



# Timber Tax Filing for the 2016 Tax Year

Dr. Linda Wang  
National Timber Tax Specialist  
USDA Forest Service

# Disclaimer

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**Today's discussion is educational, NOT legal or accounting advice, since the facts and circumstances of each taxpayer's individual situation need to be taken into consideration for exact application of the tax law.**

# Topics

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## Timber Tax Reporting

- Reporting Timber Sales
- Form T (Timber)
- Form 1099 Reporting on Timber Sales
- Deductible Expenses
- Casualty and Theft Loss
- Taking Reforestation Deductions

## Special Topics

- Tax Reform Issues for Forest Owners and Industries

## Bonus

- Record Keeping Rules

# Timber Ownerships

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## Personal Property

- Your main purpose of land ownership is for **personal enjoyment**, not for profit

## Investment Property

- Your main purpose of owning timber is to **generate profit**

## Business Property

- Your main purpose is to generate profit
- Your activity is more frequent and regular than investment

# Reporting Timber Sales

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## Tax Rates

### Ordinary Income:

- 10% - 39.6%

### *Long-term capital gains:*

- 0%, 15%, 20%

# Reporting Timber Sales

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## Sale of Standing Timber as Investment

- Sale of *standing* timber held as an investment is a capital gain
- Form 1040 Schedule D  
Form 8949, as applicable

# Reporting Timber Sales

## Sale of Standing Timber in Business

- Sale of *standing* timber held in a *business* is a capital gain if it's held for more than 1 year
- Tax Form 4797  
Schedule D

***Tax Code Sec. 631(b)***



# Reporting Timber Sales

## Sale of *Felled* Business Timber

### Special Election

- All gains are ordinary income unless a sec. 631(a) election is made

### Tax Forms

- Make a sec. 631(a) election by checking the YES box on Form T
- Form 4797
- Form 1040, Schedule C

*Tax Code Sec. 631(a)*



# Reporting Timber Sales

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## Taking Depletion Deduction

- Depletion is a deduction from the timber sale income.
- Depletion is calculated using the **timber basis**.

# Reporting Timber Sales

## What is “Basis”?

### For purchased property

- Your timber basis is the cost you paid for the property

### For inherited property

- Your timber basis is the fair market value of the timber on the date of the decedent’s death

# Timber and Land Basis: An Example

## Original Basis

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Land . . . . .	50 acres	\$17,000
Sawtimber . . .	100 MBF	\$20,000
Pulpwood . . . .	1000 cords	\$11,000

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**\$48,000**

# A Quiz

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**If I inherited the timber property 10 years ago, does this mean I have to go back 10 years to estimate the fair market value of my timber to set up my timber basis?**

**Yes or No?**

# Reporting Timber Sales

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## 3.8% Net Investment Income Tax

- The tax is imposed on the lesser of:
  - Net investment income for the year or
  - The excess of modified adjusted gross income over \$200,000 (\$250,000 joint filers)

# An Example

## Facts

- Husband and wife had \$270,000 adjusted gross income, including \$50,000 capital gains.

## Analysis

- The excess of \$270,000 over \$250,000 threshold is \$20,000.
- Thus, their net investment income tax is \$760 (or 3.8% of \$20,000)

# Quiz

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**If your adjusted gross income is less than \$200,000, your capital gains are not subject to the 3.8% net investment income tax.**

**True or False?**



# What Is Form T (Timber)?

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## Forest Activities Schedule

**This tax form has five parts:**

- **Acquisition**
- **Timber Depletion**
- **Profit or Loss from Land and Timber Sale**
- **Reforestation and Timber Stand Activities**
- **Ownership**

# Who Must File Form T?

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## Complete Form T only if you:

- claim depletion deduction of your timber
- sell *felled* timber in the timber business (Sec.631(a) transactions)
- sell timber outright in the timber business (Sec. 631(b))

# Who Must File Form T?

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## Occasional timber sellers

- are not required to file
- “Occasional”: one or two sales every 3 or 4 years

## However, it is prudent to file

- when you claim depletion deduction or
- if you sell business timber

# Form 1099-S Reporting

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- **Form 1099-S is the form to report real estate transactions**
- **It is required for timber sales**

# Form 1099-S Reporting

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## Who Must Issue 1099-S?

