

Timber Tax Basics From a Landowners Perspective: 2026

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RuralTax.org



- Hosted by Utah State University
- Material developed, managed, and owned by the **National Farm Income Tax Committee**
- Informational materials on ag, timber, and rural tax topics include but not limited to:
 - Disaster/weather losses
 - Treatment of government payments
 - Farm losses and hobby rules
 - Self-employment tax
 - Estate and gift tax
 - Like kind exchanges
 - Depreciation

Today's discussion

- ▶ Defining Timber
- ▶ Basis issues
- ▶ Is the timber activity a business or an investment?
- ▶ Reporting
 - ▶ Income
 - ▶ Expenses
- ▶ Reforestation
- ▶ Briefly discuss casualty losses
- ▶ Briefly discuss like-kind exchange

Timber...What is it ... taxwise?

- ▶ Is the timber and timberland...a Business? (Tree farming)
 - ▶ To be considered in the business relative to timber sales, the IRS looks to the frequency of sale events. (Taxpayer intent?)
 - ▶ Infrequent is ~1 sale every so many years ... treated as an investment return
 - ▶ Frequent sales are ~2-3 sales events within 5 years looking at the available case law (facts and circumstances taken in total)



Timber...What is it?

- ▶ Tax wise...it's an IRC §1231(b)(2) asset ("business")
- ▶ Investment (treated mostly this way for individuals)
 - ▶ With 60% of the Southeast covered in trees, most private landowners treat timber as a long-term investment
- ▶ But **NOT** ALWAYS treated as such...
 - ▶ Might be inventory if taxpayer is "in the business"
 - ▶ Depends on product
 - ▶ Firewood --- Ordinary income and subject to self-employment tax
 - ▶ Pine Straw --- Ordinary income and subject to self-employment tax
 - ▶ "Lighter wood" --- Ordinary and subject to self-employment tax



Example: Sale of Firewood

- ▶ Johnson owns several tracts of forestland. He harvests hardwood timber and cuts the leftovers (tops and branches) for firewood. He markets as 8-10-piece bundles and by the rick or cord. These sales are reported on Sch F.

SCHEDULE F (Form 1040)		Profit or Loss From Farming				OMB No. 1545-0074	
Department of the Treasury Internal Revenue Service		Attach to Form 1040, 1040-SR, 1040-SS, 1040-NR, 1041, or 1065. Go to www.irs.gov/ScheduleF for instructions and the latest information.				2025 Attachment Sequence No. 14	
Name of proprietor JOHNSON TIMBERGROWER					Social security number (SSN) JOHNSON SSN		
A Principal crop or activity FIREWOOD		B Enter code from Part IV 1 1 3 2 1 0		C Accounting method: <input checked="" type="checkbox"/> Cash <input type="checkbox"/> Accrual		D Employer ID number (EIN) (see instr.)	
E Did you "materially participate" in the operation of this business during 2025? If "No," see instructions for limit on passive losses					<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No		
F Did you make any payments in 2025 that would require you to file Form(s) 1099? See instructions					<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No		
G If "Yes," did you or will you file required Form(s) 1099?					<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No		
Part I Farm Income – Cash Method. Complete Parts I and II. (Accrual method. Complete Parts II and III, and Part I, line 9.)							
1a Sales of purchased livestock and other resale items (see instructions)					1a		
b Cost or other basis of purchased livestock or other items reported on line 1a					1b		
c Subtract line 1b from line 1a					1c		
2 Sales of livestock, produce, grains, and other products you raised					2	35,000	

Acquiring Basis in Timberland and Timber

- ▶ Methods to acquire basis
 - ▶ Purchase: Basis equals price paid for timber as allocated post purchase (IRC § 1012)
 - ▶ Inheritance: FMV on DOD (IRC § 1014)
 - ▶ Step-up occurs the **day after** death date
 - ▶ Alternate valuation 6 months after death [IRC § 2032(a)]
 - ▶ A sale within the 6-month period is deemed to be FMV
 - ▶ Gift: Carryover basis from donor (IRC § 1015)
 - ▶ Dependent upon historical records, which may or may not exist
 - ▶ Transfer is also carryover basis
 - ▶ Divorce
 - ▶ Creation of a land/timber holding entity

Biggest Issue is ... Basis!!

