2024 Tax Tips for Forest Landowners

Know the Tax Classification of Your Forest Ownership:

(1) **Personal Use or hobby**: Your primary purpose for owning the property is for personal enjoyment or hobby, rather than making a profit. Tax deductions are very limited under this category.
(2) **Investment**: You have a profit motive for the property; however, your activities do not rise to the level of a trade or business. Your primary purpose for owning the property is to make money (such as timber income or property appreciation), but the activity on the property is not continuous or regular. Tax deductions are relatively limited. Most clients will fall into this classification.
(3) **Trade or business**: You have a profit motive, and your forestry activities are conducted in a business-like manner. The involvement in the business may be material participation or passive. Material participation implies regular, continuous, and substantial activity and will result in more favorable tax deductions. Passive investors will be subject to various loss rules so the tax benefit of using these losses against other income streams is significantly limited.

Understand Timber Sales and Income:

Timber Sales are dependent on the tax classification above, and on the method on which you sell the timber. You pay taxes on the net income from the timber sales, rather than the gross proceeds.

To find the correct amount of income subject to tax take your gross proceeds and subtract the following items:

(1) selling expenses (e.g., forester, appraisal, attorney fees);

(2) State/local severance, harvest, or yield taxes, etc.

(3) timber depletion allowance (e.g., depreciation on timber, like fixed assets like machinery or equipment)

Methods of Selling Timber and Income Tax Treatment:

(1) Sale of Standing Timber: Two types of contracts (1) lump-sum timber sale and (2) pay-as-cut contract. Ordinarily this is spelt out in the contract between buyer and seller. The income from the sale of the standing timber held for more than a year will be taxed at long-term capital gains rate.

(2) Sale of Cut or Processed Timber: the income from cut timber is taxed at ordinary income rates unless a special election is made. The calculation to determine what portion is subject to a favorable rate of tax is complex and shall not be covered in this brief description of Timber property.

Timber Basis and Depletion Allowance:

Basis in timber is determined based on how you acquired the property. If you purchased the property, the timber basis is the amount of your total acquisition costs allocated to the timber. If you inherited the property, your timber basis will be the fair market value of the deceased person on the date of death. If you received it as a gift and appreciated in value, the basis is the donor's basis plus any gift tax paid by the donor. **Basis needs to be carefully tracked to benefit from this cost recovery.**

Consider Reforestation Tax Incentives:

You may deduct, in the year incurred, up to $10,000 of qualifying reforestation expenditures per year per qualified timber property.

What are reforestation expenditures? They are direct costs incurred for reforestation by planting or natural regeneration. They include costs for site preparation, seeds or seedlings, labor, tools, depreciation on equipment used in planting, and replanting.