- (1) the person (including attorney or title company) responsible for closing the transaction,**
- (2) the mortgage lender,**
- (3) the seller's broker,**
- (4) the buyer's broker, or**
- (5) the buyer**

# Deductible Expenses

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- Tools of short useful life or small cost, e.g., axes, handsaws, etc.
- Hired labor
- Fees of consultant and accountant
- Property taxes

# Deductible Expenses

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- The costs of prescribed burning
- The expenses of fire, insect and disease control and protection; and
- road and firebreak maintenance costs
- Overnight travel



# Deductible Expenses

## First-Year Expensing Deduction (or “Sec. 179 Deduction”)

- Expense up to \$500,000 spent on qualifying **business** property in 2016

## Bonus Depreciation

- It is an additional first-year depreciation deduction
- The amount is 50-percent of the adjusted basis of eligible property

# Schedules for Reporting Expenses

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## **For an investment timber property**

- Form 1040, Schedule A
- Subject to 2 percent of your AGI floor

## **For timber business expenses**

- Form 1040, Schedule C if you materially participating in the business

# Casualty and Theft Loss

- **The amount of the deduction is the lesser of**
  - the fair market value loss of your timber or
  - the adjusted basis of your timber
- **If returns from a salvage harvest, court award, or insurance claim, exceed your timber basis, you will have a *gain***

# Taking Reforestation Tax Deduction

## The First \$10,000 (married filing joint):

- You can deduct outright the first \$10,000 per year of qualifying expenses per qualified property; and

## Excess amount over \$10,000:

- Deduct (“amortize”) *any* such additional amounts over 84 months (8 tax years)

# Taking Reforestation Tax Deduction

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## For timber investment property

- take the deduction on Form 1040, as an adjustment to income

## For timber business

- take the deduction on Form 1040, Schedule C for a business or Schedule F for a farm

# Taking Reforestation Tax Deduction

- You must specifically elect to amortize reforestation expenses on **Form 4562, Part VI**
- Attach **a statement** to your return showing:
  - Unique stand identification number
  - Total acres reforested during the tax year
  - Nature of the reforestation treatment
  - Total qualified expenditures eligible to be amortized or deducted

# Tax Reform Issues for Forest Landowners and Forest Industry

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## Capital Gains

- Legislative status: the House tax reform Blueprint proposed to reduce the rates to: 6%, 12.5%, 16.5%

## Net Investment Income Tax of 3.8%

- Proposed to repeal this tax

## Federal Estate Tax

- Proposed to repeal estate and gift tax



# Tax Reform Issues for Forest Landowners and Forest Industry

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## Corporate Tax Rate

- Reduce the top rate of 35% to 20% (the House blueprint)
- Reduce to 15% (the President's campaign plan)

## Timber REITs Tax Status

- A REIT is a special tax entity
- Currently qualified timber sales may be passed to shareholders as capital gains if qualified

# Record-Keeping

## Careful Record-Keeping Helps:

- Court case 1: the Tax Court judge ruled that an Arizona couple with a landscaping business didn't owe about \$12,000 in penalties
- Court case 2: a Missouri couple won a deduction for nearly \$7,000 of car and truck expenses for a small business

# Record-Keeping Rules

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## What Records?

- Property acquisition records
- Forest management plan
- Forest management activities
- Property tax record
- Travel expenses
- Business meals and entertainment expense

# Record-Keeping Rules

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## What Kind of Records?

- Contract
- Receipts
- Statement
- Cancelled check
- Mileage logs or apps
- Excel spreadsheet or journal

# Record-Keeping Rules

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## Hong Long to Keep Records?

- Generally keep records for 3 years
- Keep records for 6 years if unreported income of 25%
- Keep records indefinitely if you do not file a return or file fraudulent return

# Record-Keeping Rules

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## Hong Long to Keep Records Related to Property?

- Keep records when you own the property and 3 years after you sold the property generally
- If exchanging the property, keep the records of the property you gave up as well as the new property's until the new property is sold

# Summary

## Timber Tax Reporting

- Timber ownership determines how your timber is taxed
- You must own your timber for more than 1 year to qualify for long-term capital gains
- Occasional timber sellers are not required to file Form T (Timber)
- Form 1099 are required for both lump-sum and pay-as-cut timber sales
- Set up and keep track of your timber basis
- Expenses are deductible for investment or business

# Summary

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- Taking reforestation deductions
- Casualty loss deduction is limited to your timber basis

## Special Topics

- Tax reform affect landowner's financial decision, forest management and rural jobs

## Bonus

- Forest management plan are part of the tax records
- Keep tax records, written records are best!



# More Information

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## **Tax Tips for Forest Landowners** For the 2016 Tax Year

# Federal Income Tax on Timber

## A Quick Guide for Woodland Owners

Fourth Edition

2012

Dr. Linda Wang



# Q & A

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**Thank you for your participation!**