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Timber is tax advantaged

- Capital gains treatment on sales
- Delay tax on value increase until sell
- Expense cultural treatments, property taxes
- Expense reforestation

Timber Tax Considerations

- Timber has special provisions and incentives in the tax code
- Many tax professionals are not familiar with these provisions
- Make sure your tax professional is timber tax wise
- If you don't take advantage of these provisions, you can lose 1/3 or more of your timber sale income in taxes

Ownership categories

- Personal use
- Investment property
- Business property – where you want to be
- Material participation determines status

Qualifying as a business

- Participation in management
- Management plan with stand maps
- Forestry courses
- Activity journal
- 2-28-10 inspect tree planting
- 9-15-09 herbicide applic. Smith tract
35 oz.chopper+7 qts. gylphosate

Timber sale taxable income

| | |
|------------------------------|----------------|
| • Sale price | \$100,000 |
| • Less expenses of sale | |
| • Cruise and sales expenses | -6,000 |
| • Boundary survey | -2,000 |
| • Less cost basis for timber | <u>-50,000</u> |
| • Taxable income | \$42,000 |

(long term capital if held for one year)

Determining cost basis

- Purchase price and acquisition expenses – allocate to timber, land, young growth, other improvements at time of acquisition.
- If not done at acquisition can do retroactive valuation.
- Inherited – step up in basis (except current)
- Gift – donor's basis + gift tax paid

Purchase 300 acres of timberland for \$425,000 (1-15-95)

| | |
|--|---------------|
| Land 300 acres @ \$600 | \$180,000 |
| Merch timber 150 acs, 10,000 tons (Cost basis \$20 per ton) | 200,000 |
| Premerch 125 acs, age 10 pltn (\$360 per acre) | <u>45,000</u> |
| Allocated basis | \$425,000 |

Depletion unit

- Depletion unit = merchantable timber cost basis divided by units of current inventory
- Units harvested times depletion unit = current cost basis for timber sold
- Timber income qualifies as a long term capital gain if held for more than one year

Accounts

| | | | | |
|---------|-----------|--------|---------|-----------|
| | | Acres | Basis | \$/acre |
| 1-15-95 | Land | 300 | 180,000 | \$600 |
| | | Tons | Basis | Dep. unit |
| 1-15-95 | Merch | 10,000 | 200,000 | \$20/ton |
| | | Acres | Basis | Dep. unit |
| 1-15-95 | Pre merch | 125 | 45,000 | \$360/ac |

Update merch account

| | | Tons | Basis | Dep unit |
|-----------|----------------------|--------------|------------------|----------|
| 1-15-95 | Cost | 10,000 | \$200,000 | \$20/ton |
| 12-31-99 | Growth | <u>2,100</u> | <u>\$200,000</u> | |
| Adj. Bal. | | 12,100 | \$200,000 | \$16.53 |
| 1-1-2000 | Premerch To merch | 6,250 | \$45,000 | |
| 1-1-2000 | update | 18,350 | \$245,000 | \$13.35 |

Cost basis for sale

| | | Tons | Basis | Dep unit |
|-----------|---------|--------|-----------|----------|
| 2-15-2000 | Balance | 18,350 | \$245,000 | \$13.35 |
| 2-15-2000 | sale | -5,000 | \$66,757 | \$13.35 |
| 2-16-2000 | Balance | 13,350 | \$178,243 | \$13.35 |
| | | | | |

Reforestation expenses

- Can expense \$10,000 per year per qualified timber property
- Amortize remaining amount over 8 years
1/14, 1/7, 1/7, 1/7, 1/7, 1/7, 1/7, 1/14
- Qualified timber property ??

Cultural expenses

- Can deduct if business
- Pre-commercial thinning
- Herbicide application
- Timber stand improvement treatment
- Fertilization

Casualty losses

- Sudden unexpected event – hurricane
- Deduction limited to the lesser of the fair market value of the loss or your timber basis.
- Cannot deduct more than the cost basis for that depletion block

Form T

- Instructions say file if having more than one or two timber sales every three or four years.
- Good way to keep records of activities.

Pine Plantation Investment

| | |
|--------------------|----------------|
| Land cost | \$600 per acre |
| Reforestation cost | \$150 per acre |
| Cost share (40%) | \$60 per acre |
| Pulpwood | \$7.50 per ton |
| Chip'n'saw | \$16 per ton |
| Sawtimber | \$30 per ton |

Current costs

Land Appreciation

- Assume 1.5% annual appreciation in land value
- Present land value \$600
- Future value \$910
- (\$600 compounded at 1.5% for 28 years = \$910)

Timber income

- Thinning Age 15

| | | |
|---------|--------------------|-----------|
| – Pulp | 27.6 tons @ \$7.50 | \$207 |
| – CNS | 4.4 tons @ \$16 | <u>70</u> |
| – Total | | \$277 |

- Harvest Age 28

| | | |
|-------------|--------------------|--------------|
| – Pulp | 21.7 tons @ \$7.50 | \$162 |
| – CNS | 36.3 tons @ \$16 | 581 |
| – Sawtimber | 51.9 tons @ \$30 | <u>1,557</u> |
| – Total | | \$2,300 |

Investment Income

| | Age | Value | NPV 6% |
|-----------|-----|---------|--------|
| Thinning | 15 | \$277 | \$116 |
| Harvest | 28 | \$2,300 | \$450 |
| Land sale | 28 | \$910 | \$178 |
| Total | | \$3,487 | \$744 |

Investment Return

- Present value of future income \$798
- (discounted at 6%)
- Current costs 690
- Investment return above 6% \$108
- Conservative analysis as stumpage prices constant
- Growth projected using DSS model