Timber Sales and Income

Agricultural Handbook 731

Type of Income

- When you sell timber, both the amount and type of income you receive are important
- Amount: *Price – Timber Basis – Costs of Sale*
- Type: Ordinary income or a capital gain

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Type of Income

- In almost every case you would prefer that the income be a long-term capital gain:
  - Lower tax rates for long-term capital gains:
    For 2012, 10–20% lower, depending on bracket
    For 2013, may be 15–18% lower
  - If you hold timber for use in a trade or business, any ordinary income you earn from it is subject to self-employment tax, at rates up to 15.3%
  - Other reasons related to Social Security, losses

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Type of Income

- Three factors determine whether income you receive from timber is ordinary income or a long-term capital gain:
  1. Your primary purpose for holding the timber
  2. How long you have held it
  3. The method you use to sell or dispose of it

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Primary Purpose

- Timber held as an investment – or for personal use – is covered under IRC sec. 1221
  - A capital asset in your hands, by definition
  - Gain from its sale or disposal qualifies as a capital gain, by definition, regardless of how you sell or dispose of it

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Primary Purpose

- Timber held for use in a trade or business is covered under IRC sec. 1231
  - *Not* a capital asset in your hands
  - But gain from its sale or disposal *can qualify* for treatment as a capital gain

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Holding Period

- Holding period for long-term treatment depends on how you acquired the timber:
  - By purchase: More than 12 months
  - By gift: More than 12 months, including time the donor held it
  - By inheritance: No requirement
- Holding period is measured from the date of acquisition to the "date of disposal"

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Method of Sale or Disposal

- Basically three ways:
  - Outright sale or exchange
  - Disposal with an economic interest retained
  - Convert standing timber into products for sale

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Outright Sale

- Direct sale of standing timber for a fixed total amount agreed upon in advance, for example, through a timber deed or sale contract
  - AKA lump-sum sale
  - Once the sale is complete, the buyer has title to the timber and bears all risk of loss
  - "Date of disposal" is the date ownership of the timber changes hands – *only* definition of "date of disposal" for an outright sale

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Outright Sale

- "Timber" is the parts of standing trees usable for wood products
  - Includes evergreen (coniferous) trees more than 6 years old when cut and sold for ornamental purposes
  - But not evergreen trees sold live, or the tops or other parts of standing trees used separately from the main stem

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Outright Sale

- For many years, only owners who held their timber as an investment (or personal property) qualified for capital gain treatment of income from the outright sale of timber
- But since Dec. 31, 2004, owners who hold timber for use in a trade or business *also can qualify* for capital gain treatment
  - Accomplished by a change in the wording of IRC sec. 631(b) put in place by AJCA

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Outright Sale

- NOTE: Timber sold outright under sec. 631(b) *must* be held more than 12 months to qualify for capital gain treatment – income from timber held 12 months or less is *ordinary income*
- Disposing of timber under sec. 631(b) gives the seller two important advantages
  - First, any gain realized is treated as a capital gain, regardless of whether the seller held the timber primarily for sale to customers

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Outright Sale

- Second, timber disposed of under sec. 631(b) is sec. 1231 property; any gain or loss from disposal of the timber is aggregated with other sec. 1231 gains and losses, with
  - A net gain treated as a capital gain …

    Tax-wise, this is the best possible outcome.

    ☑ Yes, capital gains are taxed at a lower rate

    ☒ No, ordinary income is taxed at a lower rate

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Outright Sale

- But a net loss treated as (ordinary income)

  Tax-wise, this is the best possible outcome.

  ☑ Yes, because the loss is deducted from dollars taxed at a higher rate

  ☒ No, deducting the loss from dollars taxed at a lower rate would give a better outcome

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Example

Last year a timber buyer knocked on your door and offered you $15,000, lump sum, to buy 1,000 cords of pulpwood from your 150-acre forest tract. You agreed. Your only cost of the sale was $350 to have your lawyer examine the contract. Just before the sale, the tract held 2,320 cords of pulpwood with a cost basis of $32,408.

Calculate your timber depletion deduction, your adjusted timber basis, and your net taxable proceeds from the sale.

