

The background of the slide is a dark green color with a pattern of lighter green, stylized leaf shapes. The leaves are of various sizes and orientations, creating a textured, naturalistic background.

TAXES ON TIMBER INCOME

Cycle of Logging

**Step 1- Buy
equipment &
incur massive
debt**

**Step 2-Work
your @\$ off
for a few years**

**Step 3- Pay
off equipment
& earn big \$\$**

**Step 4- Make
too much \$\$ and
accountant tells
you to return to
step 1.**



Foreword

Timber is a capital asset - real property. A lower capital gain tax rate for timber income is not a recent change in the law. From the inception of the federal income tax in 1913, timber has been recognized with special rules and rates. Recognizing the production of timber is one of our most vital natural resources, the federal income tax laws have been structured to account for the relatively long time period between crops by providing lower tax rates and deductibility of management and operating expenses.

Foreword

- -Accountants are not foresters. Most accountants are not aware of the timber tax savings landowners can utilize.
- -Timber is not one of the areas targeted by the IRS as an “abusive tax shelter”.
- -Timber income does not fall under the list of “Tax Preference Items” which require the Alternative Minimum Tax calculation. (Mineral depletion, not timber)

Internal Revenue Code – Section 631(a) Capital Gain

- 1. Used for timber cut for sale or use in your trade or business
- 2. For Loggers
 - Who want to decrease their taxes –and NOT have to buy more equipment
 - Cut on their own property OR on other landowners property (must have a written contract with the landowner)
 - Buy stumpage (private, state, feds etc)
 - Hold contract for over 12 months
 - Are not a C Corporation



Example From Logger

(Actual timber sale)

- ABC Logging paid \$333,297.10 for a lump sum state timber sale. **\$333,297.10=cost basis**
- They finished cutting it 2 years after signing the contract. **Long-term capital gain**
- There was a large over-run on this sale= **74%**

NOTE: This logger does an excellent job merchandizing his timber and tracks his production.

Example From Logger

(Actual timber sale)

<u>Species</u>	<u>Cordwood</u>	Advertised Volume	Stumpage Rate \$/unit	Stumpage Rate Total	Volume actually cut this year	Fair Market Value \$/unit	Fair Market Value Total
Aspen	Pulpwood	46	\$18.15	\$835	80	\$31	\$2,480
Hardwood Pulp	Pulpwood	22	\$10.10	\$222	38	\$28	\$1,064
Red & Jack Pine	Pulpwood	2352	\$23.95	\$56,334	4100	\$61	\$250,100
Oak Pulp	Pulpwood	137	\$9.00	\$1,233	160	\$12	\$1,920
<u>Species</u>	<u>Grade of Sawtimber</u>	Volume - MBF	\$/MBF	\$	Volume - MBF	\$/MBF	\$
Red Pine	Sawlog	1130	\$243.10	\$274,703	2009	\$215	\$431,935
				Cost Basis		FMV	
				\$333,327		\$687,499	

\$ paid for timber sale



Example From Logger

(Actual timber sale)

- BIG POINT - Will deduct ^{FMV}\$687,499 as an expense instead of just ^{Cost Basis}\$333,297 at the end of the year
- Will show ^{FMV}\$354,202 (^{Cost Basis}\$687,499 - ^{Cost Basis}\$333,297) as a long-term capital gain

WHAT DOES THIS MEAN?

Example From Logger

(Actual timber sale)

- \$354,202 Long-term capital gain (LTCG)
 - 15.3% You do not pay self employment tax on LTCG
 - = \$21,530 - savings in self employment tax
- LTCG is taxed at much lower rate, assuming the lowest tax brackets, by converting regular income to LTCG
 - = \$60,830 will save as LTCG
 - = \$82,360 cash stay in your pocket!!!!

**REMEMBER-in order to this,
you MUST file a Form T.**

Need timber volume, species, & product information

Sample Savings per cord

Cords Cut	Fair Market Value	Amount paid to landowner clients	*Capital Gain	15.3% Self Employment not paid	\$ saved in Self Employment per cord
171	\$4,951	\$2,080	*\$2,871	\$440	\$2.57
729	\$45,804	\$25,370	*\$16,024	\$2,451	\$3.36
1,634	\$64,253	\$31,998	*\$32,254	\$4,934	\$3.02
6,456	\$370,508	\$293,240	*\$77,268	\$11,822	\$1.83
8,421	\$374,101	\$248,056	*\$126,045	\$14,912	\$1.77
17,592	\$671,367	\$543,229	*\$128,138	\$14,973	\$0.86

\$32,000 cash savings on their taxes

This is savings on ONLY the self employment tax, there are many other taxes this WILL decrease.

