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Timber Tax

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Federal Tax Obligations from Timber Sales and Reforestation

by
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Regardless of a woodland owner's objectives for their property, it is really important to establish and maintain financial records associated with the management of the property. At some point in time there might to be a need for a timber sale and stand reestablishment. This always involves timber taxes so it is best to be prepared to assure your tax burden is fair and appropriate. Recordkeeping begins when you assume ownership.

Property can be acquired four different ways: purchased, inherited, gifted, or exchanged. How it is received determines the Basis. Basis is the cost of property and other expenses incurred during transfer. It is best determined at acquisition but it can be done later if needed. It is essential to establishing a fair market value and calculate the Depletion Unit. The Depletion Unit, usually expressed as a cost per unit of volume, is used to determine a taxable gain or loss from timber sales by recovering a portion of your Basis. It is also important in tax determinations for casualty losses, timber theft, and condemnations.

Recordkeeping

To properly manage your woodland investment, specifically for tax purposes, it is important to setup different accounts to monitor expenses. One suggestion would be to have up to three categories like land, equipment, and timber accounts. Separating the land account from the timber account is the best way to establish the Basis. You can have subaccounts under each category as needed. Using timber accounts as an example, you can set up a ledger system with subaccounts like merchantable timber, young growth, and reforestation. In some cases, a simple journal record may be all you need.

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One good model to follow for a timber account is to use IRS Form T (Timber) or Forest Activities Schedule.as shown at https://www.irs.gov/pub/irs-pdf/ft.pdf. The latest iteration of the form includes five sections as listed below.

Part l – Acquisitions
Part ll – Timber Depletion
Part lll – Profit or Loss from Timber Sales
Part lV – Reforestation and Timber Stand Activities
Part V – Land Ownership

It generally is important to create other accounts like those for day-to-day operating expenses, timber sales expenses, and carrying charges like interest. Such records can be helpful in tax determinations for casualty losses. Regulations allow recovery of losses up to the basic value of the timber lost. Loss is the difference between basic value and the amount received from salvage. You can receive similar treatment from timber theft.

Timber Sales

When a landowner sells at least $600 worth of timber then the buyer must file Form 1099-S (Timber Transaction Report) with the IRS and give a copy of the form to the seller. The seller uses the form in filing income tax returns. The purpose of Form 1099-S is to prevent under-reporting of income from timber transactions and it gives the IRS a way to compare their records with your returns. As of May 2009, this requirement started appling to lump-sum sales as well as pay-as-cut transactions.

Can your receive capital gains tax treatment for the sale of you timber? Yes, it you meet two qualifications. If you have owned (held) the timber for more than one year before selling it, you may quality for capital gains tax treatment. An exception would be for inherited and some gifted property where you may use the donor's holding period if it is over one year. Standing timber that not held primarily for sale to customers in the ordinary course of a trade or business is considered a capital asset. Therefore, you can qualify for capital gains treatment for timber sales on property held for personal use or an investment.

A capital gain is determined by subtracting the allowable basis and timber sale expenses from timber sale proceeds for a taxable year. All other expenses are deducted from ordinary income. The capital gains will be taxed at the 15% for income under $467,000 and 20% for higher amounts. At the 15% ordinary income tax bracket and below, the capital gain will be zero.

Reforestation

After a timber sale you may consider reforestation. There a number of tax-related considerations to keep in mind and they all involve recordkeeping. Utilizing reforestation tax credits offers a great financial incentive to woodland owners. First, qualified reforestation expenses up to $10,000 per year are eligible for a 10% tax credit. These expenses include site preparation, fencing, herbicides, seeds and seedlings, labor, and tools. Capital expenditures over this $10,000 level may qualify for amortization (annually deducted) over a period of 84 months..

The deduction and amortization can be taken for a Qualified Timber Property (QTP) only. A QTP is at least one acre that contains trees in commercial quantities held for commercial production of timber products. Commercial production means that the timber is being grown for the eventual sale to commercial timber processors or for use in your own trade or business.

If you received cost share payments to cover a portion of the expenses of a reforestation project and the expenditures qualify for the reforestation deduction or amortization you should consider including the cost share payments in your ordinary income. Doing so allows you to claim the reforestation deduction or amortization deduction on your total qualified reforestation expenses.

Summary

This brief introduction to timber taxes is intended to give woodland owners a start in the proper financial management of their forest investment so they can better control their expenses, especially taxes. An exhaustive treatment of timber tax issues can be found at the National Timber Tax website. The address is http://www.timbertax.org.