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Solution

- Calculate your timber depletion deduction:
  - = Depletion unit x Cords sold
  - = ($32,408 ÷ 2,320 cord) x 1,000 cords
  - = $13.97 per cord x 1,000 cords = $13,970
- Calculate your adjusted timber basis:
  - = Original basis – Depletion deduction
  - = $32,408 – $13,970 = $18,438
- Report them on Form T (Timber), Part II ①

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Part II **Timber Depletion** (see instructions)

1 Name of block and title of account ▶ (Your Name) Merchantable Sawtimber Subaccount:
Investor: Lump sum sale of pulpwood
Material participant: Outright sale of pulpwood under sec. 631(b)

If you express timber quantity in thousand board feet (MBF), log scale, name the log rule used. If another unit of measure is used, provide details ▶

		(a) Quantity	(b) Cost or other basis
2	Estimated quantity of timber and cost or other basis returnable through depletion at end of the preceding tax year	2,000 cd	32,408
3	Increase or decrease of quantity of timber required by way of correction	--	
4a	Addition for growth (number of years covered ▶ 2)	320 cd	
b	Transfers from premerchantable timber account	--	--
c	Transfers from deferred reforestation account	--	--
5	Timber acquired during tax year	--	--
6	Addition to capital during tax year		--
7	Total at end of tax year, before depletion. Add lines 2 through 6	2,320 cd	32,408
8	Unit rate returnable through depletion, or basis of sales or losses. Divide line 7, column (b), by line 7, column (a)		13.97/cd
9	Quantity of timber cut during tax year	--	
10	Depletion for the current tax year. Multiply line 8 by line 9		--
11	Quantity of standing timber sold or otherwise disposed of during tax year	1,000 cd	
12	Allowable as basis of sale. Multiply line 8 by line 11		13,790
13	Quantity of standing timber lost by fire or other cause during tax year	--	
14	Allowable basis of loss plus any excess amount where decrease in FMV (before and after the casualty) exceeds the standard depletion amount, but not the block basis (see instructions)		--
15	Total reductions during tax year:		
a	In column (a), add lines 9, 11, and 13	1,000 cd	
b	In column (b), add lines 10, 12, and 14		13,790
16	Net quantity and value at end of tax year. In column (a), subtract line 15a from line 7. In column (b), subtract line 15b from line 7	1,320 cd	18,438

17 Quantity of cut timber that was sold as logs or other rough products

18 **Section 631(a):**

a Are you electing, or have you made an election in a prior tax year that is in effect, to report gains or losses from the cutting of timber under section 631(a)? (see instructions) ☐ **Yes** ☐ **No**

b Are you revoking your section 631(a) election (see instructions)? ☐ **Yes** ☐ **No**

Effective date ▶

Solution

- Calculate your net taxable proceeds from the sale:

Gross sale proceeds	$ 15,000
Minus depletion deduction	- 13,970
Minus cost of the sale	- 350
Net taxable sale proceeds	$ 680

- Report them on Form T (Timber), Part III ②
  Participants in a business include a note that your income is reported on Form 4797

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Outright Sale

- Investors report a capital gain from an outright sale of timber on new Form 8949 and Form 1040, Schedule D ③④
  - It will be combined with other capital gains and losses, with the net amount and your total tax due transferred to Form 1040
- You *may be* required to file Form T, Parts II and III – unless you only sell timber "infrequently"
- You can expect to receive a Form 1099-S

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SCHEDULE D (Form 1040)

Department of the Treasury Internal Revenue Service (99)

Capital Gains and Losses

► Attach to Form 1040 or Form 1040NR.
► Information about Schedule D and its separate instructions is at *www.irs.gov/form1040*.
► Use Form 8949 to list your transactions for lines 1, 2, 3, 8, 9, and 10.

OMB No. 1545-0074

2012

Attachment Sequence No. **12**

Name(s) shown on return: (Your Name)

Your social security number: XXX-XX-XXXX

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

Complete Form 8949 before completing line 1, 2, or 3. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price) from Form(s) 8949, Part I, line 2, column (d)	(e) Cost or other basis from Form(s) 8949, Part I, line 2, column (e)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
1 Short-term totals from all Forms 8949 with **box A** checked in **Part I**				
2 Short-term totals from all Forms 8949 with **box B** checked in **Part I**				
3 Short-term totals from all Forms 8949 with **box C** checked in **Part I**				

4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824	4	
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	5	
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your **Capital Loss Carryover Worksheet** in the instructions	6	( )
7 **Net short-term capital gain or (loss).** Combine lines 1 through 6 in column (h). If you have any long-term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back	7	

