

Tax Tips for Forest Landowners for the 2019 Tax Year

by Linda Wang, National Timber Tax Specialist, USDA Forest Service

The Federal income tax laws contain forestry-specific provisions that are important for managing and conserving timber. This publication provides forest owners, foresters, loggers, and timber businesses a guide of the applicable Federal income tax laws, including the latest tax law changes, for filing their 2019 tax returns. The information is not intended to render legal or accounting advice and is current as of September 30, 2019.

Timber Property Classifications

Classifications of your timber property for tax purpose are important as the tax treatment and the associated tax reporting vary considerably for each property type. Depending on your ownership purpose, how you use the property, and your activities, there are three types of timber classifications: (1) an *investment* property (mainly used for producing income from growing timber or asset appreciation); (2) *personal-use* property (mainly used for personal enjoyment versus for profit); and 3) a *business* property (having regular, active, and continuous income-producing timber activities). If you do not materially participate in the business (i.e., “passive activity”), losses from such business are not deductible against income of nonpassive source (*passive loss* rules). Also, if the profit objective is not met, your timber activities may be considered a hobby rather than a business. Losses that are deductible for a business are not allowed for a hobby. Depending on the specific situation, woodland or tree farms are typically not considered as “farming” for tax purpose. You must make a determination of your timber property categorization each year.

Example 1: In 2019, you had a timber sale from your 49-acre timber property. You own the timber mainly for profit and classify your timber as investment.

Timber Sales

Sale of standing timber held as investment or personal-use may qualify for the beneficial long-term capital gains, rather than as ordinary income, if you own it for more than 1 year before the sale (inherited timber is automatically considered long-term). Sale expenses and the timber depletion (see below) are deductible from the sale proceeds. Use Form 8949 and Form 1040 Schedule D to report the sale.

Example 2: In 2019, you sold your standing timber for \$20,000. Your selling expenses were \$2,500. You owned the timber as an investment for 10 years. The sale qualified for long-term capital gains that can be reported on Form 8949 and Form 1040 Schedule D. The \$2,500 selling expenses were deductible from the sale.

Under Section 631(b), business timber sale may be eligible for

long-term capital gains (Section 1231 gains) if the timber is held for more than 1 year before the sale. Use Form 4797 and Form 1040 Schedule D. It is prudent to file Form T (Timber), Forest Activities Schedule (see below).

Example 3: Your forester administered a timber sale for you using the competitive bidding method. You accepted the highest bid. Because you owned the timber in your business for more than 1 year before the sale, the standing timber sale qualified for long-term capital gains.

Different rules apply if the business taxpayer cut his or her timber (or had “a contract right to cut” the timber) to sell or to use in his or her trade or business. To qualify for the long-term capital gains, the taxpayer must own such timber for more than 1 year and elect to treat the cutting as a sale. That is, make the Section 631(a) election on Form T, Forest Activities Schedule, Part II.

Example 4: You hired and directed a logger to cut your standing timber and sold the logs to a mill you specified for \$20,000. From the sale, you paid the logger \$4,000 for cutting and hauling the timber. Assuming the fair market value (FMV) of the standing timber on January 1, 2019, was \$15,000, and your timber depletion (see below) was \$2,000, if you made a Section 631(a) election, you could report \$13,000 (\$15,000 - \$2,000) as capital gains, and \$1,000 (\$20,000 - \$15,000 - \$4,000) as ordinary income.

Taxpayers (other than corporation) may deduct up to 20 percent of qualified business income subject to taxable income and wage and/or property basis limitations if applicable. However, Section 1231 gains that are treated as capital gains are not qualified business income. Also, timber sales from an investment or passive business may be subject to a 3.8-percent net investment income tax for single taxpayers with adjusted gross income (AGI) over \$200,000 (or \$250,000 for couples).

Form 1099-S

Form 1099-S, Proceeds from Real Estate Transactions, is required for lump-sum or pay-as-cut standing timber sale (Corporate and high-volume business sellers are exempt).

Timber Basis and Depletion Deduction

The basis of your timber refers to your investment in the timber and is defined differently depending on how you acquire your timber property. For purchased property, your timber basis is its purchase cost, allocated separately from that of land. For gifted property, it is the donor’s adjusted basis when the FMV of the timber at the time of the gift is equal to or more than the donor’s adjusted basis. For inherited property, it is the timber’s fair



market value on the decedent's date of death (or alternate date). Keep records to verify your timber basis calculation.