- ▶ Allocation of BASIS between asset types and classes
 - ▶ Land
 - ▶ Timber
 - ▶ Improvements



Basis Considerations to think about

- ▶ Allocation is a proration of FMV, which hopefully is based on an appraisal of the property
 - ▶ Bought below appraisal value ... a good deal
 - ▶ Bought above appraisal value ... maybe not a good deal
 - ▶ IRS rules are found in
 - ▶ Treas. Reg. §1.61-6(a)
 - ▶ IRC §1060
 - ▶ Treas. Reg. §1.338-8
 - ▶ Treas. Reg. §1.1060-1

Determination of Timber Basis

- ▶ Real estate acquisitions require taxpayers and tax practitioners to consider if more than one asset was acquired in the same transaction.
 - ▶ Allocation of basis per Treas. Reg. § 1.61-6(a)
 - ▶ For standing timber, a consulting forester may be helpful.
- ▶ In this picture there are several assets



Example: Allocation of Basis Following Purchase

- ▶ Frazer Furr paid \$410,000 for land with standing timber plus other assets. Following an appraisal, he determined he made a “good buy” .
 - ▶ The FMV per an appraisal was determined to be \$490,000.

Frazer's Basis Allocation

Asset	FMV	% of FMV	Basis
Home	\$100,000.00	20.4082%	\$83,673.47
Shop/Barn	\$25,000.00	5.1020%	\$20,918.37
Timberland	\$65,000.00	13.2653%	\$54,387.76
Farmland	\$160,000.00	32.6531%	\$133,877.55
Homestead (land)	\$5,000.00	1.0204%	\$4,183.67
Timber, merchantable	\$125,000.00	25.5102%	\$104,591.84
Timber, young	\$10,000.00	2.0408%	\$8,367.35
Totals	\$490,000.00	100.0000%	\$410,000.00

Depreciable v. Nondepreciable

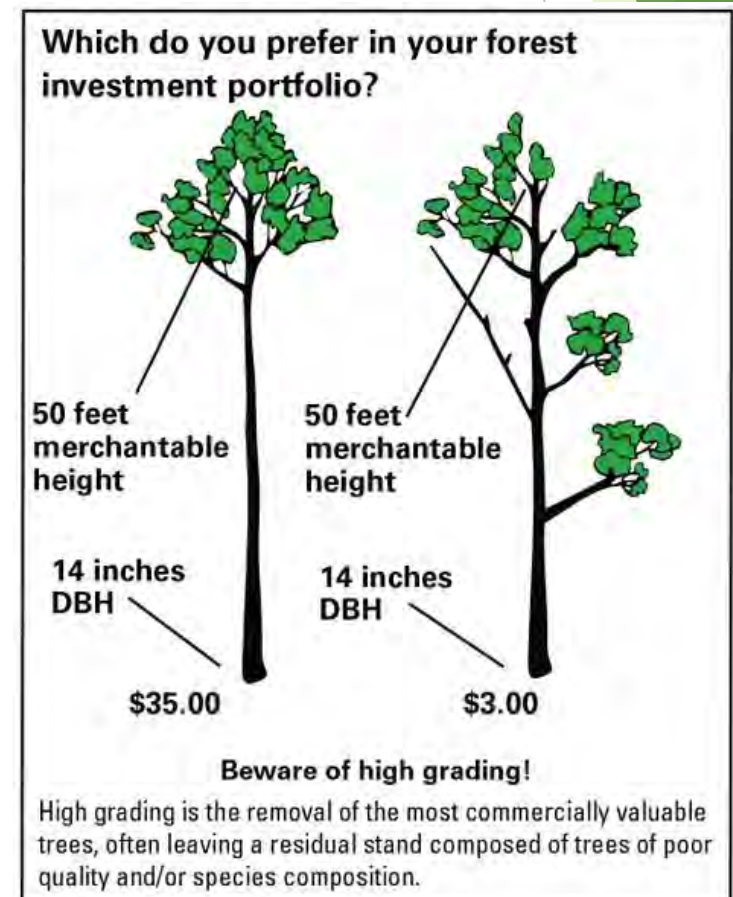
- ▶ **Example:** Shop/barn has allocated basis of \$20,918.37; it is depreciable if used in a T or B.
- ▶ **Example:** Home has allocated basis of \$83,673.47 and if used by Frazer as his residence it is not eligible for depreciation but is eligible for § 121 exclusion.
 - ▶ Residential rental 27.5-year recovery period using straight-line
 - ▶ Farm building 20-year recovery period 150 DB (eligible for Bonus Depreciation)

