

Income Tax on Timber
For Your 2012 Return Filing

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Disclaimer

**The materials and discussions are
educational, not legal or accounting advice.**

How Is My Woodland Property Classified for Tax Purpose?

- **Personal property**
 - **Deductions are limited**
- **Investment property**
- **Business property**
 - **Income-producing purpose**

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What Qualifies as a Business?

- **Profit motive—Does the activity make profit?**
 - The IRS presume an activity is for profit if it makes a profit during at least 3 of the last 5 years
 - Profit also include expectation that assets appreciate in value

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What Qualifies as a Business?

- Does the time and effort put into the activity indicate an intention to make a profit?
- Does the taxpayer depend on income from the activity?
- Does the taxpayer or his advisors have the knowledge to carry on the activity as a business?

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What Qualifies as a Business?

- Does the activity make a profit in some years?
- Has the taxpayer made a profit in similar activities in the past?

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Deducting Expenses by a Business

Ordinary and necessary business expenses are fully deductible on Schedule C (material participants)

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Passive Business?

- **If you don't "materially participate" in your woodland business, your activity may be "passive"**
- **Loss from passive business activity cannot offset income from non-passive activity**
 - Retirement income
 - Salary
 - Self-employment income ...

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Business or Hobby?

- **If the profit objective is not met, your activity may be a hobby**
- **Losses that are deductible for a business are disallowed for a hobby**

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Deducting Expenses for Woodland Investment Property

- **Deduct on Schedule A, but it is subject to 2% of your adjusted gross income floor;**
or
- **Elect to keep them in the cost of your timber and recover upon timber sale**

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An Example

Your adjusted gross income was \$40,000.

Your woodland expenses was \$1,000.

But only \$200 is deductible on Schedule A:

$$\text{\$1,000} - 2\% \times \text{\$40,000} = \text{\$200}$$

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Quiz: True or False

Form T, Forestry Activity Schedule, is a tax form.

Is This True or False?

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What is Form T?

Forest Activities Schedule

This schedule has five parts:

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

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Who Must File Form T?

- File Form T only if you:
 - claim a depletion deduction
 - timber sold after cut (vs. *sold on the stump*) (Sec. 631(a))
 - make an outright timber sale by business (Sec. 631(b))

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Quiz

What Form Is for Reporting Woodland Business Expenses?

- A) Schedule A**
- C) Schedule C**

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Timber Basis

- **Timber acquisition and sale may involve its basis.**
- **Basis reduces sale proceeds and thus save taxes.**

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What Is Your Timber Basis?

- For purchased property, your timber basis is the purchase price plus other acquisition cost
- For inherited property, it is the fair market value of timber on the date of death
- For gifted property, it is generally the cost in the donor's hand

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An Example of Timber Basis

- Pine Sawtimber: \$9,000 (\$300/MBF, 30 MBF)
- Hardwood Pulpwood: \$3,500 (\$5/cord, 700 cords)
- Pine pulpwood: \$2,000 (\$10/cord, 200 cords)

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Quiz: True or False

If your woodland is an investment property, the expenses are deductible but are subject to 2% of your adjusted gross income floor.

Is This True or False?

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Cost Share Payment

- **Cost share payment must be included in your income unless it qualifies for income exclusion (Sec. 126)**
- **The excludable cost share payment must be:**
 - **From an approved program**
 - **For capital project (such as reforestation)**

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Timber Loss from Casualty



Forest Fire



Hurricane Damage

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Timber Loss from Casualty

- **Casualty loss is deductible**
- **However, the amount of deduction is the smaller of fair market value loss of the timber or the timber's basis**
- **Tip: Timber basis and fair market value loss is for the entire timber account (vs. only the destroyed portion)**

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Quiz

Is Cost Share Payment Income?

- A) Yes, you must always include it in your income.
- B) No, it's not taxable.
- C) Yes, but certain qualified cost share may be excluded from your income.

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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

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3.8% Investment Tax for 2013 and Beyond

- **Beginning in 2013, investment income of a high-income taxpayer is subject to a new tax of 3.8%**
- **The tax applies to taxpayers with adjusted gross income of \$200,000 (\$250,000 for couples) ONLY**

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Sweeping Changes by the “Fiscal Cliff” Bill for 2013 and Beyond

- **Enacted on Jan. 2, 2013**
- **Long-term capital gain maximum tax rates will have two types:**
 - **20% maximum rate if your income is over \$450,000 (joint returns), or \$400,000 (single)**
 - **15% maximum rate for the rest of the taxpayers**

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2013 Tax Rates

- **Ordinary Income: 10% - 39.6%**
- **Long-term capital gains: 0%, 15%, 20%, 23.8% (although 3.8% is taxed on the *excess* amount over the set threshold)**

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0% Capital Gain Tax Rates How Does It Work?

- **For 2012 returns, the 0% rate applies to the long-term capital gains if the taxable income (including gains) is up to:
 \$35,350 (individual) or
 \$70,700 on a joint return**

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Quiz: True or False

Reporting timber sale and claiming casualty loss may involve timber basis.

Is This True or False?

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Federal Income Tax on Timber A Quick Guide for Woodland Owners

Fourth Edition
2012



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