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Damage Recovery Opportunities for Loss of Landscape Trees

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Loss of landscape trees can drastically reduce the value of residential or commercial property. However, there are several options available to the landowner that can minimize loss should the trees die suddenly.

Salvage

If practical, trees that are killed may be disposed of in a salvage timber sale. Salvaging is merely recovering wood value of damaged or destroyed trees that would otherwise be lost. Usually a salvage sale will net a greater real return to the landowner than any of the other alternatives discussed.

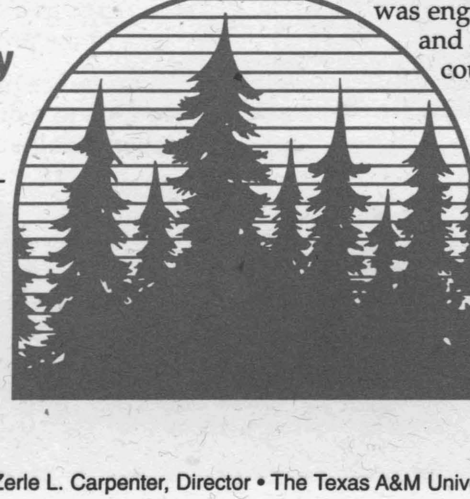
For several reasons, however, a salvage sale may not be possible. Occasionally only a few trees, often just one, are killed and wood harvesters simply are not willing to make a special trip to remove them. This is especially true when removal of the dead trees requires extraordinary effort and where there is danger of damage to nearby structures or other landscaping. Wood harvesters may also be reluctant to extract dead trees from locations outside their market area. Normal decaying processes begin as soon as the trees are killed and the wood fiber may deteriorate beyond usefulness in as few as 60 days. Finally, some species of trees are not useful for commercial wood products in certain areas because no local markets exist.

Tax-Deductible Casualty Losses

If trees that are killed suddenly cannot be sold for salvage, how can the property owner recover part of the loss to his real estate value? Section 165 (a) of the Internal Revenue Code of 1954 states, generally, that all uncompensated casualty losses are deductible from ordinary income in the year the losses are sustained. Section 165 (c) provides the limitations that permit deduction for casualty losses. The Tax Equity and Fiscal Responsibility Act of 1982 limits the casualty loss to the extent that it must exceed 10 percent of the taxpayer's adjusted gross income in the year of the loss less a $100 deductible. During the remainder of this discussion, non-business casualty losses, section 165 (c) (3), and casualty losses on property held for investment, section 165 (c) (2) will be addressed. Provisions for deductions for casualty losses sustained on property operated as a trade or business for profit are not covered by this discussion.

First, it is essential to understand what constitutes a casualty loss under the Internal Revenue Code. I.R.S. Publication 547 defines a casualty as "the complete or partial destruction or loss of property resulting from an event that is: (1) identifiable, (2) damaging to property and (3) sudden, unexpected and unusual."

A "sudden" event is swift and precipitous, not gradual or progressive. An "unexpected" event is normally unanticipated and occurs without the intent of the one who suffers loss. "Unusual" events are extraordinary and nonrecurring, do not commonly occur during the activity in which the taxpayer was engaged when damage was sustained, and do not commonly occur during the course of day-to-day living.



Some examples of casualties that might cause loss of landscape trees are: damages from a hurricane, tornado, flood, storm, ice, fire or accident; damage from an automobile accident; and vandalism, if sudden and unexpected. Loss as a result of any qualifying casualty is determined as the decrease in the total value of real estate.

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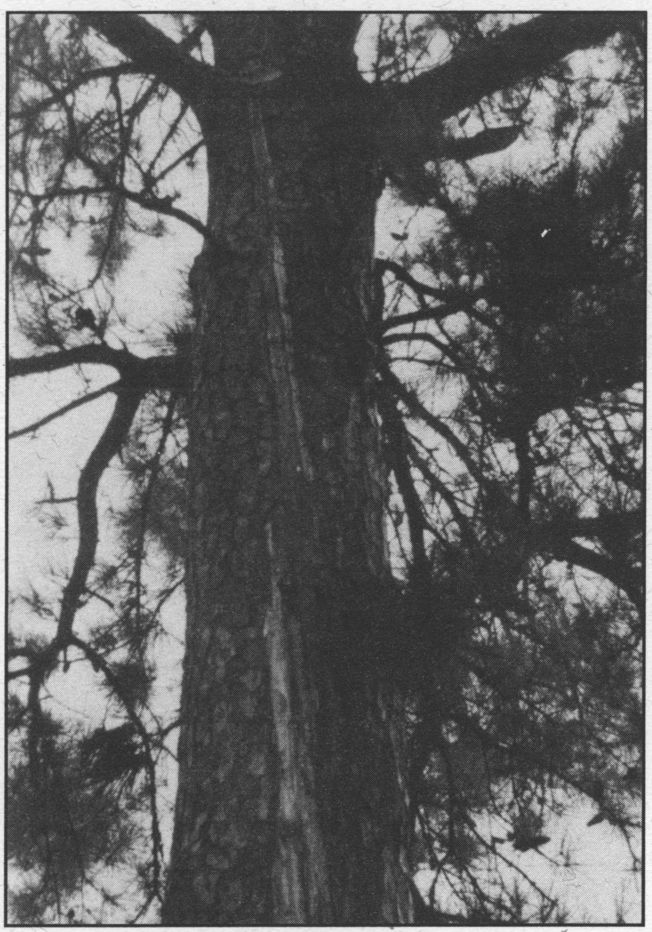
Losses not generally allowable as casualties and, therefore, not deductible under Section 165, are: damages or losses due to disease, insects, (except in certain instances of pine bark beetles), progressive deterioration due to a steadily operating force, general decline in market value and loss of future profits. In 1968 one Texas tax court ruled that the loss of loblolly pine trees on residential property due to mass attack by southern pine beetles was a loss by casualty within the meaning of section 165 (c) (3), I.R.S. 1954.

