later tax year.

5 Fair market value before casualty or theft

6 Fair market value after casualty or theft

7 Subtract line 6 from line 5

8 Enter the smaller of line 2 or line 7

9 Subtract line 3 from line 8. If zero or less, enter -0-

10 Casualty or theft loss. Add the amounts on line 9 in columns A through D

11 Enter the smaller of line 10 or \$100

12 Subtract line 11 from line 10

Caution: Use only one Form 4684 for lines 13 through 18.

13 Add the amounts on line 12 of all Forms 4684

14 Add the amounts on line 4 of all Forms 4684

15 If line 14 is more than line 13, enter the difference here and on Schedule D. Do not complete the rest of this section (see instructions).

If line 14 is less than line 13, enter -0- here and go to line 16.

If line 14 is equal to line 13, enter -0- here. Do not complete the rest of this section.

16 If line 14 is less than line 13, enter the difference

17 Enter 10% of your adjusted gross income from Form 1040, line 38, or Form 1040NR, line 37, Estates and trusts, see instructions

18 Subtract line 17 from line 16. If zero or less, enter -0-. Also enter the result on Schedule A (Form 1040), line 20, or Form 1040NR, Schedule A, line 6, Estates and trusts, enter the result on the "Other deductions" line of your tax return

For Paperwork Reduction Act Notice, see instructions.

Name(s) shown on tax return. Do not enter name and identifying number if shown on other side.

Identifying number

SECTION B - Business and Income-Producing Property

Part I Casualty or Theft Gain or Loss (Use a separate Part I for each casualty or theft.)

19 Description of properties (show type, location, and date acquired for each property). Use a separate line for each property lost or damaged from the same casualty or theft.

Property A
Property B
Property C
Property D

Table with columns A, B, C, D and rows 20-27 for business and income-producing property.

Part II Summary of Gains and Losses (from separate Parts I)

Summary of Gains and Losses table with columns (a) through (d) and rows 29-39.

Example

- Land and Timber Purchased 1978 - 100 acres @ \$ 300 acre Total Cost \$ 30,000
- Allocate Land \$ 20/acre -- Total land value \$ 2,000
- Allocate Improvements such as Roads \$ 5/acre -- Total Improvement value \$ 500
- Merch. Timber PP & DF @ 5Mbf/ac \$ 55/Mbf Total Timber value \$ 27,500

- Allocate Premerchantable timber \$ 0/acre
- Allocate Reproduction \$ 0/acre
- Assume 3% growth for 35 years for example Total Harvest Volume is 10 Mbf/ac

Change in Fair Market Value

- 2014 FMV **Before** fire value
10 Mbf @ \$ 250/Mbf x 100 acres =
\$ 250,000
- 2014 FMV **After** fire value
10 Mbf @ \$ 150/Mbf x 100 acres =
\$ 150,000

Tentative Loss Based on Difference in Fair Market Value Before and After Fire

Before Value less **After** Value \$ 100,000.

Loss is limited by the Lower of Adjusted Basis **or** Difference in Fair Market Value =
\$ 27,500

with no loss for any reproduction or premerchutable timber.

Assuming Salvage of Timber

- Sale of Delivered Logs IRC § 631(a)

Harvest 1,000 Mbf at \$ 150/Mbf stumpage

Net sale Income = \$ 150,000

Potential Capital Gain \$ 150,000 – Timber

Basis \$ 27,500 = \$ 122,500

- Potential Capital Gains marginal rate = 15% versus Potential Ordinary income marginal rate = 25% Potential Tax Difference = \$ 12,250

- FMV January 1, 2014 \$ 230/Mbf
- FMV October 1, 2014 \$ 150/Mbf

- Ordinary Income Loss
10 Mbf @\$ 80/Mbf x 100 acres
= \$ 80,000

Process is slightly different if selling stumpage with the mill responsible for harvesting.

Involuntary Conversion IRC § 1033

- Purpose: to permit a taxpayer to avoid paying gain on property that is disposed of involuntarily.
- An involuntary conversion occurs when property is destroyed, stolen, or condemned for public use. Destruction is often synonymous with a casualty such as a fire or wind storm but it need not be sudden.

Involuntary Conversion cont.

- Allows for reinvestment of income generally within a 2 year time period.
- Replacement property must be similar in nature
 - Reforestation on timberland owned by the taxpayer
 - Buying additional land for replanting
 - Acquisition of standing timber
 - Acquisition of timberlands

Reforestation

IRC § 194(3) defines reforestation costs to include site preparation costs, seedling costs and labor and tool expense.

Treas. Reg. 1.611-3(a) and Revenue Ruling 75-467 reforestation costs are to be capitalized.

However, beginning in the fall 2004, IRC § 194(b) generally permits a deduction of up to \$ 10,000 for reforestation expenses per Qualified Timber Property (QTP).

Reforestation cont.

- Additional reforestation expenditures generally amortizable over 7 years (84 months) under IRC § 194(a)
- What is a QTP? Property \geq 1 acre used for growing production of timber products under IRC § 194(c)(1) & Treas. Reg. § 1.194-3(a).
- Does not include ornamental trees including Christmas trees.
- Must make a timely election.

