

# **Income Tax on Timber**

## ***For Your 2013 Return Filing***

**Dr. Linda Wang**

**National Timber Tax Specialist**

**US Forest Service**

# Disclaimer

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

# Three Woodland Types for Tax Purpose

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

# Woodland Expenses

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

# 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

# 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):

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

# Deducting Expenses by A Business

## 1. Material participants:

Ordinary and necessary business expenses are fully deductible

# Material Participation Tests

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



# Material Participation Tests

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

# Material Participation Tests

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

## 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**.

## Quiz: True or False

**“Material participation” applies to woodland owners who structure their timber ownership as a business.**

**Is This True or False?**

# Timber Sales

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“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.”

# #1. Type of Income

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➤ **The first question is:**

**Is your timber sale income  
capital gains or ordinary income?**

# Sale of Investment Timber

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

# 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



## #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**

## #3. Deductions from the Sale

**Gross sale proceeds**

– **Basis** (generally “Cost”)

– **Sale expenses** \_\_\_\_\_ :

**Taxable gain**

# 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

# An Example of Timber Basis

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

# What Is “Basis” for Inherited Property?

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

# A Question

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**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?**

# Recover Basis Through “Depletion”

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

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**\$30 / MBF (“Depletion Unit”)**

**× 100 MBF (Volume Sold in 2013)**

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**\$3,000 (Depletion Deduction from Sale)**

# Reforestation Cost

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



# 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

# 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)

# 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**

# 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

# Quiz: True or False

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

**Is This True or False?**

# Payment Received (“Cost Share”)

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

# Cost Share Payment

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

# Timber Loss from Casualty



**Forest Fire**



**Hurricane Damage**



# 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**

# 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.**

# Quiz: True or False

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

**Is This True or False?**

## **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**

# 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

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

# Capital Gain Rates 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**

# 2014 Tax Rates

- **Ordinary Income: 10% - 39.6%**
- **Long-term capital gains: 0%, 15%, 20%, 23.8%\***

# Federal Income Tax on Timber

## A Quick Guide for Woodland Owners

**Fourth Edition**  
**2012**





# Rising Tax Code Complexity