Note:

- ▶ Best to make allocations as soon as possible after the sale while memories are fresh and the market “unchanged”.
- ▶ If proposed legislation in Congress repeals step-up in basis at date of death and requires carry-over basis, basis records become very important. Many pundits believe this is unlikely because step-up has been available for over 100 years ... but one never knows what the future might bring.

OOOPS... Landowner doesn't have BASIS

- ▶ IRS allows for a back cruise if the timber is still standing and attached to the roots.
- ▶ If the landowner doesn't have or can't prove basis, the presumption is that basis is \$0.00



Back Cruise to establish Timber Basis after the fact [Treas. Reg. § 1.611-3(f)]

- ▶ Consulting Forester conducts a statistical survey
 - ▶ Sample of trees: species, density and size
- ▶ Consulting Forester counts rings from statistically selected trees
 - ▶ From wood bores obtained at breast height (4ft from the ground)
- ▶ Applies historic timber prices
 - ▶ Extension Services often have historic price data
- ▶ Determines a timber value and thereby basis
 - ▶ However, cannot zero out land value
- ▶ Generally, cannot be applied after trees are cut

Inheritance of Land with Timber

- ▶ Basis of property acquired through an estate is the FMV on the date-of-death or the alternate valuation date.
 - ▶ Step-up occurs on day after death
- ▶ As noted previously a qualified appraisal determines FMV.
 - ▶ Treas. Reg. § 1.170A-17 defines a qualified appraisal and appraiser
 - ▶ Ad valorem appraisals are not the best, though tempting.
 - ▶ For property tax purposes
 - ▶ How current?

Special Use Valuation

- ▶ Rural landowners who may be subject to estate and gift tax may elect to use I.R.C. § 2032A to reduce the value of “qualified real property” .
 - ▶ 2026 Estate Exclusion amount is \$15,000,000 (\$30,000,000 married individuals)
 - ▶ 2026 I.R.C. § 2032A reduction is \$1,460,000, potentially reducing estate tax \$584,000

Example: Special Use Valuation

- ▶ Yolanda inherits land and standing timber
- ▶ Estate elects to use I.R.C. § 2032A and reduces value by \$1,460,000 thus bringing the grandmother's estate to the 2026 exclusion amount and saving \$584,000 of estate tax.
 - ▶ Must be held by qualified heir
 - ▶ Must be in continuing special use for 10 years
 - ▶ Timber harvest violates special use...triggers recapture of deferred taxes plus interest.

Basis: Gifts of Land with Timber

- ▶ Gifts transfer three items to the donee: 1) the asset, 2) the donor's holding period and 3) the donor's adjusted basis.
 - ▶ 2026 Annual gift exclusion is \$19,000
- ▶ The donee should record these details in their permanent records.
- ▶ Other factors may come into play:
 - ▶ Gift prior to 1977, basis of donee increased by any gift tax paid, limited to FMV
 - ▶ Gift after 1976, basis of donee increased by gift tax paid, but limited
 - ▶ If FMV of property was less than donor's basis, special loss limit applies.

Form T and Timber Basis Calculations

- ▶ A Landowner who claims a deduction timber depletion, depreciation of improvements or who makes an election under I.R.C. § 631(a) must file Form T.
- ▶ As a practical matter, IRS hasn't enforced this for individuals who have relatively small land holdings and are investors.
 - ▶ Landowners holding timber as a long-term investment need not file Form T.

Timber Business or Investment

- ▶ Taxpayers and tax professionals need to be clear as to taxpayer intent and the fact pattern which may prevail in determining the difference between business or investment activities relative to timber.
 - ▶ In the business?
 - ▶ Or an investor?

