

Taxes for Working Forests and Tree Farms

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Income Tax Implications

- 1. Timber Sales and Basis**
- 2. Cost-Share Payments**
- 3. Reforestation Tax Incentive**

Timber Sales

Gross Income	\$50000
Costs of Sale	(8500)
Basis	<u>(21500)</u>
Net Taxable Income	\$20000

Timber Sale (cont.)

Net Taxable Income **\$20000**

Long-Term Capital Gains (LTCG)

1 Year Holding Period

For Both Investors and Businesses

Report on Schedule D (Investors)

Report on 4797 (Business)

LTCG Rates

<u>Income*</u>	<u>Ordinary Rate</u>	<u>LTCG**</u>
\$0-16,050	10%	0%
\$16,051-65,100	15%	0%
\$65,100-131,450	25%	15%
\$131,451-200,300	28%	15%
\$200,301-357,700	33%	15%
\$357,701+++	35%	15%

***Married Filing Jointly, **2008-2012**

COST OF SALE

Tree marking

Scaling

Cruising

Temporary roads

Consultant fees

Legal fees

Advertising fees

Survey

Etc....

Timber Basis

Why is it important?

- Basis reduces timber sale proceeds
- Basis or FMV (whichever less)=loss
- Only the net amount is taxable

(Tax Code §1001(a))

An Example

- Joe inherited a timber tract in Louisburg 2 years ago.

What is his timber basis?

Answer to the Example

- Timber quantity and price 2 years ago in Joe's land:

– Pine sawtimber 100 tons x \$30/ton = \$3,000

– Pine pulpwood 200 tons x \$6/ton = \$1,200

– Hardwood pulpwood 300 tons x \$4/ton = \$1,200

\$5,400

Land with Pre-Merchantable Timber

- The FMV of timber generally means \$/acre

Special Tips for Timber Basis

- Timber basis has **two parts**:
- **timber quantity and**
- **\$ value**

(Tax Regulation §1.611-3)

Special Tips for Timber Basis

- Basis must be allocated between **land** and **timber**

(Tax Regulation §1.611-3)

Timber Basis

- For *purchased* property, timber basis is the purchase price plus acquisition costs

Timber Basis

- For gifted property, if no gift tax is paid, the basis is:
 - (a) donor's adjusted basis (gain at disposal)
 - (b) the lower of the donor's adjusted basis or the FMV (loss at disposal) (§1015 and §1.1015)

ADJUSTED BASIS

Original plus:

Capitalized Expenses

Carrying charges

Capital improvement investment

OR

Original Minus:

Depletion

Casualty loss deduction

Business loss deduction

BACK CRUISE

Use to establish a basis

Allocates timber value at time of acquisition

4 step process

1. Determine present volume
2. Estimate growth over period since acquisition
3. Reduce present volume by growth
4. Volume past X stumpage past = Basis

Note: Limited by purchase price or by FMV accepted by IRS

ESTIMATED TAX FROM TIMBER SALES

Estimated taxes should be paid on income resulting from a timber sale.

Exceptions: Farmers with at least $\frac{2}{3}$ of their income from agriculture, are exempt from filing estimated tax.

ANNUAL EXPENSES

Interest on loans

Timber insurance

Road and fireline maintenance

Insect and disease protection

Prescribed burning

Administrative fees

Labor, tools, materials

TSI

Property taxes

PASSIVE LOSS RULES

1. Timber is held as part of a trade or business in which the taxpayer materially participates.
2. Timber is part of a trade or business in which the taxpayer is not a material participant (passive).
3. Timber held for the production of income (investment) not a part of a trade or business.

MATERIAL PARTICIPATION

1. 500 or more hours/year.
2. Taxpayer does substantially all activities.
3. More than 100 hours and this is at least as much as anyone else.
4. 500 or more hours in all businesses and the forest business is a significant portion of the total.
5. Taxpayer has been a material participant for 5 or the past 10 years.
6. More than 100 hours and based on facts and circumstances participates on a regular, continuous, substantial basis.

ACTIVE (MATERIAL) BUSINESS

Management expenses deducted as business expenses with no limit on schedule F or C or expenses may be capitalized.

Note: If expenses are capitalized, a statement of the amount and decision to capitalize should be attached to the year's tax return.