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

Complete Form 8949 before completing line 8, 9, or 10. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price) from Form(s) 8949, Part II, line 4, column (d)	(e) Cost or other basis from Form(s) 8949, Part II, line 4, column (e)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 4, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8 Long-term totals from all Forms 8949 with **box A** checked in **Part II**				
9 Long-term totals from all Forms 8949 with **box B** checked in **Part II**				
10 Long-term totals from all Forms 8949 with **box C** checked in **Part II**	15,000	14,320		680

11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824	11	
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	12	
13 Capital gain distributions. See the instructions	13	
14 Long-term capital loss carryover. Enter the amount, if any, from line 13 of your **Capital Loss Carryover Worksheet** in the instructions	14	( )
15 **Net long-term capital gain or (loss).** Combine lines 8 through 14 in column (h). Then go to Part III on the back	15	680

Name(s) shown on return. (Name and SSN or taxpayer identification no. not required if shown on other side.)

(Your Name)

Social security number or taxpayer identification number

XXX-XX-XXXX

Most brokers issue their own substitute statement instead of using Form 1099-B. They also may provide basis information (usually your cost) to you on the statement even if it is not reported to the IRS. Before you check Box A, B, or C below, determine whether you received any statement(s) and, if so, the transactions for which basis was reported to the IRS. Brokers are required to report basis to the IRS for most stock you bought in 2011 or later.

Part II **Long-Term.** Transactions involving capital assets you held more than one year are long term. For short-term transactions, see page 1.

You *must* check Box A, B, *or* C below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

☐ **(A)** Long-term transactions reported on Form(s) 1099-B showing basis **was** reported to the IRS

☐ **(B)** Long-term transactions reported on Form(s) 1099-B showing basis was **not** reported to the IRS

☑ **(C)** Long-term transactions not reported to you on Form 1099-B

3 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the **Note** below and see *Column (e)* in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). **See the separate instructions.** (f) Code(s) from instructions	(g) Amount of adjustment	(h) **Gain or (loss).** Subtract column (e) from column (d) and combine the result with column (g)
1,000 cords pine stumpage	02/01/2009	08/15/2012	15,000	14,320			680
4 Totals. Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, **line 8** (if **Box A** above is checked), **line 9** (if **Box B** above is checked), or **line 10** (if **Box C** above is checked) ▶			15,000	14,320			680

Note. If you checked Box A above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See *Column (g)* in the separate instructions for how to figure the amount of the adjustment.

Part III Profit or Loss From Land and Timber Sales (see instructions)

1 Name of block and title of account

(Your Name) Timber Account

2 Location of property (by legal subdivisions or map surveys)

(Legal description)

3a Purchaser's name and address (Buyer's name and address)	b Date of sale 08/15/2011
4 Amount received: a In cash	15,000
b In interest-bearing notes	--
c In non-interest-bearing notes	--
5a Amount of other consideration	--
b Explain the nature of other consideration and how you determined the amount shown on line 5a:	
6 Total amount received for property. Add lines 4a, 4b, 4c, and 5a	15,000

7 Cost or other basis of property:	Unit	Number of units	Cost or other basis per unit	Total cost or other basis
a Forested land	Acre			--
b Nonforested land	Acre			--
c Improved land (describe) ▶	Acre			--
d Merchantable timber. Estimate in detail the quantity of merchantable timber on the date of sale or exchange. Include the quantity of timber in each species of timber by diameter at breast height (DBH) classes. State the log rule used if the unit of measure is thousand board feet (MBF), log scale. If another unit of measure is used, provide details. ▶	Cord	1,000	13.97 / Cord	13,970
				--
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				--
				--
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				--
e Premerchantable timber				--
				--
				--
				--
				--
f Improvements (list separately)				--
				--
				--
				--
				--
g Mineral rights				--
h Total cost or other basis. Add lines 7a through 7g				13,970
i Direct sale expenses (cruising, marking, selling)				350
8 Profit or loss. Subtract the sum of lines 7h and 7i from line 6				680

Outright Sale

- Participants in a business report a capital gain from an outright sale of timber on Form 4797 ⑤
  - It will be combined with other sec. 1231 gains and losses, with a net gain transferred to Form 1040, Schedule D, as a capital gain ⑥
  - But a net loss transferred to Form 1040 as (ordinary income)
- You *are* required to file Form T, Parts II and III
- You also can expect to receive a Form 1099-S