Example: Investment in Timber

- ▶ Southern Pine purchased 50 acres of land with standing young timber in 1990. His **intent** was to hold as an investment to finance his children's college tuition.
- ▶ Sold timber for \$150,000 in 2025, \$10,000 was allocated to timber as basis at time of purchase.
 - ▶ \$140,000 long-term capital gain

Sch D

SCHEDULE D (Form 1040)

Department of the Treasury
Internal Revenue Service

Capital Gains and Losses

Attach to Form 1040, 1040-SR, or 1040-NR.
Use Form 8949 to list your transactions for lines 1b, 2, 3, 8b, 9, and 10.
Go to www.irs.gov/ScheduleD for instructions and the latest information.

OMB No. 1545-0074

2025

Attachment
Sequence No. 12

Name(s) shown on return

SOUTHERN PINE

Your social security number

SOUTHERN SS

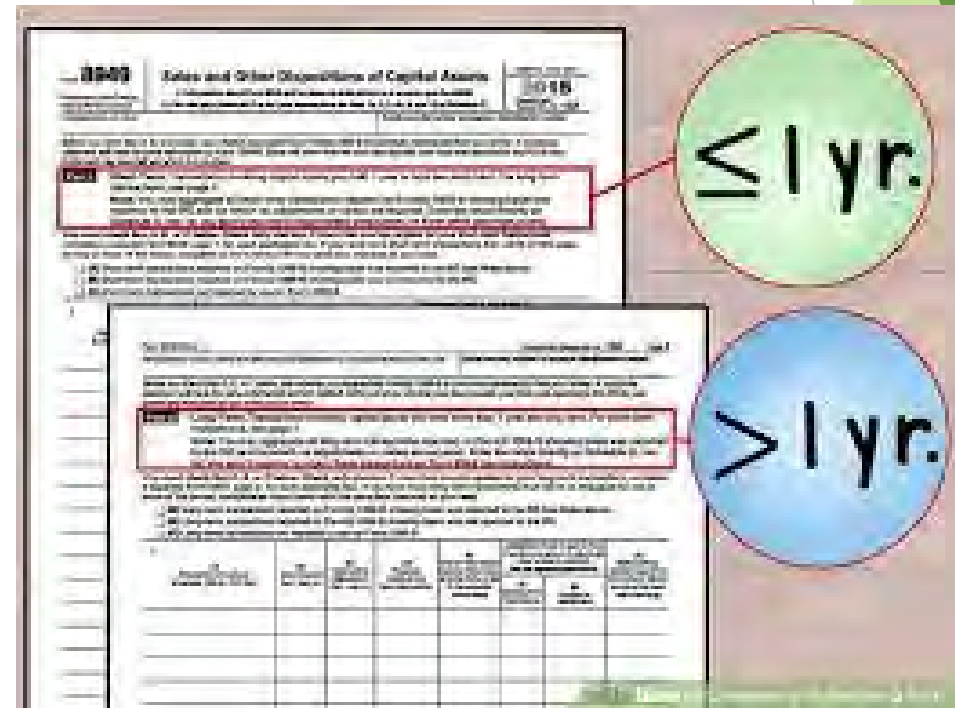
Did you dispose of any investment(s) in a qualified opportunity fund during the tax year? Yes No
If "Yes," attach Form 8949 and see its instructions for additional requirements for reporting your gain or loss.

Part II Long-Term Capital Gains and Losses—Generally Assets Held More Than One Year (see instructions)

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	(d) Proceeds (sales price)	(e) Cost (or other basis)	(g) Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	(h) Gain or (loss) Subtract column (e) from column (d) and combine the result with column (g)
8a Totals for all long-term transactions reported on Form 1099-B or Form 1099-DA for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b				
8b Totals for all transactions reported on Form(s) 8949 with Box D or Box J checked				
9 Totals for all transactions reported on Form(s) 8949 with Box E or Box K checked				
10 Totals for all transactions reported on Form(s) 8949 with Box F or Box L checked	150,000	10,000		140,000
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824				11
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				12
13 Capital gain distributions. See the instructions				13
14 Long-term capital loss carryover. Enter the amount, if any, from line 13 of your Capital Loss Carryover Worksheet in the instructions				14 ()
15 Net long-term capital gain or (loss). Combine lines 8a through 14 in column (h). Then, go to Part III on the back				15 140,000

