

Tax Tips for Forest Landowners for the **2017 Tax Year**

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Specific federal income tax laws and rules apply to timber-related income and expenses. The tax tips provided in this bulletin are intended to assist timber owners, foresters, loggers and their tax preparers in filing the 2017 tax returns. This material has been prepared for informational purposes only, and is not intended to provide tax, legal, or accounting advice. Please consult your own tax, legal, and accounting advisors before engaging in any transaction. The information is current as of September 30, 2017.

Timber Property for Tax Purpose

For federal individual income tax purposes, there are three types of timber properties: 1) property held mainly for personal-use purpose (for personal enjoyment, not for income generation), (the deductions are generally limited for personal-use property); 2) property held as an investment (generating profit from growing timber or asset appreciation); or 3) property held as business (with regular, active, and continuous commercial timber activities). Timber businesses can deduct expenses, but are subject to passive loss rules (where passive loss cannot be used to offset non-passive income). If the profit motive is not met, your timber may be considered a hobby rather than business (losses from hobby activities are not deductible). Finally, timber is generally not treated the same as a business of farming for tax purposes. Certain tax provisions for farming may not be available for timber.

Example 1: Mr. Anderson replanted his 30-acre property after the timber sale. He reports his timber as an investment property.

Example 2: Mr. Smith owned his woodland primarily for personal vacation property. Expenses may not be tax deductible for personal-use property.

Timber Expenses and Property Taxes

Expenses paid for growing timber for profit are deductible. For example, expenses may be paid for services of forester, attorney, or accountant; firebreak maintenance; overnight travel; vegetation competition control; insects, disease, and fire control; pre-commercial thinning; and depreciation from equipment used. Investment timber expenses are deductible on Schedule A, subject to a 2 percent of adjusted gross income (AGI) floor. Business timber expenses are deductible in full for 'material participants' on Schedule C. State and local property taxes are fully deductible on Schedule A (investment) or Schedule C (business) and are not subject to the 2 percent AGI floor.

Example 3: Mrs. Walters grew timber for profit as an investment and paid \$1,500 timber management expenses. Her AGI was \$50,000. Her timber expense deduction is \$500 ($\$1,500 - 2\% \times \$50,000$ AGI) after the 2 percent AGI floor.

Timber Sales and Form 1099-S

Sales of standing timber held as an investment are taxed as capital gains rather than ordinary income. If you own the timber for more than one year before the sale, the sale is eligible for long-term capital gain, which is taxed at lower tax rates than ordinary income. Report the sale of standing investment timber on Form 8949 and Schedule D. Sales of standing timber by a business qualify for long-term capital gain (Sec. 1231 gain) if the timber has been held for more than one year (Sec. 631(b)). Report the sale on Form 4797 and Schedule D. Timber sale expenses, such as fees paid to foresters, are deductible from the sale proceeds. Form 1099-S is required for lump-sum and pay-as-cut standing timber sales, except corporate and high-volume business sellers.

Example 4: In 2017, Mrs. Young sold pine standing timber held as an investment for \$9,000. Its adjusted basis was \$3,000. The selling expenses are \$1,000. She reports \$5,000 ($\$9,000 - \$3,000 - \$1,000$) as a capital gain on Form 8949 and Schedule D.

Special rules apply for the following type of sales: if you cut your own timber or have it cut by a contractor working at your direction, and sell the cut timber products or use the products in your business, the gains are ordinary income unless you elect to use Sec. 631(a) on Form T, Part II.

Example 5: Mrs. Henderson manages her timber farm as a business. In 2017, she hired a logger to cut her timber and sold the log products to the mill she selected for \$10,000. She paid \$4,000 to the logger. The fair market value of the standing timber on January 1, 2017 was \$3,000 and her timber basis was \$2,000. Under Sec. 631(a) election, gains of \$1,000 ($\$3,000 - \$2,000$) from standing timber are capital gains and the \$3,000 ($\$10,000 - \$3,000 - \$4,000$) from the sale of log products is ordinary income. Without a Sec. 631(a) election, the gains of \$4,000 ($\$10,000 - \$2,000 - \$4,000$) are ordinary income.

Timber and Landscape Tree Casualty Loss

Timber and landscape trees destroyed by a casualty event such as hurricane, fire, earthquake, tornado, hail, or ice storms may be tax deductible. But the amount of deduction varies depending on the type of properties. Deductible casualty loss for timber held for business or investment purposes is the smaller of the adjusted basis of timber, and the difference of the fair market value of the timber immediately before and after the casualty in the block. Salvage sale of timber is reported separately and a taxable gain may result if the salvage sale exceeds the adjusted basis of the timber and related selling expenses.

Example 6: A hurricane damaged Mr. Smith's woodland tract, resulting in \$8,000 fair market value loss of his timber. Assuming his timber basis is 2,000, the amount of casualty loss deduction is only \$2,000, not \$8,000.