PASSIVE BUSINESS

Management expenses deducted as business expenses but only to the extent of passive income from other passive activities.

INVESTMENTS

1. Management costs – miscellaneous itemized deductions subject to 2% floor or capitalized. Deducted on schedule A or Form 1040
2. Property taxes – fully deductible.
3. Interest – deductible to the extent of net investment income or capitalized.

Note: If expenses will be capitalized, it is recommended that a written summary of this decision be attached to that year's return.

Reforestation Tax Treatment

- 1. First \$10,000 is fully deductible**
- 2. Write-off (84-months) of all amounts over \$10,000**
- 3. Both deductions taken as "Adjustments to Income" (no need to itemize)**
- 4. Equally available to small businesses and investors.**
- 5. Elected on a property by property basis each tax year.**
- 6. May not include cost-share amounts excluded from income (IRC 126)**

EXCLUSION OF COST-SHARE PAYMENTS

1. Must be for approved practices under approved programs. Rental payments such as CRP do not qualify. Neither do payments for perpetual or temporary easements.
2. Payment must not substantially increase the gross receipts of the landowner from the property being improved.

Cost Share - To Wait or Not?

- Reforest Immediately -
No Cost Share

\$75	Cost/Acre
<u>(\$18.75)</u>	Tax Deduction @ 25%
\$56.25	Net Cost



Waiting for Cost Share

\$ 90	Site prep
<u>\$ 75</u>	Planting cost
\$165	Total Cost
(\$ 66)	Less 40% Cost share (excluded)
<u>(\$ 24.75)</u>	Less tax deduction @25%
\$ 74.25	Net Cost



Cost Share or Not - Summary

Not

\$56.25 Net Cost

Wait

\$74.25 Net Cost
Loss of \$60-\$100
annual gross
income

Tax Resources

- National Timber Tax Website:

www.timbertax.org

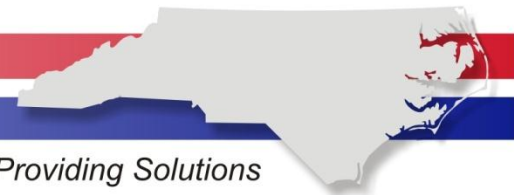
Ruraltax.org

- Extensive: Income, estate and property law
- Professional referencing

- Service and Publications by Extension, State Agency and University

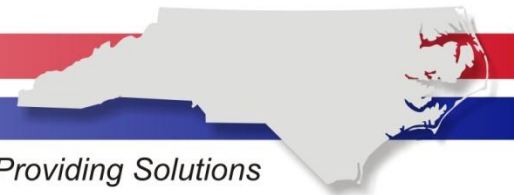
Federal Income Tax Changes Affecting Agriculture

- Individual Income Tax Rates
 - 10%, 15%, 25%, 28%, 33%, 35% **AND**
**39.6% for \$400,000 MFS; \$450,000 MFJ;
\$425,000 for HoH**
 - The bill permanently keeps the 10 percent bracket



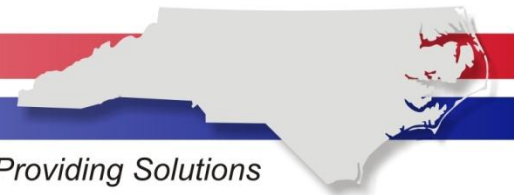
Federal Income Tax Changes Affecting Agriculture

- Capital Gain Income Tax rates
 - 0% for taxpayers in the 10 and 15% income tax brackets
 - 15% for taxpayers in the 25, 28, 33, and 35% income tax brackets



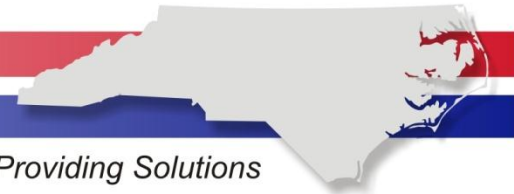
Federal Income Tax Changes Affecting Agriculture

- Capital Gain Income Tax rates
 - 20% for taxpayers in the 39.6% income tax bracket
 - >\$400,000 taxable income for singles
 - >\$450,000 taxable income for MFJ
 - However, a 3.8% Medicare surtax hits folks with AGI over \$200,000 and \$250,000 on capital gains: 18.8% or 23.8% rates may apply.