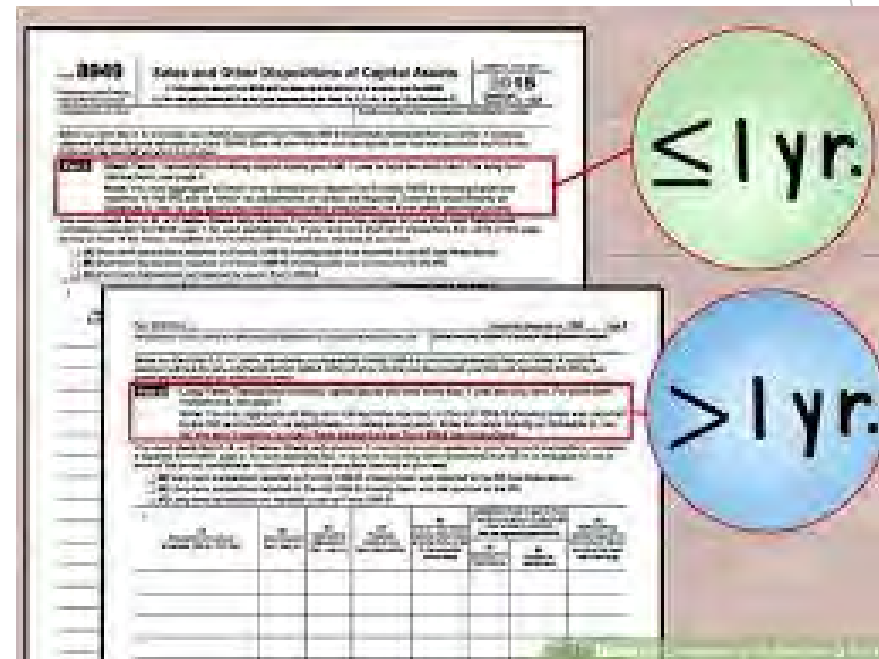
Timber Sale Reporting

- ▶ Timber is a real estate transaction: expect a 1099-S
- ▶ For Investors
 - ▶ Initial Reporting on IRS Form 8949
 - ▶ **Part I for Short-term**: Held for one year or less
 - ▶ Gifts: Donor holding period attaches to the donee



