

Income Tax on Timber
For Your 2013 Return Filing

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Disclaimer

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

Tax Issue Is Important to Private Woodland Owners

**Tax is *consistently* listed as one of
the top concerns for private
woodland owners**

from National Woodland Owners Survey

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Three Woodland Types for Tax Purpose

- **Personal property**
- **Investment property**
- **Business property**

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Three Woodland Types for Tax Purpose

- **Personal property:**
 - owned primarily for **personal enjoyment**, rather than for **making a profit**

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Three Woodland Types for Tax Purpose

- **Investment property:**
 - owned primarily for **making a profit**

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Three Woodland Types for Tax Purpose

- **Business property:**
 - ***You regularly and continuously engage in the activity primarily for making a profit***

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Woodland Expenses

- **the cost of tools**
- **fees for forestry consultant**
- **firebreak maintenance cost**
- **stand management expense**
- **insect control cost**
- **vehicle and overnight travel**

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Deducting Expenses by Woodland Investor

- Ordinary and necessary woodland expenses are deductible
- However, such expense is subject to 2% of your adjusted gross income reduction

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An Example

Your woodland expenses was **\$1,000**.

Because your adjusted gross income (AGI) was **\$40,000**, only \$200 is the final deduction amount (on Schedule A):

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

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Deducting Expenses by A Business

1. Material participants:

Ordinary and necessary business expenses are fully deductible

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Material Participation Tests

1. Participated in the activity for more than **500 hours** during the year
2. Participation is substantially all of the participation

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Material Participation Tests

3. Participated for more than **100 hours** and no other individual participated more
4. Participated more than **500 hours** for **timber and other businesses**

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Material Participation Tests

5. Materially participated for at least **5 of the 10 preceding years**

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2. Passive Participation in Business

- If you do not “materially participate” in the business activity, you are a “passive” participant.
- **Loss deduction** from a passive activity is **limited**.

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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 reduction.

Is This True or False?

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Timber Sales

“I have let a local company cut down my trees on my land and want to know:

- 1) how to report the \$10,000 I received for taxes;
- 2) what deductions I can take.”

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#1. Type of Income

➤ The first question is:

Is your timber sale income
capital gains or ordinary income?

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Sale of Investment Timber

- Sale of *standing* timber (“stumpage”) held as an investment is a capital gain

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Sale of Timber Held in A Business

- 1). Sale of *standing* timber held in a *business* is a capital gain if it's **held for more than 1 year**
- 2). Sale of *cut* timber product: all gains are ordinary income unless a special election is in effect and the timber must be held for more than 1 year before it is cut

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#2. Two Kinds of Capital Gains

Only long-term capital gain is taxed at the lower rate

- 1) **Long-term** capital gains: own the property for more than 1 year before sale
- 2) **Short-term** capital gains: own the property 1 year or less

****Inherited property is long-term**

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#3. Deductions from the Sale

Gross sale proceeds
– **Basis** (generally “Cost”)
– **Sale expenses**

Taxable gain

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What Is “Basis”?

- For **purchased** property, your timber basis is the **cost** you paid for the property
 - *Only* the timber portion, separate from that of the land

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An Example of Timber Basis

Pine Pulpwood	200 cords	\$2,000
Pine sawtimber	10 MBF	\$3,000
Hardwood pulpwood	300 cords	<u>\$1,500</u>
Total:		<u>\$6,500</u>

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What Is “Basis” for Inherited Property?

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

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A Question

If I inherited the timber property 15 years ago, does this mean I have to go back 15 years to estimate the fair market value of my timber to set up my timber basis?

The answer is: Yes!

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Recover Basis Through “Depletion”

\$9,000 (Total Basis of Your Sawtimber)
÷ 300 MBF (Total Volume of Your Sawtimber)

\$30 / MBF (“Depletion Unit”)
× 100 MBF (Volume Sold in 2013)

\$3,000 (Depletion Deduction from Sale)

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Reforestation Cost

- Hired labor
- Seedling cost
- Site preparation costs
- Equipment
- Competition control to establish trees

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Reforestation Cost Deduction

- In 2013, you can deduct outright **the first \$10,000 per year** of qualifying expense per property (married filing joint, \$5,000 single) and
- Take *amortization* deduction on any additional amounts over 84-month

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Reforestation Example

Total Cost of Reforestation: \$14,000

1. Take \$10,000 deduction (MFJ)

2. Amortization:

1) $(\$14,000 - \$10,000) / 14 = \underline{\$286}$ (Year 1)

2) $(\$14,000 - \$10,000) / 7 = \underline{\$571}$ (Years 2-7)

3) \$286 (Year 8)

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What Is Form T?

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

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Who Must File Form T?

- It's **prudent** to file when you claim depletion deduction and if you are a business taxpayer whether you are required to file or not
- Occasional timber sellers are not required to file
 - Occasional: one or two sales every 3 or 4 years

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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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Payment Received (“Cost Share”)

- Check received from agency to help with your planting, thinning, or insect control, etc.
- This is also called “Cost Share” Payment

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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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Quiz: True or False

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

Is This True or False?

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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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An Example: 3.8% Tax

- **Assume your adjusted gross income is \$260,000:**
 - **Salary of \$200,000 and \$60,000 timber sale (capital gains)**
 - **You are single taxpayer**

$$(\$260,000 - \$200,000 \text{ threshold}) \times 3.8\% = \$2,280$$

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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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Federal Income Tax on Timber

A Quick Guide for Woodland Owners

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2012