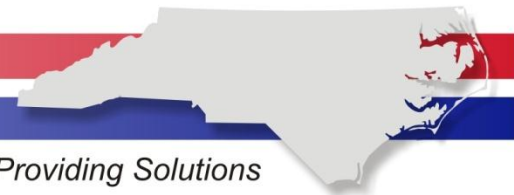
Federal Income Tax Changes Affecting Agriculture

- Marriage Penalties eliminated permanently:
 - Increases the size for MFJ of the 15% rate bracket to twice the 15% for filing single
 - Increases standard deduction for MFJ to twice for filing single



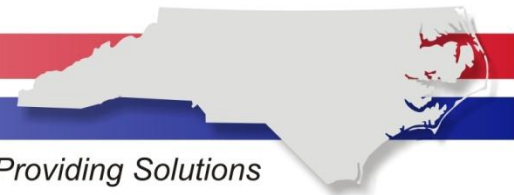
Special Conservation Real Estate Donation extended

- For donations of qualifying real estate for conservation purposes special rules were extended through 2013.
 - 50% AGI deduction for non-farmers
 - 100% AGI deduction for farmers
 - 15 year carry over of unused contribution amount.



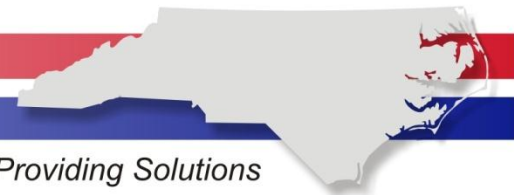
New Medicare Surtaxes for 2013

- Medicare surtax of 0.9% and 3.8% were part of the Affordable Care Act levied to provide additional revenue for Medicare
- These may affect some agricultural producers in the near term, or, more likely in retirement.



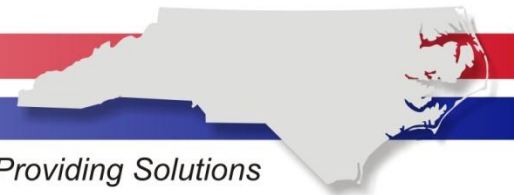
New Medicare Surtaxes for 2013

- 0.9% is applied to wages and self-employment income once total income exceeds \$200,000 for singles and head-of-households, \$250,000 for married filing jointly.
- Therefore, for earnings above these thresholds, the Medicare tax is 3.8%.



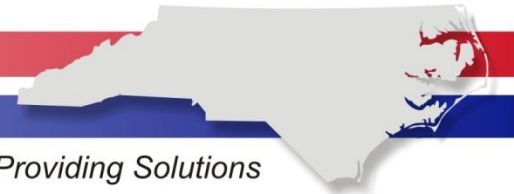
New Medicare Surtaxes for 2013

- 3.8% Medicare tax on investment income for the same AGI thresholds
 - \$200,000: singles, HoH
 - \$250,000: married file jointly
 - \$125,000: married filing separately



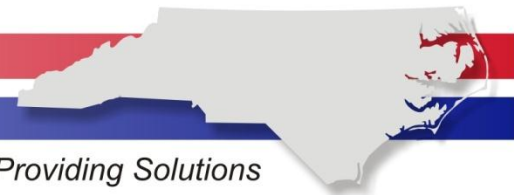
Federal Estate Tax

- The \$5 million estate and gift tax exclusion is made permanent.
- The exclusion is inflation indexed
 - 2011 \$5 million
 - 2012 \$5.12 million
 - 2013 \$5.25 million



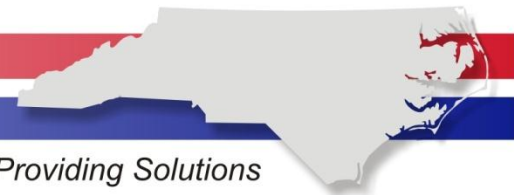
Federal Estate Tax

- The tax rate on taxable estates increased from 35% to 40%; which is effectively a flat tax.
- “Portability” election is permanent
 - Unused portion of deceased spouse can be used by surviving spouse
 - Election is made on a timely filed estate tax return (including extensions)



Gift tax issues

- Annual gift exclusion is \$14,000 for 2013
- Lifetime gifts now the same value as the estate tax exclusion, \$5.25 million for 2013
- A powerful tool for business succession



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