

# TIMBER TAXATION

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# INTRODUCTION

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Tax law is  
very complex



Often hinges  
on details



Always  
changing



NOT tax  
advice

# AGENDA

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- Basis
- Reforestation
- Timber sales
- Casualty loss
- Cost Share
- Recordkeeping



# KNOW YOUR CLASSIFICATION

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- Key to treatment of losses, expenses
- Business, Investment, Personal/Hobby
  - Active, Passive
- Consider frequency of activity and intent
- Often “facts & circumstances”
  - Document activity, compare to other landowners

# KNOW YOUR BASIS!

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- Basis is the amount of your investment in capital assets for tax purposes
  - Purchased: Acquisition cost
  - Inherited: Fair market value (FMV)
  - Planted: cost of stand establishment \*
  - Gifts & Exchanges: Various rules
- Allocate basis to land, timber (merch, premerch), buildings
- Established at the time of acquisition (can be done retroactively)
- Increased by capital expenditures, decreased for sales

A photograph of a forest with a path leading through green ferns and young trees. The path is made of dirt and is surrounded by lush green ferns in the foreground. In the background, there are several young trees with thin trunks and sparse foliage. The sky is overcast and grey.

# ACCOUNTS NEEDED

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- Land: bare land, land improvements such as leveling costs, impoundments, permanent non-depreciable structures
- Depreciable assets: buildings, bridges, fences, etc.
- Equipment: planting machine, tractors, etc.

# ACCOUNTS NEEDED

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- Merchantable timber: record both quantity and dollar value (basis).
  - Keep units attached to quantity (cords, tons, MBF, etc.)
- Pre-merchantable timber: number of acres and basis
  - If landowner plants once owned: site prep, planting costs



# EXAMPLE ALLOCATION

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Asset Description	Fair Market Value	% of total FMV	Basis
Merchantable Timber	\$50,000	0.40	\$ 40,000
Land	\$65,000	0.52	\$ 52,000
<u>Premerch</u>	<u>\$10,000</u>	<u>0.08</u>	<u>\$ 8,000</u>
Totals	\$125,000	1.00	\$100,000

100,000  
x .4





# HOW DO I FIGURE OUT BASIS IF IT WAS NEVER ALLOCATED??

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Called a retroactive basis determination



Same method as if figured at time of acquisition, just requires research



Will need to determine timber prices



Volume estimation

# BASIS FOR NEW STANDS

- Costs of establishing trees
- Record number of acres and basis
  - Once merchantable, record volume and basis

# REFORESTATION

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Afforestation or reforestation

- Site prep, seed or seedlings, brush & weed control
- Natural and artificial regeneration
- **NOT PERSONAL LABOR**



# REFORESTATION TAX INCENTIVES

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Outright deduction of expenses up to \$10K

Per qualified timber property

Per tax year



Remainder amortized over 7 tax years

# NOTES ON REFORESTATION INCENTIVE

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On timely filed return

- Can not amend after 6 months

Must include cost share income

No carryover of unused deduction

Recapture provisions!

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# TAX STRATEGY!!!



Reforestation incentive available each tax year



Forestry operations often naturally staggered



Take advantage of staggering operations



# PROPERLY CLASSIFY SALE PROCEEDS

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- How did you sell your timber?
  - Sold on stump or sale of logs
  - Cut own or sell firewood
- Did you meet holding period?
- Capital vs Ordinary (or both!)
  - Different rates
  - Self-employment tax



# EXAMPLE CLEARCUT TIMBER SALE

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- Receives \$65,000 for sale
- Sales expenses are \$5,000
- Ordinary income bracket 35%
- Capital gains bracket 15%

# REMEMBER THE BASIS!

- \$15,000 in basis account

Sale proceeds – expenses – basis = gain

- $65,000 - 5,000 - 15,000 = 45,000$
- $45,000 \times (.15) = 6,750$  tax paid

## RECOVERING TIMBER BASIS

- Done through depletion
- Adjusted basis  $\div$  total volume of timber
- Calculated for each account

# EXAMPLE PARTIAL HARVEST

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- Adjusted basis \$5,000
- Total volume of timber 800 tons
- Depletion unit = \$6.25/ton sold

# TIMBER SALE

- Sell 1/3 of timber (267 tons)
- Receive \$3,204 for timber
- Sale expenses of \$320
  
- $267 \text{ tons} \times \$6.25/\text{ton} = \$1,669$
- $\$3,204 - \$1,669 - \$320 = \$1,215$ 
  - Taxable Gain

# SIDE NOTE

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- Medicare Tax
  - on “net investment income”
- Income over \$200K/\$250K
- 3.8%
- Capital Gains
- Passive Activities



# OTHER INCOME

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- Hunting Lease
- Pine Straw
- Decoratives
- Carbon?