For landscape trees in the private residence, deductible casualty loss is subject to a \$100 limit per casualty and 10 percent AGI floor. However, for taxpayers affected by Hurricanes Harvey, Irma, and Maria, the 10 percent AGI floor was eliminated. The requirement for taking 'itemized deductions' is also eliminated.

Installment Sales

An installment sale allows you to defer tax by spreading your gain over two or more years. Interest is charged on deferred payments and is ordinary income.

Example 7: You sold \$10,000 of timber (\$7,500 after deducting timber depletion and sale expenses) in 2017. Your gross profit percentage is 75 percent ($\$7,500 \div \$10,000$). The buyer paid you \$6,000 in 2017 and you took a note payable in 2018. Report a \$4,500 gain ($\$6,000 \times 75\%$) for 2017, using Form 6252.

Reforestation Costs

Taxpayers may deduct up to \$10,000 per year (\$5,000 for married couples filing separately) of reforestation costs per qualified timber property (QTP). Any amount over \$10,000 per year per QTP may be deducted over 84 months (amortized). Trusts are eligible for amortization deduction only.

Example 8: Assume you spent \$17,000 to reforest, deduct \$10,000, plus $1/14^{\text{th}}$ of the remaining \$7,000 (\$500) in 2017. Deduct $1/7^{\text{th}}$ of the \$7,000 (\$1,000) for 2018 through 2023 and the last $1/14^{\text{th}}$ (\$500) in 2024. For investment timber, report the reforestation deduction as an adjustment to gross income on the front of Form 1040. For business taxpayers, report it on Schedule C. Elect to amortize and take amortization deductions on Form 4562. Attach a statement to your return showing the date, location, and amount of the expenditure.

Timber Basis and Depletion Deduction

For purchased property, the timber basis is the amount you paid for it. For inherited property, the basis of timber is its fair market value on the decedent's date of death.

Example 9: You inherited a woodland property five years ago. Your forester provided a retroactive appraisal of the timber quantity and value on the date of the decedent's death. Your timber basis was set up as: \$25,000 for 100 thousand board feet of pine sawtimber and \$4,000 for 200 cords of pine pulpwood.

Example 10: You sold 50 thousand board feet of sawtimber in 2017. Your depletion deduction from the sale is \$12,500 ($\$25,000$ of total timber basis \div 100 thousand board feet of total volume \times 50 thousand board feet of timber sold).

Depreciation and Sec. 179 Expensing

For timber held to produce income, you may take depreciation on the assets used such as logging equipment, tractor, computer, car, bridge, culvert, fence, temporary road, or the surface of permanent road. For example, logging equipment and light-duty trucks are depreciated over five years. Land, however, is not

depreciable. Also, business taxpayers may deduct up to \$510,000 in the first year for qualifying property in 2017, subject to a \$2,030,000 annual phase-out and business taxable income limitation (Sec. 179 expensing). Separately, business taxpayers may take bonus depreciation equal to 50 percent of the cost of qualifying new business property.

Net Investment Income Tax

For single taxpayers with AGI over \$200,000 (or 250,000 for couples), investment and passive business timber sales are subject to a 3.8 percent net investment income tax.

Example 11: Mr. and Mrs. Walters' AGI is \$270,000, including a \$40,000 capital gain from their investment timber sale. The timber gain of \$20,000 ($\$270,000 - \$250,000$, which is less than the \$40,000 gain) is subject to the 3.8 percent tax (\$760 tax), in addition to the capital gain tax on the sale.

Cost-share Payments

If you receive a payment from a qualified program, you may exclude part or all of the payment from your income if the cost-share payment is used for capital expenditure. Otherwise, it is ordinary income. Qualified federal programs for income exclusion include the Forest Health Protection Program, Conservation Reserve Program (CRP), Conservation Security Program, and Environmental Quality Incentives Program. Several state programs also qualify for exclusion. The excludable amount is the present value of the greater of \$2.50 per acre or 10 percent of the average annual income from the affected acres over the last three years.

Example 12: The CRP paid you \$6,000 as cost share for your qualified capital expense in your timber property. If you had no income from the property in the last three years, you could exclude up to \$6,250 ($(\$2.50 \times 100 \text{ acres}) \div 4\%$) from your income. The interest rate is from the Farm Credit System Bank. If you had \$9,600 of income from the property in the last three years, you could exclude up to \$8,000 ($(10\% \times (\$9,600 \div 3)) \div 4\%$). Attach a statement to your tax return describing the cost-sharing program and your exclusion calculations.

Filing Form T (Timber)

You must file Form T (Timber), Forest Activities Schedule, if you claim a timber depletion deduction, sell cut products in a business (under Sec. 631(a)), or sell outright timber held for business use. However, if you only have occasional timber sales (one or two sales every three or four years), you are not required to file.

Conservation Easement

Donors of qualified conservation easements can take a tax deduction. The deduction is up to 50 percent (or 100 percent for qualified farmers and ranchers including forest landowners) of the taxpayer's AGI in a year. Any excess donation over the 50 or 100 percent limit may be carried forward to 15 years. ☸