

Key Tax Updates for Tree Farmers

**Dr. Linda Wang
National Forest Tax Specialist
USDA Forest Service**

September 29, 2009

A Tax Expert?

Who is the figure behind every great man, the individual who knows his ultimate secrets? A father confessor?... no, the tax expert.

Louis Auchincloss

Forest Land

- More than half of the forest land in the US is privately owned

From USDA Forest Service, National Woodland Owner Survey

Family and Individual Woodland Owners

- **11 million family and individuals owns almost two-thirds of US private forest land (264 million acres)**

From USDA Forest Service, National Woodland Owner Survey

Selling Carbon Offset Ranked Top by Woodland Owners

- **Income from selling ecosystem services—especially carbon offset—are hot issues**

From USDA Forest Service, National Woodland Owner Survey

Tax Issue Is *Important to Private Forests*

- Tax is consistently listed as one of the top concerns for private forest owners

Tax Exerts Powerful Influence Over Private Forestry

- Tax is a major cost of owning and managing private forests.

General Tax Principles

- **Income:** capital gains better than ordinary income
- **Loss:** ordinary loss better than capital loss

Tax Rates

- **Ordinary Income:**
10% - 35%
- ***Long-term* capital gains:**
0% - 15%

Your Tax Status Is Key

- Timber property is taxed either as an investment or a business
- Business is taxed either as an active or passive one

Tax Term: Basis

- **Most useful**
 - at timber sale
 - when timber suffers loss
- **Basis relates to property**
- **It is the purchase cost of a property**

Inherited Property: Basis

- The basis is the fair market value of the property
- Measured on the date of the decedent's death

Timber Basis: An Example

Pine sawtimber:

$$200 \text{ tons} \times \$20/\text{ton} = \$4,000$$

Pine pulpwood:

$$100 \text{ tons} \times \$5/\text{ton} = \$500$$

Hardwood pulpwood:

$$2000 \text{ tons} \times \$1/\text{ton} = \$2,000$$

\$6,500



Sale Income of Timber

- Sale of stumpage are capital gains
 - Investment: Sec. 1221
 - Business: Sec. 631(b)
- Sale of cut timber by business: two parts
 - Capital gain and ordinary income
 - Sec. 631(a)

Forest Management Expenses

- **For Investment tax status:**
 - **Currently deductible but subject to income limit**
 - **The expenses must be reduced by 2% of adjusted gross income**

Forest Management Expenses

- **Business:**
 - **Active Business: Fully deductible**
 - **Passive Business: Restricted**

Property Taxes

- It is a deductible expense
 - Deduct it annually
 - Or put it into the timber basis (“capitalize”) and deduct it upon timber sale



Quiz #1

- **Is income from stumpage sale taxed as capital gains?**

Reforestation

- Reforestation costs may be expensed, up to \$10,000
- Excess over \$10,000 may be deducted over 8 years (“amortized”)

Timber Loss

- **Hurricane**
- **Tornado**
- **Ice**
- **Fire**



Timber Loss

- Loss is deductible
- The amount is: the smaller of FMV loss or timber basis.

An Example

A 80-acre tract of timber was damaged by hail storm.

FMV of timber prior: \$100,254

FMV after: \$8,850

Loss: \$91,404

If adjusted basis: \$4,167

Casualty loss deduction: \$4,167

Residential Tree Casualty Loss

- Backyard trees in urban setting
- Loss is deductible
- The amount is determined as:
 - 1) the *smaller* of FMV loss or basis of property
 - 2) then, reduced by insurance and \$100
 - 3) then, reduced by 10% of adjusted gross income
 - 4) the remaining amount is the actual deduction

An Example

- **One large backyard tree fell during the hurricane.**
 - **The FMV loss caused by damaged tree was \$5,000.**
 - **Insurance paid \$500.**
 - **Adjusted gross income: \$80,000**

Loss Deduction

FMV Loss:	\$5,000
Property basis:	\$200,000
Loss, tentative:	<u>\$5,000</u>
– Insurance:	- \$500
– \$100 reduction:	- \$100
– \$10 AGI of \$80,000:	- \$8,000
Your deduction:	\$0