Reforestation cont.

- Cost share payments are not includable for purposes of IRC § 194 unless included in gross income. IRC § 194(c)(3)(B)
- Must keep data to track the location and costs of each plantation.

Cost Share Payments

- Treatment of Cost Share payments under programs like CFIP, EQUIP, WHIP are generally includable as gross income under provisions of IRC § 126 and Treas. Reg. § 16A.126-1.
- A portion of the income can be excluded under the provisions of Treas. Reg. § 16A.126-1 and 2.

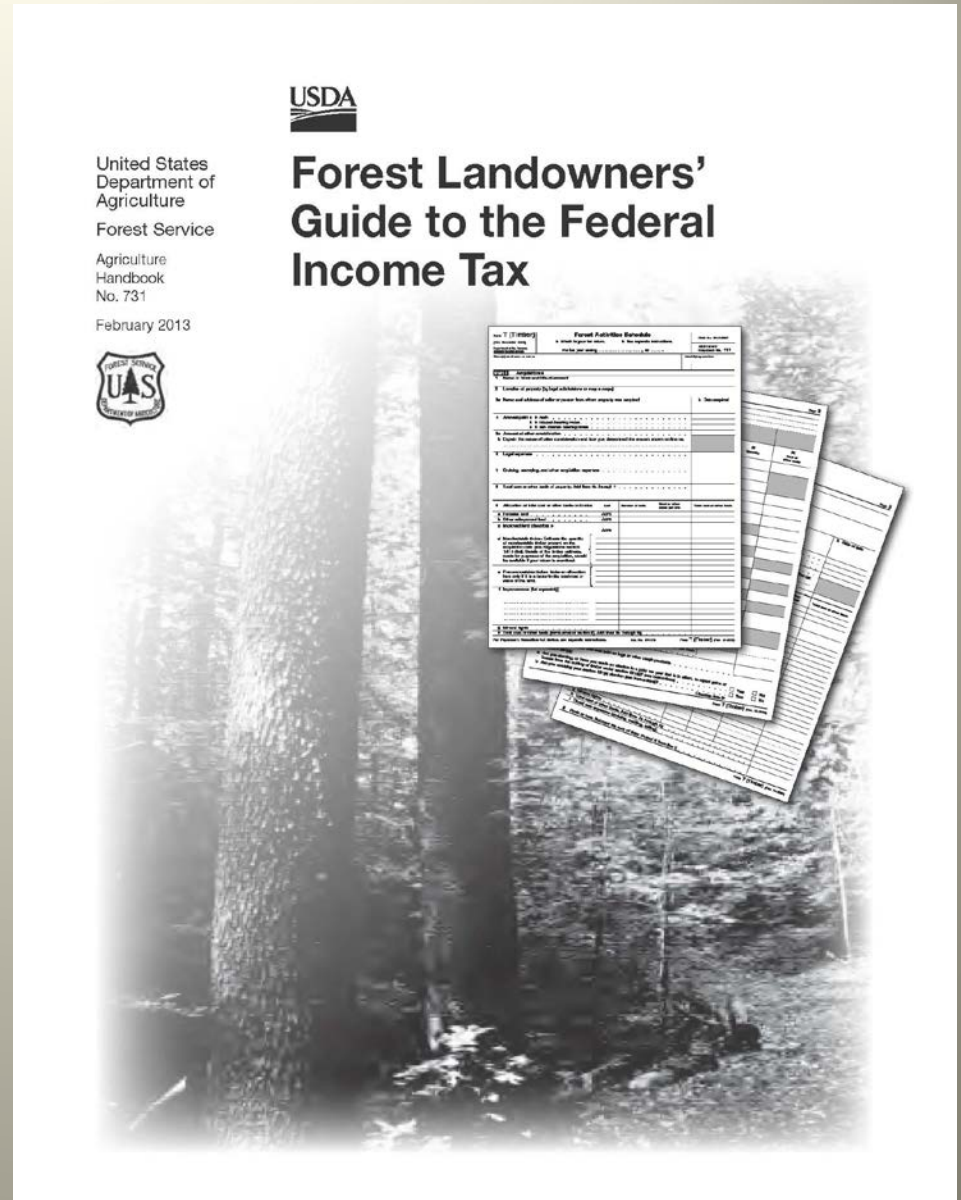
Other Things to Remember

- When you do have a timber sale, you are allowed to deduct the direct timber sale expenses from the proceeds.
- The tax laws and regulations change – remember to stay current.

References & Resources

- www.irs.gov
- www.timbertax.org a good non-government site sponsored by USFS, Univ. Georgia, American Tree Farm System
- www.fs.fed.us/spf/coop USDA Forest Service tax publications
- Cooperative Extension Services

Agricultural
Handbook 731
Forest Landowners'
Guide to the
Federal
Income Tax
(February 2013)
Available from
www.timbertax.org



- **Field Directive on Timber Casualty Losses**
- April 16, 2004 from Bobby E. Scott /s/ Bobby E. Scott Industry Director Natural Resources and Construction
- [Exhibit A](#) Timber Casualty Losses Audit Guideline
- [Exhibit B](#) Issue Paper on the Valuation of a Single Identifiable Property

Questions ?