

Timber Taxes and the Forest Landowner: An Overview

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► This presentation is for general educational purposes and does not take the place of qualified tax advice based on your individual facts and circumstances!

Timber Taxes

- Categories of Ownership
- Record Keeping
- Timber Sales income
- Reforestation

Categories for Forest Ownership

- ▶ Hobby
- ▶ Investor
- ▶ Business-material participant
- ▶ Business-passive participant

Hobby

- ▶ No profit motive
- ▶ You cannot deduct your ordinary expenses
- ▶ You cannot deduct cost of planting trees

Investor

- ▶ Landowner not active manager
- ▶ Isolated timber sales
- ▶ Ordinary Expenses- misc. itemized deductions
- ▶ Generally gets capital gains on timber sales

Business--Material Participant

- ▶ Landowner is active in management
- ▶ More frequent timber sales
- ▶ Cannot get capital gains on lump sum sales

Business--Material Participant

- ▶ Deduct expenses on Form C or Form F
- ▶ No restrictions on tax credits

Business--Passive Participant

- ▶ Landowner not active in management
- ▶ Deductions only allowed when offset by passive income

Material or Passive Participant

- ▶ Depends on level of activity
- ▶ Involvement on a “regular, continuous, and substantial basis.”
- ▶ Must meet one of IRS six rules

Material Participation Test 2

- ▶ Your participation constitutes substantially all of the participation of all individuals

Material Participation Test 3

- ▶ You participate more than 100 hours
- ▶ No one else participates more

Why Category Matters

- ▶ Deduction of expenses
- ▶ Capital gains treatment of timber sales income
- ▶ Recordkeeping

Record Keeping

- ▶ For taxes
- ▶ Support your ownership category
- ▶ Investment Analysis
- ▶ For guidance to future owners

Basic Records

- ▶ Management Plan
- ▶ Goal --profit or hobby
- ▶ Maps, surveys
- ▶ Copy of legal records
- ▶ Historical documents

Basic Records

- ▶ Tree Farm Journal
- ▶ Capital Accounts:
Timber, Land,
Equipment
- ▶ Operating Accounts

Basic Records

- ▶ Copies of Form T:
Timber Activities
Schedule
- ▶ Receipts, cancelled
checks, bills, etc.

Tree Farm Journal

- ▶ Date
- ▶ Activity--what, when,
who, time
- ▶ Revenue or expense

Timber Accounts

- ▶ Reforestation account
- ▶ Young timber account
- ▶ Merchantable timber account

Reforestation Account

- ▶ Cost of establishing a stand of trees
- ▶ Tax treatment of these expenses

Young Timber Account

- ▶ Value of young timber not yet ready to cut

Merchantable Timber

- ▶ Value of the timber that is currently big enough to sell

Land Account

- ▶ Value of the land at time of acquisition
- ▶ Cost of permanent improvements
- ▶ Any reduction in asset value

Definition: Basis

- ▶ Value at time of acquisition
- ▶ Plus additional investment
- ▶ Minus any depletion of the asset

Determining Basis

- ▶ Purchased asset--cost
- ▶ Inherited asset--FMV at death
- ▶ Gifted asset--donor's basis

Determining Timber Basis

- ▶ Timber cruise
- ▶ Back cruise
- ▶ Contemporary prices

Timber Sales--Three Methods

- ▶ Lump Sum
- ▶ 631(a)
- ▶ 631(b)

Definition: Lump Sum

- ▶ Selling timber for a single sum
- ▶ Sale of standing timber
- ▶ Price agreed on in advance

Definition: Lump Sum

- ▶ No change in price regardless of amount cut
- ▶ Buyer owns trees when contract is signed

Section 631(a)

- ▶ Taxpayer cuts his/her own standing timber and sells sawlogs, poles, or pulpwood as part of his/her trade or business

Section 631(b)

- ▶ Per-Unit Sale or Pay-as-Cut Sale
- ▶ Selling timber by measurement of cut and delivered timber
- ▶ \$X per MBF or per cord

Section 631(b)

