Timber Tax

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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?

The answer has implications for deductions and income

Three Holding Purposes...

- A woodland property may be considered as one of three tax categories:
 - personal property
 - investment property
 - business property

Woodland as Personal Property

- Your holding is for personal purpose, not for profit seeking
 - -Personal hunting and fishing
 - -Family retreat
- This classification is at a disadvantage because its tax deductions are limited

Is Your Woodland Property an Investment?

 Woodland property held for incomeproducing purposes may be an investment when your activity does not rise to the level of a business

Tax Treatment of Investment Property

- Expenses:
 - Don't file Schedule C as it is for business
 - ** 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

2% Floor Example

Your adjusted gross income was \$40,000. Your woodland expenses was \$1,000. But only \$200 is deductible on Schedule A: \$1,000 - 2% x \$40,000 = \$200

One of the best way to document your income-producing purpose...

• is by including income production and cash flow projection in your woodland management plan

What Is This Year's Tax Filing Deadline?

A) April 13, 2012 B) April 15, 2012 C) April 17, 2012 (Tuesday)

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What Is A Business?

• A business is an activity you regularly and continuously engage in primarily to make a profit

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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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Deducting Expenses by a Business	
Ordinary and necessary business	
expenses are fully deductible on Schedule C (material participants)	
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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?	

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?
- The timber activities and transactions by a business are generally more active, regular, intensive and continuous than investment

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Business or Hobby?

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

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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.

- A) True
- B) False

Example of Woodland Management Expenses







Southern Pine Beetle

Examples of Woodland Management Expenses



Firebreak Maintenance Cost

Expenses...



Hiring Consulting Forester



Weed Control

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 <u>outright</u> timber sale by <u>business</u> (Sec. 631(b))

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Form T

- · What about occasional timber sales?
 - defined as: One or two sales every 3 or 4 years
 - $\boldsymbol{-}$ not required, but prudent to file

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Quiz: True or False	
Quiz. True of Fullot	
Form T, Forestry Activity Schedule, is a	
tax form.	
A) True	
B) False	
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Figure Out Timber Basis	
Transactions regarding timber	
acquisitions and sale involve its basis.	
Basis reduces sale proceeds and therefore save taxes.	
increme save taxes.	
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Figure Out Timber Basis	
•	
 For purchased timber property, the basis is the <u>purchase price</u> plus <u>other acquisition</u> 	
cost	
 For inherited property, it is the <u>fair market</u> 	
value of timber on the date of death	
 For gifted property, it is generally the cost in the donor's hand 	
in the donor's hand	

An Example	of Timber Basis	
Pine Sawtimber:	• 30 MBF (\$300/MBF)	
Hardwood Pulpwood:	• 100 cords (\$15/cord)	
Pine Pulpwood	• 600 cords (\$7/cord)	
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		28

Quiz

What Form Is for Reporting Woodland Business Expenses?

- A) Schedule A
- B) Schedule B
- C) Schedule C

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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)

So, tree stand improvement cost share are taxable income as it is not a capital expenditure

Approved Federal Programs

- Excludable Federal Programs that may affect timberland owners include:
 - Conservation Reserve Program (CRP)
 - Environmental Quality Incentives Program (EQIP)
 - Wetland Reserve Program (WRP)
 - Wildlife Habitat Incentive Program (WHIP)
 - Forest Health Protection Cost Share
 - Conservation Security Program

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Approved State Programs

 Approved State cost-share programs that most often affect timberland owners include:

- Forestry Development Program	.NC
- Reforestation of Timberlands Act Program	VA
- Forest Resource Development Program	.MS
- Forest Improvement Program	.CA
- Forest Renewal Program	SC
- Forestry Development Program	IL
- Forestry Productivity Program	IΔ

Timber Loss from Casualty





Forest Fire

Hurricane Damage

Timber Loss from Casualty

- · Casualty loss is deductible
- The amount of deduction is the smaller of fair market value loss or timber basis
- Tip: Basis and fair market value loss is for the entire timber account (vs. only the destroyed portion)
- Caution: the loss valuation for the entire property may be expensive or even prohibitive

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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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1099-S Reporting

- Lump sum timber sales are subject to 1099-S reporting
 - Effective for timber sales after May 28, 2009
 - Treasury Decision 9450
- Pay-as-cut sales has been subject to 1099-S reporting

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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Taxes on Investment Income

New Tax for High-Income Taxpayer

- Beginning in 2013, investment income of a high-income taxpayer is subject to a new tax of 3.8%
 - Married filing joint: \$250,000
 - Single: \$200,000

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Quiz

What transactions may involve timber basis?

- A) Timber sale
- B) Timber sale and claiming casualty loss

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