***Capital Gain = Fair Market Value of timber cut - \$ paid to landowner**

Business Structure

- Sole Proprietor
 - LLC
 - Partnership
 - S Corporation
- Long Term Capital Gains
Rates apply

- C Corporation - No Capital Gains treatment
 - Soooo, create a procurement division as a LLC/Partnership from owners or major share holders of the business
 - Additional insurance, bookkeeping, forms but will save you \$1000's in taxes

FAIR MARKET VALUE APPRAISAL

- Stumpage value as of the first day of the year of:
 - Species
 - Product type
 - Volume
- Based on many factors:
 - Comparable stumpage sales
 - Logging conditions
 - Location
 - Stumpage quality
- This is deductible off of your REGULAR taxable income, instead of what you actually pay the landowner for stumpage

What is Timber?



- 1. Standing Trees attached to the soil
- 2. Timber = Real Property = Capital Asset

What is Timber?



- Sale of timber results in capital gain or loss
- Severed trees become personal property
- Stumpage = Price paid for the right to cut timber
- Stumpage = Timber = Useable wood that can be cut from trees

Long Term Capital Gain or Loss

Definition:

Net income realized on the sale or exchange of a capital asset. A capital gain (or loss) is treated differently for tax purposes from ordinary income or the profit realized from the operation of a business.

I.E. - Capital gains are taxed at a lower rate than regular income!!!

2018 Tax Rates- Taxable income level, not AGI

Tax Rate +15.3%	Regular paid per \$1000	Married Filing Jointly	Single	Long Term Capital Gains	Long term capital gain paid per \$1000
10%	\$ 253	\$ 0+	\$ 0+	0%	\$ 0
12%	\$ 273	\$ 19,051+	\$ 9,526+	0%	\$ 0
22%	\$ 373	\$ 77,401+	\$ 38,701+	15%	\$ 150
24%	\$ 393	\$ 165,001+	\$ 82,501+	15%	\$ 150
32%	\$ 473	\$ 315,001+	\$ 157,501+	15%	\$ 150
35%	\$ 503	\$ 400,001+	\$ 200,001+	15%	\$ 150
37%	\$ 523	\$ 600,000+	\$ 500,000+	20%	\$ 200

Medicare sur-tax on net investment income applies to investment timber sale too. It applies to single taxpayers that make over \$200,000 or MFJ over \$250,000.

Cut Timber

Type & Species

- Sawlogs
 - Veneer
 - Grade
- Utility poles
- Pulpwood
- Firewood
- Chips
- Fuelwood

Volume

MBF - Doyle,
Scribner,
International 1/4

Tons

Cords, Tons etc.

“

“

“



Loggers who cut timber

- On their own property
 - Capital gain treatment of timber owned by themselves personally or by their company (is treated differently)
 - C-Corps (beginning in 2016) –capital gain treatment of timber cut off of property they have owned over 15 years, max tax rate of 23.8%
- With a written contract with landowners, DNR, FS, County sales etc.

Contract

- To be eligible for capital gain you need a contract stating you now own the timber being harvested – *GET IT IN WRITING!!*
 - Utilize or sell the timber where you choose
 - Written contract with the landowner prior to harvest
- No – *Service Contract* -Paid for production of timber.
ie – The local sawmill pays you \$100/mbf for cutting one of their sales & the wood will be delivered to where they choose –
REGULAR INCOME

Contracts

- Must have:
 - Name of landowner selling
 - Your name as buyer
 - Legal description the timber is located on
 - Purchase price of the timber (Lump Sum or Cut & Scale)
 - Length of time you have the right to cut (hold it for over 12 months to reduce your taxes)
 - Both buyer & seller sign and date document
 - **Social security # or EIN of seller – you will send a 1099S out at the end of the year**

DO NOT include limitations on where you can sell the cut product

Loggers Tax Savings

- Who is the contract with & where?
- When did you bid on/sign the contract & when did you finish cutting & scaling the job?
- What did you pay for the timber sale?
 - And break down by ...
- What did you actually cut (volume & species)?
 - Establish a Fair Market Value
 - Timber Mart North, MDNR, USDA FS, County, & your timber sales

What type of 1099 ???