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Disposal with Economic Interest Retained

- Disposal of timber under a contract that requires payment at a specified rate for each unit of timber that actually is cut and measured
  - AKA pay-as-cut contract
  - Technically a "disposal with economic interest retained," which means the seller typically retains title to the timber and bears all risk of loss until it is cut
  - "Date of disposal" is the date when the volume of the cut timber is first definitely determined

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SCHEDULE D (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Capital Gains and Losses

► Attach to Form 1040 or Form 1040NR.
► Information about Schedule D and its separate instructions is at *www.irs.gov/form1040*.
► Use Form 8949 to list your transactions for lines 1, 2, 3, 8, 9, and 10.

OMB No. 1545-0074

2012

Attachment Sequence No. **12**

Name(s) shown on return: (Your Name)

Your social security number: XXX-XX-XXXX

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

Complete Form 8949 before completing line 1, 2, or 3. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price) from Form(s) 8949, Part I, line 2, column (d)	(e) Cost or other basis from Form(s) 8949, Part I, line 2, column (e)	(g) Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
1 Short-term totals from all Forms 8949 with **box A** checked in **Part I**				
2 Short-term totals from all Forms 8949 with **box B** checked in **Part I**				
3 Short-term totals from all Forms 8949 with **box C** checked in **Part I**				

4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824	4	
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	5	
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your **Capital Loss Carryover Worksheet** in the instructions	6	( )
7 **Net short-term capital gain or (loss).** Combine lines 1 through 6 in column (h). If you have any long-term capital gains or losses, go to Part II below. Otherwise, go to Part III on the back	7	

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

Complete Form 8949 before completing line 8, 9, or 10. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price) from Form(s) 8949, Part II, line 4, column (d)	(e) Cost or other basis from Form(s) 8949, Part II, line 4, column (e)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 4, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8 Long-term totals from all Forms 8949 with **box A** checked in **Part II**				
9 Long-term totals from all Forms 8949 with **box B** checked in **Part II**				
10 Long-term totals from all Forms 8949 with **box C** checked in **Part II**				

11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824	11	680
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1	12	
13 Capital gain distributions. See the instructions	13	
14 Long-term capital loss carryover. Enter the amount, if any, from line 13 of your **Capital Loss Carryover Worksheet** in the instructions	14	( )
15 **Net long-term capital gain or (loss).** Combine lines 8 through 14 in column (h). Then go to Part III on the back	15	680

Form **4797**

Department of the Treasury
Internal Revenue Service

Sales of Business Property

(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

▶ Attach to your tax return.

▶ Information about Form 4797 and its separate instructions is at *www.irs.gov/form4797.*

OMB No. 1545-0184

2012

Attachment Sequence No. 27

Name(s) shown on return: (Your Name)

Identifying number: XXX-XX-XXXX

1 Enter the gross proceeds from sales or exchanges reported to you for 2012 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions) 1

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)

2 (a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)
1,000 cords pine stumpage	01/01/2009	08/15/2112	15,000		14,320	680

3 Gain, if any, from Form 4684, line 39 3

4 Section 1231 gain from installment sales from Form 6252, line 26 or 37 4

5 Section 1231 gain or (loss) from like-kind exchanges from Form 8824 5

6 Gain, if any, from line 32, from other than casualty or theft. 6

7 Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows: 7 680

Partnerships (except electing large partnerships) and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.

Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.

8 Nonrecaptured net section 1231 losses from prior years (see instructions) 8

9 Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return (see instructions) 9

Part II Ordinary Gains and Losses (see instructions)

10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):

11 Loss, if any, from line 7 . . . . . . 11 ( )

12 Gain, if any, from line 7 or amount from line 8, if applicable 12

13 Gain, if any, from line 31 13

14 Net gain or (loss) from Form 4684, lines 31 and 38a 14

15 Ordinary gain from installment sales from Form 6252, line 25 or 36 15

16 Ordinary gain or (loss) from like-kind exchanges from Form 8824. 16

17 Combine lines 10 through 16 17

18 For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below:

a If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the part of the loss from income-producing property on Schedule A (Form 1040), line 28, and the part of the loss from property used as an employee on Schedule A (Form 1040), line 23. Identify as from "Form 4797, line 18a." See instructions . . 18a

b Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Form 1040, line 14 18b

Disposal with Economic Interest Retained

- Before AJCA, a disposal with economic interest retained was the only method to dispose of standing timber recognized under sec. 631(b)
  - Owners who held their timber for use in a trade or business had to use this method to ensure their timber income qualified for treatment as a capital gain

