INTRODUCTION

Tax law is very complex
Often hinges on details
Always changing
NOT tax advice
AGENDA

• Basis
• Reforestation
• Timber sales
• Casualty loss
• Cost Share
• Recordkeeping
KNOW YOUR CLASSIFICATION

- Key to treatment of losses, expenses
- Business, Investment, Personal/Hobby
  - Active, Passive
- Consider frequency of activity and intent
- Often “facts & circumstances”
  - Document activity, compare to other landowners
KNOW YOUR BASIS!

- Basis is the amount of your investment in capital assets for tax purposes
  - Purchased: Acquisition cost
  - Inherited: Fair market value (FMV)
  - Planted: cost of stand establishment *
  - Gifts & Exchanges: Various rules

- Allocate basis to land, timber (merch, premerch), buildings
- Established at the time of acquisition (can be done retroactively)
- Increased by capital expenditures, decreased for sales
ACCOUNTS NEEDED

- Land: bare land, land improvements such as leveling costs, impoundments, permanent non-depreciable structures

- Depreciable assets: buildings, bridges, fences, etc.

- Equipment: planting machine, tractors, etc.
ACCOUNTS NEEDED

• Merchantable timber: record both quantity and dollar value (basis).
  • Keep units attached to quantity (cords, tons, MBF, etc.)

• Pre-merchantable timber: number of acres and basis
  • If landowner plants once owned: site prep, planting costs
## EXAMPLE ALLOCATION

<table>
<thead>
<tr>
<th>Asset Description</th>
<th>Fair Market Value</th>
<th>% of total FMV</th>
<th>Basis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merchantable Timber</td>
<td>$50,000</td>
<td>0.40</td>
<td>$ 40,000</td>
</tr>
<tr>
<td>Land</td>
<td>$65,000</td>
<td>0.52</td>
<td>$ 52,000</td>
</tr>
<tr>
<td>Premerch</td>
<td>$10,000</td>
<td>0.08</td>
<td>$ 8,000</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>$125,000</strong></td>
<td><strong>1.00</strong></td>
<td><strong>$100,000</strong></td>
</tr>
</tbody>
</table>
HOW DO I FIGURE OUT BASIS IF IT WAS NEVER ALLOCATED??

Called a retroactive basis determination

Same method as if figured at time of acquisition, just requires research

Will need to determine timber prices

Volume estimation
BASIS FOR NEW STANDS

- Costs of establishing trees
- Record number of acres and basis
  - Once merchantable, record volume and basis
REFORESTATION

Afforestation or reforestation

- Site prep, seed or seedlings, brush & weed control
- Natural and artificial regeneration
- NOT PERSONAL LABOR
REFORESTATION TAX INCENTIVES

Outright deduction of expenses up to $10K Per qualified timber property Per tax year

Remainder amortized over 7 tax years
NOTES ON REFORESTATION INCENTIVE

On timely filed return
  • Can not amend after 6 months

Must include cost share income

No carryover of unused deduction

Recapture provisions!
TAX STRATEGY!!!

- Reforestation incentive available each tax year
- Forestry operations often naturally staggered
- Take advantage of staggering operations
PROPERLY CLASSIFY SALE PROCEEDS

• How did you sell your timber?
  • Sold on stump or sale of logs
  • Cut own or sell firewood
• Did you meet holding period?
• Capital vs Ordinary (or both!)
  • Different rates
  • Self-employment tax
EXAMPLE CLEARCUT TIMBER SALE

• Receives $65,000 for sale
• Sales expenses are $5,000
• Ordinary income bracket 35%
• Capital gains bracket 15%
REMEMBER THE BASIS!

- $15,000 in basis account

Sale proceeds – expenses – basis = gain

- 65,000 – 5,000 – 15,000 = 45,000
- 45,000 x (.15) = 6,750 tax paid
RECOVERING TIMBER BASIS

- Done through depletion
- Adjusted basis ÷ total volume of timber
- Calculated for each account
EXAMPLE PARTIAL HARVEST

- Adjusted basis $5,000
- Total volume of timber 800 tons
- Depletion unit = $6.25/ton sold
TIMBER SALE

- Sell 1/3 of timber (267 tons)
- Receive $3,204 for timber
- Sale expenses of $320

- 267 tons x $6.25/ton = $1,669
- $3,204 – $1,669 - $320 = $1,215
  - Taxable Gain
SIDE NOTE

• Medicare Tax
  • on “net investment income”

• Income over $200K/$250K

• 3.8%

• Capital Gains

• Passive Activities
OTHER INCOME

- Hunting Lease
- Pine Straw
- Decoratives
- Carbon?
COST SHARE PAYMENTS

• Income is taxable unless specifically excluded
• May qualify to exclude part of payment from income
• Must be payment determined by Sec. of Ag for conservation purpose
• May include in taxable income
COST SHARE PAYMENTS

• Payment must be for capital expenditure
• Cannot exclude if deductible in year incurred
• Cannot deduct reforestation expense and exclude cost share
EXCLUDING COST SHARE

Greater of present FMV of right to receive annual income

- 10% of avg. annual income for three tax year immediately prior
  - OR
  - Amount equal to $2.50 per acre times number of acres

Use interest rate from Farm Credit Bank
COST SHARE PAYMENTS

• Excluding
  • Include statement showing total cost, amount of cost share, date received, purpose of payment, amount excluded and how amount was determined
CASUALTY LOSS

• Loss due to fire or storm
  • Identifiable event
    • Sudden, unusual and unexpected

• Lesser of
  • Decrease in FMV
  • Adjusted basis
CASUALTY LOSS

• Must take into account salvage and insurance proceeds
  • May result in taxable gain

• May postpone gain by replacement within 2 years

• Loss calculated based on record-keeping unit
DETERMINE TIMBER CASUALTY LOSSES

Casualty loss shall be the lesser of:

Decrease in fair market value (FMV) of the block due to the event

Adjusted timber basis of the block
EXPENSES

Businesses deduct all “ordinary and necessary” expenses incurred for production or collection of income

- Maintenance
- Ordinary
- Necessary

Investors deduct expenses associated with production of income (management, conservation or maintenance of property)

- Suspension of miscellaneous itemized
DEDUCTIONS

• **Hobby expenses are not deductible!**

• **Hobby Test**
  • Not conducted in businesslike manner
  • Expertise of taxpayer or advisor
  • Time & effort expended
  • Expectation of appreciation in value
WHICH IS BETTER?

- Usually better to deduct
- Opportunity cost of capital
KEEP GOOD RECORDS

• Journal, ledger, accounting program

• Keep all receipts, invoices, sale documents
  • 3 years minimum
  • Capital expense keep until asset disposed of plus 3 years
RECORD KEEPING

- Be consistent
- Keep in mind the cost of record keeping vs the benefit
WHO FILES FORM T?

• Filed only if
  • Depletion deduction claimed
  • Elect §631(a) for sale
  • Outright sale of timber
FILING EXCEPTIONS

Only occasional sale of timber (1-2 sales every 3-4 years or less)
Maintain in records
If not filing Form T, still submit other appropriate forms (ex. 4562)
RESOURCES

- Tax Tips for Forest Landowners 2022
- Hardwood Timber Industry Audit Technique Guide
- Forest Landowners Guide to the Federal Income Tax
- Woodland Stewards Tax Webinar Series
Planning is best defense!

Don’t structure around taxes
QUESTIONS?

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