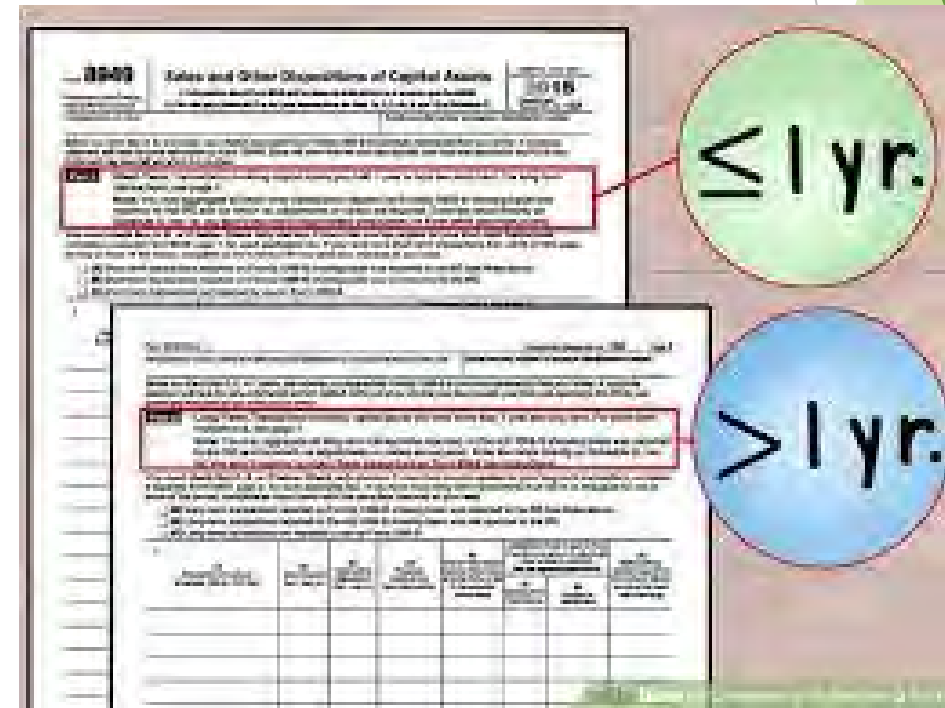
Timber Sale Reporting

- ▶ Timber is a real estate transaction: expect a 1099-S
- ▶ For Investors
 - ▶ Initial Reporting on IRS Form 8949
 - ▶ **Part II for Long-term**: Held for more than a year
 - ▶ Gifts: Donor holding period attaches to the donee
 - ▶ Inheritance: Presumption of law is to be long-term



Timber Sale Reporting

- ▶ The IRS Form 8949 net results (long-term and short-term) flow to Schedule D. Long-term gets capital gain treatment. Short-term gets ordinary treatment.
- ▶ Timber sales are subject to NIIT
 - ▶ 3.8% surtax above thresholds
 - ▶ MFJ = \$250,000
 - ▶ Single = \$200,000



Timber Activity treated as a Trade or Business

- ▶ Generally, a business activity is conducted with **regularity, continuity**, and with frequency of transactions and a **profit motive**. (I.R.C. § 162) (see *Commissioner v. Groetzinger*)
 - ▶ Timber investments, by contrast, have infrequent transactions
 - ▶ Investors need to be aware of Net Investment Income Tax (NIIT)

Being Treated as in the Trade or Business of Timber

- ▶ I.R.C. § 199A (QBID) makes life interesting
 - ▶ Obtaining capital gain treatment eliminates QBID as capital gains are treated at preferential income tax rates of 0%, 15%, or 20%
- ▶ Facts and circumstances will determine outcome of a landowner's tax rate(s).

Timber Sale Reporting

- ▶ For those in the business of timber production
 - ▶ May make an IRC §631(a) election to capture most if not all gain as capital gain. (Pub. L. 108-357, Oct. 22, 2004)
 - ▶ Step one: “sell to self” on January 1, 20xx on Part One of IRS Form 4797.
 - ▶ Mark-to-market “book” transaction
 - ▶ Net all section 1231 transactions: net gains are capital, net losses are ordinary
 - ▶ Step two: with actual sale, report on “Schedule F”, line 1a with the basis from Form 4797 (Jan 1 sale value) on line 1 b, and report net gain on line 1c subject to Ordinary and SE taxation.
 - ▶ Step three: deduct, on Schedule F, sales expenses and timber harvest costs, which oftentimes results in a loss.
 - ▶ Commissions
 - ▶ Temporary logging roads
 - ▶ Temporary culverts and bridges
 - ▶ Boundary survey costs
 - ▶ Etc.

Expenses of the Timber Activity

- ▶ Whether the landowner can deduct the timber expense in the current tax year is dependent upon several factors:
 - ▶ Acting as an Investor
 - ▶ Engaged in an Active and Material Trade or Business
 - ▶ Do Passive Activity Rules apply

Timber Expenses for investors which are non-Deductible

- ▶ The OBBB (2025) permanently eliminates itemized miscellaneous deductions subject to the 2% floor.
- ▶ Therefore, landowners treating timber as an **investment** cannot deduct many of their expenses and must capitalize these costs into timber basis.

Trade or Business Carrying Charges

- ▶ If the timber activity rises to a “T or B” operating costs and carrying charges are generally treated as “ordinary and necessary” business deductions.
- ▶ However, if there are **no sales** in the current year, the carrying charges may not be deducted.

Trade or Business Carrying Charges

- ▶ Carrying charges are:
 - ▶ Property taxes
 - ▶ Insurance
 - ▶ Interest paid on loans related to timber

Treas. Reg. § 1.266-1(b)(1)(i) allows for capitalizing the carrying charges to the timber account.