Example 5: You purchased a tract of pine plantation for a total of \$33,000 (2,000 tons of pulpwood). Assuming the FMV of the land and timber was \$10,000 and \$20,000, respectively, the original basis for timber was \$22,000 ($\$33,000 \times (\$20,000 / \$30,000)$). The basis for the land was \$11,000.

Timber depletion refers to the cutting of standing timber, and it is a deduction based on the timber basis and timber volume upon timber sale. The amount of depletion is subtracted from the timber sale.

Example 6: Your timber account contained 1,000 tons of sawtimber (\$10,000 basis) and 6,000 tons of pulpwood (\$6,000 basis). In 2019, you sold 500 tons of your sawtimber and 3,000 tons of pulpwood. Your depletion deduction was \$8,000 ($((500 \times (\$10,000 / 1,000)) + (3,000 \times (\$6,000 / 6,000)))$).

Deductions of Timber Expenses and Taxes

Timber expenses (along with certain other "miscellaneous itemized deductions") cannot be deducted for investment in 2019 (Public Law 115-97). They are fully deductible on Schedule C of Form 1040 if you materially participate in your timber business. Such expenses include those paid for insects, disease, and fire control, firebreak maintenance, overnight travel, precommercial thinning, vegetation-competition control, depreciation from equipment used, and fees paid for forester, attorney, or accountant. Severance and yield taxes paid are deductible from the timber harvests. State and local property taxes on timber investment property are deductible. Alternatively, you may elect to treat these taxes as part of the timber costs (i.e., as "carrying charges") and deduct them upon timber sales.

Casualty Loss of Timber and Landscape Tree

Loss of timber due to a casualty event such as hurricane, fire, earthquake, tornado, hail, or ice storms may be tax deductible. For timber held as an investment or a business, the loss deduction is the smaller of the adjusted basis of timber and the difference of the FMV of the timber immediately before and after the casualty in the block. Report salvage sale of timber separately. A taxable gain may result if the salvage sale exceeds the adjusted basis of the timber and related selling expenses. Casualty loss of landscape trees at a private residence is deductible only for federally declared disasters.

Example 7: A hurricane damaged your investment timber with \$6,000 timber basis in it. A qualified professional assessed the FMV loss of the timber before and after the hurricane to be \$10,000. Your casualty loss deduction would be \$6,000.

Reforestation Costs

Taxpayers may deduct up to \$10,000 qualified reforestation costs (\$5,000 for married couples filing separately) per year 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 only. Report the deduction as an adjustment to gross income on the front of Form 1040 for investment, or Schedule C for business. Elect to amortize on Form 4562. Also, attach a statement to the return showing the date, location, and amount of the expenditure.

Example 8: Mr. and Mrs. Smith spent \$17,000 to reforest their timber property in 2019. They deduct \$10,000, plus 1/14th (\$500) of the remaining \$7,000 for a total deduction of \$10,500 in 2019. For 2020–2025, they will deduct 1/7th (or \$1,000) of the \$7,000. In 2026, they will deduct the last 1/14th (or \$500).

Depreciation, Section 179 Expensing and Bonus Depreciation

Depreciation is a deduction you take for the cost (or other basis) of properties you used to produce timber (e.g., logging equipment, tractor, or temporary road). Land is not depreciable. Business taxpayers may elect to deduct up to \$1,020,000 for qualifying property in 2019, subject to \$2,550,000 annual phaseout and business taxable income limitations (Section 179). Also, taxpayers may take a bonus depreciation equal to 100 percent of the cost of qualifying property.

Cost-Share Payments

Cost-share payments are ordinary income unless it qualifies for income exclusion (Section 126). To be eligible for income exclusion, the cost-share payment is from a qualified program and is used for capital expenditure. 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 (fixed) per acre or 10 percent of the average annual income from the affected acres over the last 3 years.

Example 9: You received \$6,000 from CRP cost share for qualified capital expenditure. If you had \$9,600 of income from the property in the last 3 years, you could exclude up to \$6,400 ($((10\% \times (\$9,600 / 3)) \div 5.00\%)$) from your income. If you had no income from the property in the last 3 years, you could exclude up to \$5,000 ($((\$2.50 \times 100 \text{ acres}) / 5.00\%)$) (Interest rates differ for different regions, Farm Credit System Bank). Attach a statement to the tax return describing the cost-share program and the exclusion calculations.

Form T (Timber)

Form T (Timber), Forest Activities Schedule, is required if you claim a timber-depletion deduction, sell cut products in a business (under Section 631(a)), or sell outright business timber. However, it is not required if you only have occasional timber sales (one or two sales every 3 or 4 years).

Conservation Easement

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