Tax Relief

***Those that complain about taxes
are two groups: men or women.***

Anonymous

Form T

- **A tax form not familiar to most tax professionals**
- **Filing is not always required**



Quiz #2

- **Can landowner write off \$14,000 reforestation cost in one year?**



New Tax Incentives from Farm Bill

- **Passed in May 2008**
- **Contains tax incentives for timber**



Timber Corporation Receives Lower Tax Rate

- **15% rate is granted for C-corp**
- **Available only for 1 year**
- **Must have held timber for more than 15 years**



Conservation Easement Donation

- This donation deduction is: up to 50% of adjusted gross income
 - 100% if a traditional forest owner

Presidential Tax Return

President George W. Bush 2004 Tax Return

Salary **\$397,065**

Interests **\$363,483**

\$672,788

Total Taxes: **\$207,307**

Refund: **\$38,534**

Tax Return

Teresa Heinz 2003 Tax Return

<i>Salary</i>	\$0
<i>Tax-Exempt Interests</i>	\$2,781,791
<i>Dividends</i>	\$2,216,280
<hr/>	
<i>Taxable Income</i>	\$2,023,596
<i>Total Taxes:</i>	\$628,401
<i>Refund:</i>	\$247,933



Endangered Species Expenditure

- One of the first tax incentives for ecosystem service production
- Not applicable to forest land



Cellulosic Biomass

- **Brand new tax credit—\$1.01 per gallon of fuel**
- **For fuel producers, not landowners**

The Size of the IRS

The IRS employs over 100,000 people and had a total budget of about 11 billions!

Source: IRS Website

Latest IRS Regulation

- For lump-sum timber sale
- Timber buyers file Form 1099-S with the IRS
- Effective for sales after May 28, 2009

Cost Share Payment

- **Must report in the tax return**
- **May be excluded from income if qualified (Sec. 126)**

“Forest Health Management” Cost Share

- **Examples: Southern Pine Beetle, Mountain Pine Beetle cost shares**
- **IRS approved exclusion under Sec. 126**
- **The approval is retroactive**

Tax Resources

by US Forest Service

- Provide timber tax workshops
- National Timber Tax Website:

www.timbertax.org

Tax Publications

by US Forest Service

- Annual Timber Tax Tips
- The Forest Landowner's Guide to the Federal Income Tax
- Federal Income Tax on Timber: A Key to Your Most Frequently Asked Questions
- **2009 Edition: Estate Planning for Forest Landowners—available now**

Forms of Forestry Carbon Projects

- Individual forest landowners contract with aggregator to create a pool to be sold via the CCX

For example: landowners in the South was reported to receive checks for carbon credits sold, averaging \$1,000 per owner

From the Forestry Source, December 2008

Requirements of Forestry Carbon Projects

- **Enrolled forests are to be maintained by set standards**
- **Requires third-party verification by authorized verifier**
- **Acceptable forestry projects include**
 - **Afforestation (planting trees)**
 - **managed existing forests**
 - **long-lived wood products**

From the Forestry Source, December 2008

Carbon Offset Payment

- **Currently no law or IRS guidance**
- **Ordinary income, royalty income or capital gain (?)**
- **Royalty income is not subject to self-employment tax**
- **Expenses may be deducted**

3) Is Carbon Offset a Capital Asset, Inventory or Intangible Asset?

- **Capital gains apply to sale of “capital asset” and business use asset**
 - **“Capital asset” include all property, such as personal or investment property, not specifically excluded by Sec. 1221**

3) Is Carbon Offset a Capital Asset, Inventory or Intangible Asset?

- **Typical byproducts from timber is ordinary income**
 - **Firewood, nuts, maple syrup (Revenue Ruling 56-434)**
 - **An exception: capital gains is provided for tree stumps from cutover land held as investment**

Legislative Effort: Income Averaging

- Spread high-income in one year over 3 prior years**
- Currently not available to timber owners**

Tax Freedom Day

- **In 1944, Americans must work the first 90 days, until March 30, to pay all taxes**
- **By 2008, it was April 23**

Source: Tax Foundation

Rising Tax Code Complexity

