



TAX ISSUES FOR FOREST LANDOWNERS

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Today's discussion is educational, NOT legal or accounting advice, since the facts and circumstances of each taxpayer's individual situation need to be taken into consideration for exact application of the tax law.

DISCLAIMER

Taxes Exert Powerful Influence on Private Forestry

- Tax has been consistently listed as one of the top concerns for private forest landowners

Survey of National Woodland Owner Association

Topics

Tax Issues:

- Reporting Timber Sales
- Deductible Expenses
- Casualty and Theft Loss
- Form T (Timber)
- Taking Reforestation Deductions
- Form 1099 Reporting on Timber Sales

Special Topic

- New Tax Law Updates

Timber Ownerships

Personal Property

- Your main purpose of land ownership is for **personal enjoyment**, not for profit

Investment Property

- Your main purpose of owning timber is to **generate profit**

Business Property

- Your main purpose is to generate profit
- Your activity is **more frequent and regular** than investment

Tax Rates

- **Ordinary Income:**
10% - 37%
- ***Long-term* capital gains:**
0% - 20%

Tax Rates

- **3.8% Net Investment Income Tax**
- **The tax is imposed on the lesser of:**
 - **Net investment income for the year or**
 - **The excess of modified adjusted gross income over \$200,000 (\$250,000 joint filers)**

An Example

A Hypothetical Case:

- Husband and wife had **\$270,000 adjusted gross income**, including \$50,000 investment timber capital gains.

Analysis

- The excess of \$270,000 over **\$250,000 threshold** is \$20,000.
- Thus, their net investment income tax is \$760:
$$3.8\% \times \$20,000 = \$760$$

Quiz

If your adjusted gross income is less than \$250,000, your capital gains are not subject to the 3.8% net investment income tax.

True or False?



TIMBER SALES

Reporting Timber Sales

Sale of Standing Timber as Investment or Personal Property

- Sale of *standing* timber held as an investment or personal property is a capital gain

Reporting Timber Sales

Sale of Standing Timber in Business

- Sale of *standing* timber held in a *business* is a capital gain if it's held for more than 1 year

Tax Code Sec. 631(b)

Reporting Timber Sales

Sale of *Felled* Business Timber

Special Election

- All gains are ordinary income unless a sec. 631(a) election is made

Tax Code Sec. 631(a)

What Is “Basis”?

- For purchased property, your timber basis is the cost you paid for the property

What Is “Basis” for Inherited Property?

- It is the fair market value of the timber on the date of the decedent’s death.

Timber and Land Basis

	Proportion of FMV	Original Basis
Land	34%	\$16,966
Sawtimber . . .	43%	\$21,457
Pulpwood	23%	\$11,477
	100.0%	\$49,900

A Question

If I inherited the timber property 10 years ago, does this mean I have to go back 10 years to estimate the fair market value of my timber to set up my timber basis?

Yes or No?



DEDUCTIBLE EXPENSES

Deductible Expenses

- Tools of short useful life or small cost, e.g., axes, handsaws, etc.
- Hired labor
- Fees of forestry consultant and accountant
- Property taxes

Deductible Expenses (Cont'd)

- The costs of prescribed burning
- The expenses of fire, insect and disease control and protection
- Road and firebreak maintenance costs
- Overnight travel

Deductible Expenses

Depreciation of Property

Depreciable Assets

- are property used in business or income production in forest land:
 - Logging machines and equipment
 - Pickup trucks, tractors
 - Temporary road
 - Computer
 - Farm buildings
- Land cannot be depreciated

Deductible Expenses

Special Depreciation

First-Year Expensing of Asset (or “Sec. 179 Deduction”)

- Expense up to \$1 million spent on qualifying **business** property in 2018

Bonus Depreciation

- It is an additional first-year depreciation deduction
- The amount is 100-percent of the cost (adjusted basis) of eligible property

Schedules for Reporting Expenses

For an investment timber property

- Form 1040, Schedule A
- Subject to **2 percent of your AGI floor**

For timber business expenses

- Form 1040, Schedule C if you materially participating in the business

Casualty and Theft Loss

Investment or Business Property

- **The amount of the deduction is the lesser of**
 - the fair market value loss of your timber or
 - the adjusted basis of your timber
- If returns from a salvage harvest, court award, or insurance claim, exceed your timber basis, **you will have a *gain***

What Is Form T (Timber)?

Forest Activities Schedule

This tax form has five parts:

- **Acquisition**
- **Timber Depletion**
- **Profit or Loss from Land and Timber Sale**
- **Reforestation and Timber Stand Activities**
- **Ownership**

Who Must File Form T?

Complete Form T only if you:

- claim timber depletion deduction
- sell *felled* timber in the timber business (Sec.631(a) sales)
- sell timber outright in the timber business (Sec. 631(b) sales)

Who Must File Form T?

Occasional timber sellers

- are not required to file
- “Occasional”: one or two sales every 3 or 4 years

It is prudent to file

- when you claim depletion deduction or
- if you sell business timber

Taking Reforestation Tax Deduction

The First \$10,000 (married filing joint):

- You can deduct outright the first \$10,000 per year of qualifying expenses per qualified property; and

Excess amount over \$10,000:

- Deduct (“amortize”) *any* such additional amounts over 84 months (8 tax years)

Quiz

You own a woodland tract. In 2018, you paid a total of \$15,000 to reforest the property.

You can deduct the \$15,000 in your 2018 tax return.

True or False?

Form 1099-S

- Form 1099-S is the form to report real estate transactions
- It is required for timber sales

Form 1099-S Reporting

Who Must Issue 1099-S?

- (1) the person (including attorney or title company) responsible for closing the transaction,
- (2) the mortgage lender,
- (3) the seller's broker,
- (4) the buyer's broker, or
- (5) the buyer



TAX LAW CHANGES

Tax Laws Updates

Pass through business

- 20% income deduction

Miscellaneous Itemized Deduction (subject to 2% AGI floor)

- Repealed temporarily

State and Local Tax Deduction

- Capped at \$10,000

Tax Law Updates

Capital Gain Rates

- Remain unchanged: 0%, 15%, or 20%

Individual Tax Rates

- 10% - 37%

Corporate Tax Rates

- Top tax rate drops from 35% to 21%

Tax Law Updates

Sec. 179 Expensing

- Deduction increased to \$1 million

Bonus depreciation

- Deduction increased to be 100%

Federal Estate Tax

- Exemption doubled, to \$10 million per individual (indexing)

Quiz

Whether timber sale qualify for capital gains

Starting in 2018, due to the new tax law changes, timber sale no longer qualify for capital gains. That provision was eliminated.

True or false?

Summary

- Timber ownership types determines how your timber is taxed
- You must own your timber for more than 1 year to qualify for long-term capital gains*
- Occasional timber sellers are not required to file Form T (Timber)

**** Exceptions for inherited timber***

Summary (Cont'd)

- Form 1099 is required for both lump-sum and pay-as-cut timber sales
- Set up your timber basis for tax deductions
- Expenses are deductible for investment or business
- Casualty loss deduction is limited to your timber basis

Summary (Cont'd)

New Tax Law Updates

- Most tax law changes for individuals are temporary (2018-2025)
- Many taxpayers may see lower taxes
- Elimination or restrictions of certain deductions affect property owners including timber

Summary (Cont'd)

- Forest management plan is part of the tax records
- Keep tax records, written records are best!

Federal Income Tax on Timber

A Quick Guide for Woodland Owners

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