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Disposal with Economic Interest Retained

- In a sec. 631(b) disposal "owner" is any person or legal entity with the right to cut the timber for sale or use on their own account
  - Can be the holder of a sublease or cutting contract, as long as they meet the 12-month holding requirement
- Selling timber held for use in a trade or business "on shares" with a harvester likely is a sec. 631(b) disposal with economic interest retained

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Example

Say that instead of accepting the timber buyer's offer, you decide to take bids for the 1,000 cords of pulpwood. A consulting forester solicits the bids, structures the sale as a disposal with economic interest retained, and administers it for 10% of the gross proceeds. The best bid you receive is $22 per cord, or $22,000.

Calculate the adjustments to your timber basis and your proceeds from the sale.

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Solution

- The adjustments to your timber basis are the same as they were for the outright sale
  - Your timber depletion deduction is $13,970
  - Your adjusted timber basis is $18,438
- Report them on Form T (Timber), Part II

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Solution

- Calculate your net taxable proceeds from the sale:

Gross sale proceeds	$ 22,000
Minus depletion deduction	- 13,970
Minus cost of the sale	- 2,200
Net taxable sale proceeds	$ 5,830

- Report them on Form T (Timber), Part III

  Participants in a business again include a note that your income is reported on Form 4797

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Disposal with Economic Interest Retained

- Investors report a capital gain from a disposal with economic interest retained timber on new Form 8949 and Form 1040, Schedule D
  - It will be combined with other capital gains and losses, with the net amount and your total tax due transferred to Form 1040
- You *may be* required to file Form T, Parts II and III – unless you only sell timber "infrequently"
- You can expect to receive a Form 1099

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Disposal with Economic Interest Retained

- **Participants in a business report a capital gain from a disposal with economic interest retained on Form 4797**
  - **It will be combined with other sec. 1231 gains and losses, with a net gain treated as a capital gain but a net loss treated as ordinary income**
- **You *should* file Form T, Parts II and III, to support your status as a participant in a business**
- **You also can expect to receive a Form 1099**

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Convert Standing Timber into Products for Sale

- **If you cut standing timber and convert it into logs, pulpwood, or other products for sale, all of the income that results will be *ordinary income* unless you have a sec. 631(a) election in effect**

  If you have an election in effect, then the income that results from holding the timber will be a capital gain – just as if you had sold it outright – and only the value added by converting it into products for sale will be ordinary income 7

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Part II Timber Depletion (see instructions)

1 Name of block and title of account ▶

	(a) Quantity	(b) Cost or other basis
If you express timber quantity in thousand board feet (MBF), log scale, name the log rule used. If another unit of measure is used, provide details ▶		
2 Estimated quantity of timber and cost or other basis returnable through depletion at end of the preceding tax year		
3 Increase or decrease of quantity of timber required by way of correction		
4a Addition for growth (number of years covered ▶)		
b Transfers from premerchantable timber account		
c Transfers from deferred reforestation account		
5 Timber acquired during tax year		
6 Addition to capital during tax year		
7 Total at end of tax year, before depletion. Add lines 2 through 6		
8 Unit rate returnable through depletion, or basis of sales or losses. Divide line 7, column (b), by line 7, column (a)		
9 Quantity of timber cut during tax year		
10 Depletion for the current tax year. Multiply line 8 by line 9		
11 Quantity of standing timber sold or otherwise disposed of during tax year		
12 Allowable as basis of sale. Multiply line 8 by line 11		
13 Quantity of standing timber lost by fire or other cause during tax year		
14 Allowable basis of loss plus any excess amount where decrease in FMV (before and after the casualty) exceeds the standard depletion amount, but not the block basis (see instructions)		
15 Total reductions during tax year: a In column (a), add lines 9, 11, and 13		
b In column (b), add lines 10, 12, and 14		
16 Net quantity and value at end of tax year. In column (a), subtract line 15a from line 7. In column (b), subtract line 15b from line 7		