Property Basis Adjustment

Most property is acquired by purchase and its basis value is its cost. But if the property has been subject to depreciation, previous casualty losses or other recovery adjustments, the basis must be reduced to reflect these amounts. Similarly, any expenditures for capital improvements should be added to the basis. If a deduction for casualty loss under section 165 (c) (2) or (3) is not permissible, expenditures such as clean up, purchasing and planting new yard trees for landscape restoration may be added to the basis of the property. If the clean up or new trees are received as a gift, their value cannot be added to the basis.



Lightning damage is the most common cause for claiming casualty losses for ornamental trees.

Valuation of Damaged Trees

If the property owner believes the loss qualifies as a casualty there are acceptable techniques for arriving at the value of the damaged trees and landscape. Earlier, the value of the casualty loss was defined as the decrease in the total value of the real estate. Three factors are important in computing the loss. They are: (1) the decrease in the fair market value of the property as a result of the casualty, (2) the adjusted basis in the property, and (3) the amount of insurance or other compensation received. Qualifying losses must exceed 10 percent of adjusted gross income to be claimed.

There are two ways to arrive at the decrease in fair market value (f.m.v.) of the property: (1) appraisals immediately before and after the casualty, and (2) deduction of the costs of cleaning up, repairing or replacing property after the casualty from the before-casualty f.m.v. The use of competent appraisals is preferred and the fees associated with making the appraisals are deductible under expenses incurred to determine tax liability—they are not part of the casualty loss.

The costs associated with cleaning up, repairing or refurbishing the damaged landscape after the casualty may be used to measure the decrease in property value if:

- the repairs are necessary to restore the property to its condition before the casualty;
- the amount spent on repairs is not excessive;
- the replacement or repairs do no more than take care of the damage sustained; and
- the value of the property after the repairs does not, as a result of the repairs, exceed the value of the property before the casualty.

Insurance proceeds or other reimbursements must be used to reduce your loss. There is also a $100 limitation that is subtracted from each casualty loss to

High winds from tornadoes or hurricanes can cause losses to property value. (Photo courtesy Houston Parks and Recreation Department.)

arrive at the reportable loss. A separate $100 limitation will apply to each separate casualty loss claimed on property held for personal use and the total of qualified losses must exceed 10 percent of the taxpayer's adjusted gross income to be claimed.

The International Society of Arboriculture (ISA) has published the "Guide for Plant Appraisal" as a means of arriving at a value for trees. In the guide, trees are evaluated by species, size, condition, and location and market conditions in the region.

The authors of the guide, however, recognize that the IRS does not currently accept such an evaluation system because of its irrelevance to the fair market value of the overall property. The ISA, National Arborists Association and other groups have petitioned the IRS to change the Treasury Regulations to permit evaluation via the referenced guide under certain conditions. The change has not been granted at the time of this printing. The IRS, meanwhile, continues to follow Revenue Ruling 68-20 which prohibits evaluation methods other than those arriving at the change in fair market value as described above.

Record Keeping Necessary

The maintenance of substantiating records is extremely important when filing claims for income tax deductions. For this reason, anyone considering claiming a deduction for trees lost under casualty conditions must be able to prove that he/she sustained a casualty loss, and that the amount claimed as loss is deductible. Such record keeping is also important in substantiating any claims for loss recovery.

One must be prepared to show the nature of the casualty and when it occurred; that the loss was the direct result of the casualty; that the claimant is the owner of the property; the costs or other basis of property evidenced by purchase contracts, deed, etc.; value before and after the casualty; and the amount of insurance or other compensation received or recoverable.

Photographs of the property before and after damage may be helpful in showing the condition and value of the property prior to the casualty. Also, local newspaper articles complete with dates and the newspaper's name may be used as evidence of the

In many urban areas, vandalism constitutes a bona fide casualty loss.

casualty and its time and place of occurrence. Appraisals are the most desirable means of establishing values before and after casualties.

It is also wise to retain all receipts for expenditures made for restoration, in the event this system of establishing damages is chosen by the claimant.

Example:

A taxpayer lives on a 1-acre lot near the Texas coast. When the land was purchased it was wooded, and it cost $10,000. Two years later a hurricane struck the area and destroyed all of the trees. Approximately six months before the hurricane the property had been appraised because the taxpayer was considering selling it. The appraised value had been $15,000 for the wooded acreage. After the hurricane the property was appraised at $12,000 fair market value. The taxpayer was able to sell the trees to a local logger for $150 with the provision that the logger remove all debris from the acreage. The taxpayer had an adjusted gross income of $24,000.

1. Value of realty before hurricane	$15,000
2. Value of realty after hurricane	12,000
3. Decrease in value of realty	$ 3,000
4. Adjusted basis of realty (cost in this example)	$10,000
5. Loss sustained on real property (lesser of 3 or 4)	$ 3,000
6. Less $150 for sale of trees as timber	150
7. Casualty loss to realty	$ 2,850
8. Less $100 limitation	100
9. Loss on landscape trees	$ 2,750
10. Less 10 percent of adjusted gross income	2,400
11. Deductible casualty loss	$ 350

References

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4. Revenue Ruling 57-599, 26 CFR. p. 142.
5. Revenue Ruling 68-20, 26 CFR. pp. 74-5.

This publication is designed to provide accurate and authoritative information regarding the subject matter covered. It is provided with the understanding that the publisher is not engaged in rendering legal, accounting or other professional services. If legal advice or other expert assistance is required, please seek the services of a trained professional.

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