- ▶ Landowner owns trees till cut
- ▶ Sales receipts depends on amount cut

Tax on Timber Sales Income

- ▶ Sales Receipts
- ▶ Less timber basis
- ▶ Less expenses
- ▶ = Net gain

***Tax on Timber Sales
Income***

- ▶ Capital gains: 10%,
20%
- ▶ New rules for property
acquired after 2000

Investor Timber Sales

GENERALLY

- ▶ Capital gains on per-unit
sales
- ▶ Capital gains on lump-sum
sales

Business Timber Sales

Generally

- ▶ Capital gains on per-unit
sales
- ▶ Ordinary income on lump-
sum sales

After the timber sale . . .

► Reforestation

***Reforestation Costs--
Two Options***

- Capitalize costs
- Use special tax treatment

Definition: Capitalization

Recording costs in an account
to recover in the future
when the asset is sold or
worn out

Capitalization of Reforestation Costs

- ▶ Pay the bill
- ▶ Keep the records
- ▶ Deduct from timber sale income in the future

Special Reforestation Tax Treatment

- ▶ Investment Tax Credit for Forestry
- ▶ Accelerated Amortization
- ▶ Covers up to \$10,000 in expenses each year

Investment Tax Credit (ITC)

- ▶ 10% tax credit
- ▶ Dollar for dollar reduction in taxes owed
- ▶ Trusts are not eligible

Definition: Amortization

- ▶ Recovery of capitalized expenses over a short period of time before any sale of property
- ▶ A deduction

Accelerated Amortization

- ▶ Recover costs over 84 months
- ▶ Covers 8 tax years
- ▶ Use alone or in connection with ITC

Accelerated Amortization

- ▶ \$10,000 in expenses each year
- ▶ If ITC is used, the amount must be reduced by 1/2 tax credit taken

***Accelerated
Amortization***

- ▶ Take 1/14 of total as a deduction the first year
- ▶ Take 1/7th for years two - seven
- ▶ Take 1/14 for year eight

***Reforestation
Example-ITC***

- ▶ Site prep expense \$10,000
- ▶ 10% ITC of \$1000

***Example: \$10,000
Amortization***

- ▶ \$1,000 tax credit
- ▶ \$10,000 minus 1/2 tax credit
- ▶ = \$9,500 to amortize

Amortization Schedule

Year	Amortization Schedule	Deduction
1999	1/14 th of \$9,500	\$ 679
2000	1/7 th of \$9,500	1,357
2001	1/7 th of \$9,500	1,357
2002	1/7 th of \$9,500	1,357
2003	1/7 th of \$9,500	1,357
2004	1/7 th of \$9,500	1,357
2005	1/7 th of \$9,500	1,357
2006	1/14 th of \$9,500	679
	Total:	\$9,500

Capitalization

If expenses = \$20,000
\$10,000 recovered
through tax programs
\$10,000 is capitalized

Tax Strategy for Reforestation

Plan timber sales so
reforestation
expenses will not
exceed \$10,000 in
one year

***Cost-Share
Payments***

Many cost-share payments can be excluded from income if certain rules are met

***Cost-Share
Payments***

- ▶ If exclude payments, then recover out-of-pocket costs with ITC and amortization

Wait-There's More!

- ▶ Losses
- ▶ Operating Expenses
- ▶ Using Form T, etc.

***Questions to Ask
Your Accountant***

- ▶ Timber basis?
- ▶ Reforestation programs?
- ▶ Cost-share?
- ▶ Timber losses?

***Final
Recommendations***

- ▶ Plan ahead
- ▶ Vet your accountant
- ▶ Learn more!
- ▶ Speak OUT!

Best Tax Guide

- ▶ Agriculture Handbook 718
- ▶ Forest Land Owner's
Guide to the Federal
Income Tax
- ▶ Ask your Extension
forester about ordering

Timber Tax Short Courses

Dr. Harry Haney, tax & estate
planning, hhaney@vt.edu

Dr. Bill Siegel, tax & estate
planning, 504-737-0583

Dr. Bill Hoover-
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***Forest Landowner's
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