Development Costs of Timber

- ▶ Capitalize development costs to timber account, Treas. Reg. § 1.266-1(b)(1)(ii)
 - ▶ Silviculture practices
 - ▶ Noncommercial thinning
 - ▶ Timber stand improvement (fertilizer/ herbicides)
 - ▶ Election remains in effect until development is completed

Purchase of Equipment/Machinery

- ▶ **Active and material trade or business of tree farming**
 - ▶ Section 179 Expensing, subject to limitations
 - ▶ Bonus Depreciation [I.R.C. § 168(k)] 100% in 2025 and future years
 - ▶ MACRS
 - ▶ New 5-year 200% DB
 - ▶ Used, 7-year 200% DB
 - ▶ Election to use 150% DB or straight line
 - ▶ Election to use ADS with 10-year life

Purchase of Equipment/Machinery

- ▶ **Investment property** for the landowner
 - ▶ Section 179 Expensing is disallowed generally
 - ▶ Bonus Depreciation [I.R.C. § 168(k)] 100% in 2025 and future years
 - ▶ Allowed for “income producing” property (investment)
 - ▶ **MACRS**
 - ▶ New 5-year 200% DB
 - ▶ Used, 7-year 200% DB
 - ▶ Election to use 150% DB or straight line
 - ▶ Election to use ADS with 10-year life

Passive Loss Rules

- ▶ Timber T or B may be classified as a passive activity, and subject to I.R.C. § 469 rules. The regs reference 7 material participation options, 6 of which are relevant to timber.
 - ▶ Landowner's activity is greater than 500 hours annually
 - ▶ Landowner's activity is substantially all the activity
 - ▶ Landowner's activity was greater than 100 hours and as much as any other
 - ▶ Timber is a significant activity, and all significant activity was 500 hours or more
 - ▶ Landowner materially participated 5 of the last 10 years
 - ▶ Landowner participates more than 100 hours, and based on F&C is treated as materially participating

Example: Passive Timber Activity

- ▶ Jose owns 200 acres of hardwood timberland.
- ▶ Jose spent less than 10 hours in the timber activity.
- ▶ Jose paid \$5,500 in various costs, no income this year.
- ▶ Therefore, under I.R.C. § 469, this is a passive activity, and the expenses are suspended and not deductible in the current year.

Timber Expenses of an Investment

- ▶ Even though OBBB eliminated certain miscellaneous itemized deductions subject to the 2% floor, other code sections may allow for a deduction.
 - ▶ **Example:** Making the choice to capitalize
 - ▶ \$3,500 herbicide costs
 - ▶ \$2,000 controlled burning costs

Allowable Deductions under I.R.C.

- ▶ Property taxes as an itemized personal deduction [I.R.C. § 164(a)(1)]
- ▶ Interest on timber related loans as an itemized deduction [I.R.C. § 163(d)] limited by investment interest rules
- ▶ **Example: Douglas Firr: property tax and interest**
 - ▶ \$5,500 of property taxes on timber land
 - ▶ \$9,500 of property taxes on principle residence
 - ▶ \$10,000 of interest on timberland loan
 - ▶ \$2,500 investment income: dividends and LTCG

Example: Continued

- ▶ Q1: Is Douglas limited regarding his deductions?
 - ▶ Yes. Under OBBB, Douglas is limited to \$40,000 of state and local taxes and can deduct \$15,000 if he itemizes.
 - ▶ He is also limited to \$2,500 of investment income for his deductions and can't deduct \$7,500 of interest.

Example: Continued

- ▶ Can Douglas receive any tax benefit from the disallowed deductions?
 - ▶ Yes. Douglas can elect to capitalize the \$10,000 of interest paid to finance the timberland. This increases his timber basis by \$10,000 which can be recovered in a subsequent timber sale.
 - ▶ Not perfect...but not lost forever either.

Is Timber Income Qualified for 20% Qualified Business Income Deduction?

- ▶ Remember, timber sales will not qualify, for the Qualified Business Income Deduction (QBID) because the gain is treated as capital gain and therefore is preferentially taxed to begin with.
 - ▶ 0%, 15%, 20%
 - ▶ May be subject to NIIT as previously mentioned
 - ▶ For the Investor

Reforestation Expenses (I.R.C. § 194)

▶ Investor landowners, who reforest, may deduct up to \$10,000 of reforestation expenses **per unique tract** of timber. Anything above \$10,000 is amortized over 84 months.

