

A Taxing Question

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Selling timber can be a source of great satisfaction to a landowner or it may be a source of surprise, frustration, and stress, especially for those landowners who make timber sales infrequently. I am reminded of this as I read a job announcement from the Internal Revenue Service (IRS) seeking to hire a Registered Forester in the Birmingham area to perform tax audits on forestry activities. Relying on the expertise of your own Registered Forester in pre-sale/pre-tax situations should help you avoid the surprises. This should help you with site preparation and reforestation declarations as well.

Even though it is not tax season, the most asked question I get is, "How do I claim capital gains treatment for the timber I sold?" I usually ask the person how and when they acquired the land, the timber sold off the land, and did they establish a "land basis" and a "timber basis" at the time of acquisition?

Unfortunately, most of the landowners that call asking this question have not established anything other than they sold their timber and received "X" amount of dollars for it and now it is time to pay "the man." They usually learn very soon in the process that it is more advantageous to claim capital gains on the sale proceeds than to declare it as ordinary income.

This article is not meant to make a timber tax expert out of the ordinary landowner. The intention is to get landowners that have never sold timber – but *plan on* selling their timber – to consider tax treatments as part of their pre-harvest planning. Competent tax advice should be sought well before a sale. It is recommended that prior to making the sale you contact your CPA for clarification of the current tax laws. There are also various sources of information you can access on the Internet. The Alabama Cooperative Extension System, my-forest.com, the US Forest Service Cooperative Forestry, and the National Timber Tax websites provide tax information through webinars and publications that may help you better understand the tax implications of selling your timber. These sites are:

- www.aces.edu/
- www.my-forest.com
- www.fs.fed.us/spf/coop/
- www.timbertax.org
- www.timbertaxadvice.com

There are some new terms and sources of income for forest landowners with which you need to become familiar. Payments are being made for environmental services – primarily carbon credits – and markets for woody biomass are expanding. Many of these type transactions taking place are not specifically addressed in existing tax law, according to William L. (Bill) Hoover of Purdue University's Department of Forestry and Natural Resources.

Hoover states that all income from whatever source is taxable, unless specifically excluded by an act of Congress and incorporated in the Internal Revenue Code. Some cost-share payments meet this exclusion. Timber sold as pulpwood for conversion to wood pellets or other non-traditional products is taxed as timber. If capital gains are desired for topwood, tops must be included in the original sales contract disposing of the timber. After-harvest sales do not qualify. This is just another good reason to have a written timber sale contract. Logging slash is the source of most woody biomass presently, and if not accounted for, does not qualify. There are two precedents that need to be considered if woody biomass sources are derived from short-rotation plantations. Both deal with the present age of the stand and the rotation length of the stand. This leaves energy plantations such as two- to three-year-old coppice cuttings in doubt. Surprised?

Carbon sequestration payments may qualify for capital gains treatment. However, the variables within any individual contract specifying the timing and amount of payments may affect whether payments qualify for capital gains treatment or have to be declared as ordinary income.

Also, effective for sales after May 28, 2009, a Form 1099-S is required for reporting lump sum sales or exchanges of standing timber, just like pay-as-cut type timber sales.

As you can see, there are both simple answers and some very complex answers, but there are numerous experts out there in tax land that can and will help you. You just have to ask. For answers to such "taxing questions," I suggest you contact one or more of the following:

- Dr. Linda Wang, National Timber Tax Specialist, US Forest Service
- William L. (Bill) Hoover, Department of Forestry and Natural Resources, Purdue University
- John L. Greene, Research Forester, Southern Research Station, US Forest Service
- Mark Batson, Forest Products Technical Advisor, IRS

Sources:

Hoover, William L., *The Forestry Source*, January 2010, Vol. 15, No. 1. "Tax Treatment of Environmental Service Payments and Woody Biomass."

"Selling Your Timber" – Alabama Forestry Commission brochure, 2010.