17 Quantity of cut timber that was sold as logs or other rough products

18 **Section 631(a):**

a Are you electing, or have you made an election in a prior tax year that is in effect, to report gains or losses from the cutting of timber under section 631(a)? (see instructions) ☑ Yes ☐ No

b Are you revoking your section 631(a) election (see instructions)? ☐ Yes ☐ No

Effective date ▶

Convert Standing Timber into Products for Sale

- AKA sec. 631(a) transaction
- Inherently a business operation: in effect, you are an integrated forest products firm, selling the standing timber to yourself at a "transfer price" and manufacturing products for sale
- Make the election on Form T, Part II, line 18a
- Less common than other two methods of sale and there is not time to cover it here, *but …*

29

Convert Standing Timber into Products for Sale

An arrangement where a consulting forester oversees a harvest and delivery of timber to a mill, receives the payment, and writes checks to the owner and logger for their shares likely is a sec. 631(a) transaction

30

Reforestation Tax Incentives

Agricultural Handbook 731

Reforestation Tax Incentives

- Incentives provided in the IRC eliminate the need to hold expenses associated with reforestation – or afforestation – in a capital account until you sell or dispose of timber
- The current incentives were put in place by the American Jobs Creation Act of 2004 (AJCA)

  They allow you to deduct outright the first $10,000 per year of qualifying expenses and amortize any additional amount over 8 tax years

2

Who is Eligible

- **Individual taxpayers, estates, partnerships, and corporations are eligible for both the deduction and amortization provisions**
  - **Trusts are not eligible for the deduction, but can amortize**

3

What Qualifies

- **Expenses to establish timber on tracts:**
  - **At least 1 acre in size**
  - **Located in the U.S.**
  - **Held to produce commercial timber products**
  - **Not limited to plantations – includes practices to encourage natural regeneration**
- **Timber establishment expenses reimbursed under an approved public cost-share program that you elect to *include in* your gross income**

4

Qualifying CRP Payments

- **Under Rev. Rul. 2003-59, you can exclude a calculated part of CRP cost-share payments from your gross income**
  - **But not any part of CRP sign-up or incentive payments, rental payments, or payments for expected environmental benefits**
- **Under IRC sec. 175, you also can deduct tree-planting expenses paid using a CRP cost-share, to a limit of 25% of your income from *farming***

5

What Does Not Qualify

- **The cost of planting non-timber trees:**
  - **Christmas trees**
  - **Shelterbelts**
  - **Windbreaks**
  - **Nut trees**
  - **Fruit trees**
  - **Ornamentals**

Why don't Christmas trees qualify?

A. They are considered a horticultural product

B. They typically are sold in less than 8 years

C. Due to a mistake by Congressional tax-writers

6

What Does Not Qualify

- **Timber establishment expenses reimbursed under an approved public cost-share program that you elect to *exclude from* your gross income**
- **The cost of intermediate treatments**

7

Expenses Up To $10,000 per Year

- **Deduct outright direct expenses of establishing timber up to $10,000 per year – $5,000 per year for married persons filing separately – for each "qualified timber property" or QTP**
  - **If you divide your holdings into two or more QTPs you cannot recombine them for calculating timber depletion or loss deductions**
  - **But most owners will only need one QTP for all of their forest holdings**

8

Expenses Up To $10,000 per Year

- Investors take the reforestation deduction on the "Adjustments to income" line of Form 1040 (line 36 for 2011)
  - Write RFST and the amount on the dots
- Participants in a trade or business take it on the "Other expenses" line of a business form
  - Form 1040, Schedule C for a business or Schedule F for a farm

9

Expenses Over $10,000 per Year

- You must amortize (deduct over a set time period) timber establishment expenses over $10,000 per year
- The amortization period nominally is 84 months (7 years), but a half-year convention applies, so you

  Take a 1/14th deduction in year 1

  Take a full 1/7th deduction in years 2–7

  Take the final 1/14th deduction in year 8

10

Expenses Over $10,000 per Year

- You must specifically elect to amortize timber establishment expenses on an original return – or an amended return filed by the due date for an original return (including extensions) – for the tax year you incurred the expenses
  - If you are required to file Form T (Timber), file Part IV – otherwise keep it in your records ⑧
  - Elect to amortize and take amortization deductions on Form 4562, Part VI ⑨

11

Expenses Over $10,000 per Year

- If you are not required to file Form T, attach a statement to your return showing the:
  - Unique stand identification number
  - Total acres of timber established
  - Treatment you used to establish the timber
  - Total qualified expenditures eligible to be deducted or amortized

  for each "qualified timber property" treated

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Part V **Listed Property** (Include automobiles, certain other vehicles, certain computers, and property used for entertainment, recreation, or amusement.)