- ▶ Possible planning opportunity
- ▶ Deduction for investors is taken on Schedule 1, Line 24d, Form 1040, as an adjustment. Total included in Line 26.

▶ For example:

▶ **Note Treasury has not amended Reg § 1.194-1 to reflect changes made by P.L. 109-135, P.L. 108-357**

Schedule 1 (Form 1040) 2022

Page 2

Part II Adjustments to Income

11	Educator expenses	11	
12	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	12	
13	Health savings account deduction. Attach Form 8889	13	
14	Moving expenses for members of the Armed Forces. Attach Form 3903	14	
15	Deductible part of self-employment tax. Attach Schedule SE	15	
16	Self-employed SEP, SIMPLE, and qualified plans	16	
17	Self-employed health insurance deduction	17	
18	Penalty on early withdrawal of savings	18	
19a	Alimony paid	19a	
	b Recipient's SSN		
	c Date of original divorce or separation agreement (see instructions):		
20	IRA deduction	20	
21	Student loan interest deduction	21	
22	Reserved for future use	22	
23	Archer MSA deduction	23	
24	Other adjustments:		
	a Jury duty pay (see instructions)	24a	
	b Deductible expenses related to income reported on line 8l from the rental of personal property engaged in for profit	24b	
	c Nontaxable amount of the value of Olympic and Paralympic medals and USOC prize money reported on line 8m	24c	
	d Reforestation amortization and expenses	24d	10,000
	e Repayment of supplemental unemployment benefits under the Trade Act of 1974	24e	

Reforestation Recapture...is this missed?

- ▶ Reforestation Expenses are to be recovered, by a sale, under I.R.C. § 194, these are recaptured and are treated as ordinary income.
 - ▶ I.R.C. § 1245 (b)(7) if within 10 years of reforestation
 - ▶ Recompute basis per I.R.C. § 1245 (a)(2)
 - ▶ For investor, the sale could go straight to Schedule D, but, if reforestation was taken, then 4797 used for the recapture, with recapture being taxed as ordinary income.
 - ▶ Recapture is separate under the “tax benefit rule”
 - ▶ If the sale is beyond 10 tax years, there is no recapture.

Casualty Loss in Timber (Hurricane Helene)

- ▶ Remember, generally the rule is the casualty loss (**business or investment**) is the lesser of basis or the decrease in FMV. (I.R.C. § **§ 165** and 1012)
- ▶ Thus, a casualty gain is often the case because of low to zero basis of the timber if there is a salvage operation.
- ▶ However, a casualty qualifies for IRC § 1033 involuntary conversion rules and the gain can be deferred by purchase of like-kind property within two years of the year of the casualty loss.
 - ▶ Rev. Rul. 80-175, 1980-2 C.B. 230

Like-kind Exchange: Definition of Real Property

- Unsevered natural products of land, including growing crops, plants, and timber; mines; wells; and other natural deposits, generally are treated as real property for purposes of this section. Natural products and deposits, such as crops, timber, water, ores, and minerals, cease to be real property when they are severed, extracted, or removed from the land.

Like-kind Exchange? Timberland versus timber...the plot thickens

- ▶ Yes, timberland for other real property, yes...quality not an issue

- ▶ Standing timber (attached to land) is Real Property for property tax purposes and IRS clarified its position in the final regulations just discussed.

- ▶ **No...**

- ▶ A cutting contract (*Oregon Lumber Company v. Commissioner*, 20 T.C. 192) (1953) is NOT like kind

- ▶ Remember: Logs on the truck are not Real property,
- ▶ The chainsaw converted to personal property



Does a Timber Sale Qualify for Like-kind Exchange?

- ▶ A very, very, very weak maybe..., nope, **now NO!!**
 - ▶ If the sale is constructed as a LKE “fee simple deed” for a “timber deed” (*Smalley v. Commissioner, 116 T.C. No 29*)
 - ▶ With the new definitions, the fact pattern in Smalley would more likely than not have a different outcome today.
 - ▶ Changes might be tested in court...



Thank you!!
What questions might you have?

