

Casualty Losses of Shade Trees and Landscaping

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Storm damage to shade trees and landscaping reduces property value and may require out-of-pocket expenses for repair, removal, and restoration. The federal tax code allows some recovery of your loss and expenses through a casualty loss tax deduction. This casualty loss tax deduction can be viewed as a five-step process.

Step 1. Document damage. Before removing damaged trees photograph them. Keep records of additional photographs of trees before the casualty event, if possible. Measure the tree stem diameter or circumference. Otherwise measure the stump diameter and take photos before grinding. Keep in mind that if a landscape appraisal is necessary, the appraiser will need to know species, size, condition, location, and placement of trees.

Step 2. Claim a loss on insurance when applicable. The amount you receive from insurance depends on the coverage in your policy. Loss that is not covered by insurance may then be deducted as a casualty loss on federal income taxes. If you are eligible to claim insurance reimbursement and fail to do so, that amount may not be claimed as a casualty loss.

Step 3. Contact your tax advisor. Personal casualty losses are miscellaneous itemized deductions on Schedule A. If a taxpayer takes the standard deduction, he or she will not be able to claim a personal casualty loss. Individual circumstances will determine if claiming a shade tree casualty loss deduction is beneficial. Discuss this with your tax advisor and provide receipts for out-of-pocket expenses associated with the clean-up and restoration of the landscaping. Remember, the value of a tax deduction is the deduction amount times the marginal tax rate. If you determine the loss deduction is not beneficial, stop here.

For personal use property, it is likely only a substantial casualty loss not covered by insurance is worth the effort. Losses are first limited by the basis of the property. For homes, the basis is typically the amount you paid for the entire property plus any significant improvements. Next, personal losses must overcome 10% of the taxpayer's adjusted gross income plus \$100 before they can be claimed.

Businesses and income producing property should have separate basis accounts for landscaping. Losses not covered by insurance are only limited by the basis in the landscaping or shade tree account. If the basis in the landscaping account has been depleted, there is no deductible loss.

Step 4. Determine the loss. This can be done by using the cost of clean-up and restoration or by appraisal.

Cost of Clean-up and Restoration

The cost of restoring landscaping to its original condition after a casualty loss may indicate the decrease in FMV. You may be able to measure your loss by what you spend on the following:

- Removing destroyed or damaged trees and shrubs, minus any salvage you receive.
- Pruning and other measures taken to preserve damaged trees and shrubs.
- Replanting necessary to restore the property to its approximate value before the casualty.
- See IRS Publication 547 *Casualties, Disasters, and Theft*, page 5.

There are restrictions on the use of restoration costs as a loss of FMV:

- Costs must be necessary to restore the property.
- The amount spent for restoration cannot be excessive.
- Costs cannot take care of more than the damage suffered.
- Restoration cannot increase the value of the property over its value before the disaster.

Costs must be the amounts actually spent, as documented by receipts. The taxpayer cannot claim his own time in clean-up and restoration. Restoration costs cannot exceed the loss in FMV of the appropriate single identifiable property. If insurance covers part or all of restoration, the loss deduction must be reduced by the amount received. If insurance reimbursement is available and you do not claim it, you must still reduce the casualty loss by the available amount.

Some individuals may wish to use an appraisal of landscaping/shade tree losses as their loss in FMV. This is not encouraged by the IRS for personal use property and may result in an audit. Businesses with separate basis accounts for landscaping which have not been fully depreciated, may choose this avenue for recovery. If an appraisal is desired, the following information may be of assistance:

Appraisal

For personal use property, the single identifiable property (SIP) damaged is the house, land and landscaping combined. They cannot be separated. Therefore, an appraisal of Fair Market Value (FMV) loss for the entire property is required. The before and after values of the landscaping is the FMV loss of the landscaping, not the entire property, and must be adjusted by the loss in FMV of the property as a whole. Thus, an arborist's appraisal alone does not determine the casualty loss.

For income producing property, trees and other landscaping are the single identifiable property damaged (separate from house and land) as long as a separate basis exists for the landscaping. Here an appraisal of individual tree losses by an arborist may be appropriate.

Real estate appraisal. The FMV of the property immediately before and immediately after the storm, including an evaluation of the effects of the damage to landscaping, is determined by standard real estate appraisal measures. The appropriate methods of estimating the loss in real estate value are the sales comparison and replacement cost methods and income approach for income producing property.

Arborist's appraisal. If an arborist's appraisal is necessary, the loss is measured by evaluating remaining trees and using information available on damaged trees. The arborist should determine the cost of repair and replacement. The value of each tree is based on several characteristics such as species, condition, location, and placement. An appraisal which gives each tree the same value is not an adequate appraisal. An appraisal which values each tree by a set value for each diameter class is not adequate. The trunk value method of valuation is not accepted by the IRS.

Deduction of appraisal expense. Appraisal expense is not part of the casualty loss. It is, however, part of the cost of preparing a tax return and is deductible as a miscellaneous itemized deduction. If, however, an audit is made and the casualty loss deduction is denied, the cost of the appraisal is no longer deductible.

Step 5. File IRS Form 4684 to claim your casualty loss. The loss is then transferred to the individual's 1040. The information needed to fill out the form is any insurance received and receipts for clean-up and replacement for personal losses. If the casualty loss is determined by real estate appraisal, then other information includes basis, FMV before, FMV after, FMV loss and adjusted gross income for

personal losses. As always, be sure to file the supporting documents with other information used to back up the tax return.

Special Rules

If the loss occurred as a result of a Presidentially-declared disaster, the taxpayer has the option of deducting the loss with the current year's return or amending last year's return and taking the deduction immediately.

Occasionally, following a significant disaster event, special rules may be passed to aid the victims of the disaster. These are usually well publicized and the IRS website (www.irs.gov) will have updated materials which reflect these changes.

For More Information:

IRS Publication 547 Casualties, Disasters, and Theft is available for download from www.irs.gov or obtain a free copy by calling the IRS Hotline at (800) 829-3676.

Timbertax.org. This website has a section which explains shade tree/landscaping losses. It also has reference materials on relevant court cases. One that explains the use of appraisals by real estate appraisers and an arborist is that of *Bowers v. Commissioner*. The Tax Court Memo is available online at www.timbertax.org. Simply type "bowers" into the search block to bring up the memo.

BOWERS v. COMMISSIONER

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