# COST SHARE PAYMENTS

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- Income is taxable unless specifically excluded
- May qualify to exclude part of payment from income
- Must be payment determined by Sec. of Ag for conservation purpose
- May include in taxable income

# COST SHARE PAYMENTS

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- Payment must be for capital expenditure
- Cannot exclude if deductible in year incurred
- Cannot deduct reforestation expense and exclude cost share

# EXCLUDING COST SHARE

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Greater of present FMV of right to receive annual income

- 10% of avg. annual income for three tax year immediately prior
  - OR
- Amount equal to \$2.50 per acre times number of acres

Use interest rate from Farm Credit Bank

# COST SHARE PAYMENTS

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- Excluding
  - Include statement showing total cost, amount of cost share, date received, purpose of payment, amount excluded and how amount was determined

# CASUALTY LOSS

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- Loss due to fire or storm
  - Identifiable event
    - Sudden, unusual and unexpected
  
- Lesser of
  - Decrease in FMV
  - Adjusted basis



# CASUALTY LOSS

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- Must take into account salvage and insurance proceeds
  - May result in taxable gain
- May postpone gain by replacement within 2 years
- Loss calculated based on record-keeping unit

# DETERMINE TIMBER CASUALTY LOSSES

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Casualty loss shall be the lesser of:

**Decrease in fair market value (FMV) of the block due to the event**

**Adjusted timber basis of the block**



# EXPENSES

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Businesses deduct all “ordinary and necessary” expenses incurred for production or collection of income

Investors deduct expenses associated with production of income (management, conservation or maintenance of property)

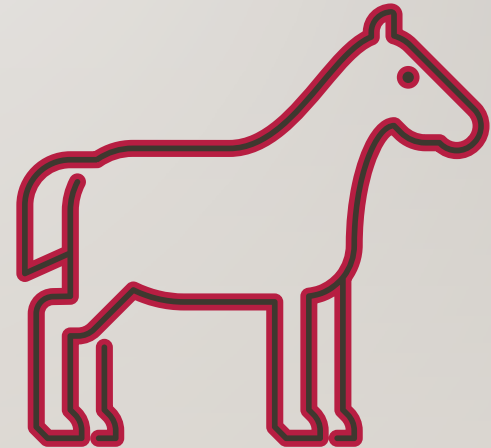
- Suspension of miscellaneous itemized

- Maintenance
- Ordinary
- Necessary

# DEDUCTIONS

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- **Hobby expenses are not deductible!**
- **Hobby Test**
  - Not conducted in businesslike manner
  - Expertise of taxpayer or advisor
  - Time & effort expended
  - Expectation of appreciation in value



# WHICH IS BETTER?

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Usually  
better to  
deduct

Opportunity  
cost of  
capital

# KEEP GOOD RECORDS

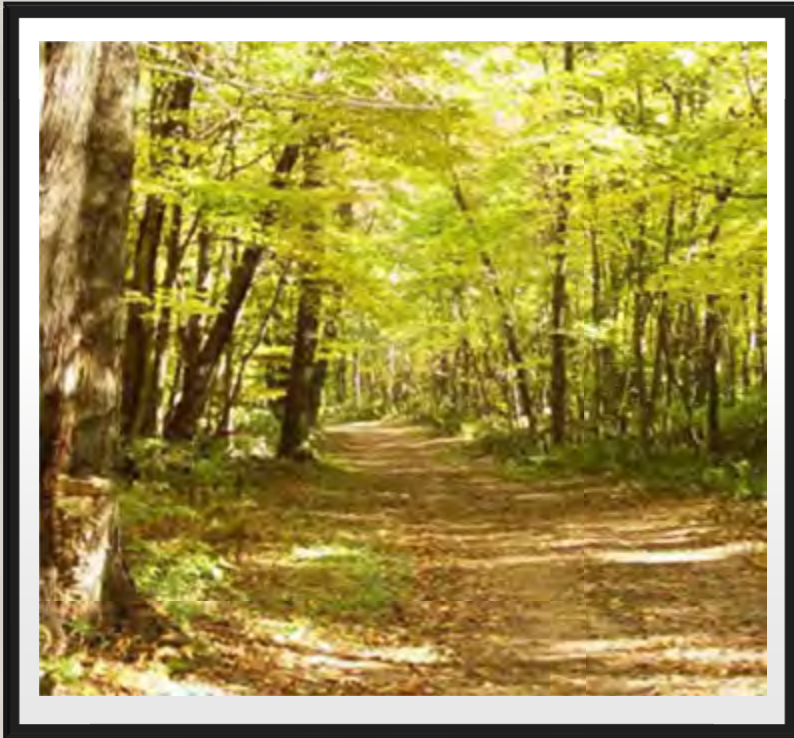
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- Journal, ledger, accounting program
- Keep all receipts, invoices, sale documents
  - 3 years minimum
  - Capital expense keep until asset disposed of plus 3 years

# RECORD KEEPING

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- Be consistent
- Keep in mind the cost of record keeping vs the benefit

# WHO FILES FORM T?

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- Filed only if
  - Depletion deduction claimed
  - Elect §631(a) for sale
  - Outright sale of timber





# FILING EXCEPTIONS

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Only occasional sale of timber (1-2 sales every 3-4 years or less)



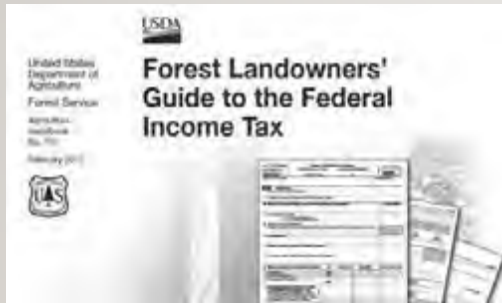
Maintain in records



If not filing Form T, still submit other appropriate forms (ex. 4562)



# RESOURCES



- Tax Tips for Forest Landowners 2022
- Hardwood Timber Industry Audit Technique Guide
- Forest Landowners Guide to the Federal Income Tax
- Woodland Stewards Tax Webinar Series

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## END NOTES



Planning is best  
defense!



Don't  
structure  
around taxes

Financial  
and legal  
consider  
ations

# QUESTIONS?

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