Note: *For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete* ***only*** *24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.*

Section A—Depreciation and Other Information (Caution: *See the instructions for limits for passenger automobiles.*)

24a Do you have evidence to support the business/investment use claimed? ☐ Yes ☐ No | **24b** If "Yes," is the evidence written? ☐ Yes ☐ No

(a) Type of property (list vehicles first)	(b) Date placed in service	(c) Business/ investment use percentage	(d) Cost or other basis	(e) Basis for depreciation (business/investment use only)	(f) Recovery period	(g) Method/ Convention	(h) Depreciation deduction	(i) Elected section 179 cost
25 Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use (see instructions) . **25**								
26 Property used more than 50% in a qualified business use:								
		%						
		%						
		%						
27 Property used 50% or less in a qualified business use:								
		%				S/L –		
		%				S/L –		
		%				S/L –		
28 Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1 . **28**								
29 Add amounts in column (i), line 26. Enter here and on line 7, page 1 . . . **29**								

Section B—Information on Use of Vehicles

Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

	(a) Vehicle 1		(b) Vehicle 2		(c) Vehicle 3		(d) Vehicle 4		(e) Vehicle 5		(f) Vehicle 6	
30 Total business/investment miles driven during the year (**do not** include commuting miles) .												
31 Total commuting miles driven during the year												
32 Total other personal (noncommuting) miles driven . . .												
33 Total miles driven during the year. Add lines 30 through 32 . . .												
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
34 Was the vehicle available for personal use during off-duty hours? . . .												
35 Was the vehicle used primarily by a more than 5% owner or related person? . .												
36 Is another vehicle available for personal use?												

Section C—Questions for Employers Who Provide Vehicles for Use by Their Employees

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who **are not** more than 5% owners or related persons (see instructions).

	Yes	No
37 Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees? . . .		
38 Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners . .		
39 Do you treat all use of vehicles by employees as personal use? . . .		
40 Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received? . . .		
41 Do you meet the requirements concerning qualified automobile demonstration use? (See instructions.) . . .		

Note: *If your answer to 37, 38, 39, 40, or 41 is "Yes," do not complete Section B for the covered vehicles.*

Part VI **Amortization**

(a) Description of costs	(b) Date amortization begins	(c) Amortizable amount	(d) Code section	(e) Amortization period or percentage	(f) Amortization for this year
42 Amortization of costs that begins during your 2012 tax year (see instructions):					
Qualifying reforestation costs	07/01/2012	4,000	194(a)	84 mo.	286
43 Amortization of costs that began before your 2012 tax year . . .				**43**	571
44 **Total.** Add amounts in column (f). See the instructions for where to report . . .				**44**	857

Part IV **Reforestation and Timber Stand Activities** (see instructions)

Account, block, tract, area, or stand ID for each Qualified Timber Property (QTP)	Kind of activity (burning, chopping, spraying, planting, seeding, thinning, pruning, fertilizing, etc.)	Number of acres treated	Total expenditures
1 (Your Name) Timber Account	Reforestation	80	14,000
			--
			--
			--
			--
			--
			--
2 Total		80	14,000
3 Total reforestation expenses		80	14,000
4a Amount to be expensed under section 194(b). (See instructions for limitations)			10,000
b Amount to be amortized under IRC 194(a), including remaining reforestation expenditures not expensed under section 194(b)			4,000

Part V **Land Ownership**

Show all changes in land accounts. Attach as many additional sheets as needed, following the format of lines 1 through 6.

	Acres	Total cost or other basis. Give amount of March 1, 1913 appreciation, if included	Average rate per acre
1 Name of block and title of account ►			
2 Balance at beginning of year			
3 Acquisitions during year			
4 Sales during year			
5 Other changes			
6 Balance at end of year. Add lines 2 and 3, subtract line 4 and add or subtract line 5			

Additional Information.

Expenses Over $10,000 per Year

- Investors also take the amortization deduction on the "Adjustments to income" line of Form 1040
- Participants in a trade or business also take it on the "Other expenses" line of a business form

13

Recapture

- Any tax saved by using either the deduction or amortization provision is subject to recapture if you dispose of the timber within 10 years
  - Disposals by gift are excepted
  - Like-kind exchanges, involuntary conversions, tax-free transfers, and transfers at death also are generally excepted

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