Do you send your landowners clients a

1099 Misc

or a

1099 S ?

End of Year – 1099 S forms

- Correct form to send to your landowners at the end of the year is a 1099 S – Real Estate Transactions – Timber Royalties
 - Security deposit is not reported here
 - Down payment for stumpage is reported in the year the volume of timber is actually cut & scaled
- 1099 Misc –WRONG –will pay LOTS of tax
 - If they keep the security deposit, it is reported as regular income

As of May 28, 2009, the IRS now requires a 1099 S to be mailed to all landowners for timber sales, lump-sum or cut & scale.

Prior to this, Lump Sum jobs did not require a 1099S, but landowners were incorrectly not reporting income so the law was changed.

End of Year – 1099 S forms

Joe Landowner makes \$20,000 off of his timber sale.
Joe is in the 25% tax bracket .

<u>Ordinary Income Rate</u>	<u>Social Security Rate</u>	<u>Total Rate As Ordinary Income</u>	1099 MISC ↓	If you send a 1099 misc
25%	15.3%	40.3%	<u>\$8,060.00</u>	Joe will pay

<u>Long term Capital Gain</u>	1099 S ↓	If you send a 1099 S
15%	<u>\$3,000.00</u>	Joe <u>might</u> only pay

If Joe files a Form T & sets up a depletion account,
he could pay much less, or even pay no tax at all!!!

Internal Revenue Code – Section 631(b) Capital Gain

- 1. For landowners that sell cutting rights (stumpage sale) to their trees
- 2. For landowners
- 3. Lump sum timber sales
- 4. Sale with economic interest retained (pay as cut) sales



Tax Assistance

- Tax is consistently listed as one of the top concerns for private forest landowner
- Tax is a major cost of owning and managing private forests
- Many retired landowners think a timber sale will reduce their social security earnings, afraid of the tax consequence of selling their timber

Take Away Points!!

- Timber is considered a capital asset
- Timber revenue is not subject to regular income, it is taxed at a lower rate.

IF YOU FILE A FORM T and
take a depletion deduction:

- A timber sale doesn't necessarily affect the social security income
- A timber sale doesn't necessarily raise a landowners tax bracket
- Timber sales may not need to be broken up over 2+ years

Myth or Fact

- I've owned the property over 10 – 20 years, my cost basis is too low to do timber taxes.
- I never had a beginning timber inventory of my property, so I can't get a starting volume.
- I'm a farmer. Since I file a Form F, I can't do my timber taxes.
- I've just bought my property, I have to wait a year before I cut it or I'll be taxed too much on my sale.
- My timber sale was pretty small, I'll just pay the tax. I'd like to support the governments' spending habits.
- If I have an occasional timber sale, I don't have to file a Form T.

Info Needed From Landowners

- Owner data & legal description of property.
- How did they acquire the property? Date?
 - Purchase / Inheritance / Gift / Trade
- Were there structures upon acquisition? Value?
- Maps, management plans for property? (MFL, FCL)
- Acquisition price of property?
 - Land & Timber
 - Appraisal / legal fees
 - Cruising / other fees
- Capital expenses?
 - Boundary survey
 - Tree planting / site prep
 - Permanent road improvements / other fees

Info Needed From Logger

- Timber type and volume prior to harvest (optional)
- Species, volume & value of timber actually harvested
- Type of timber sale – Lump sum or Scaled?
- Other relevant information

Landowner Example -

(Actual timber sale)

- Mr. Landowner inherited his 120 acres in 2012.
- He had a timber sale to clearcut the 15 acres of aspen and 105 acres cutting 35-40% of the timber in his oak forest.
- He received \$50,107.92 for his timber. He is in the 25% tax bracket.

His accountant was going to treat this as regular income, taxing him at 40.3% (25% fed tax bracket + 15.3% self-employment tax + 4.25% Michigan tax) having him pay **\$22,323.08** in tax of his \$50,107.92 timber sale.

If this same timber sale in 2017 was reported entirely as a long term capital gain, his federal tax bill (15% ltcg) and Michigan tax bill (4.25%) would be **\$9,645.77**.

Setting up the Depletion Account

\$226,200.00 = Mr. Landowner's cost basis

Bare Land

26%

\$58,812.00

Timber

74%

\$167,388.00

- 4627 cords (total volume)

\$36.18 per cord depletion rate

$\$167,388 / 4627 \text{ cords}$

Depletion deduction -

1473 cords x \$36.18

\$53,393.14

- 1473 cords cut during harvest

\$114,094.86

- 3154 cords left

\$50,107.92 – Timber sale revenue (bid sale)

-\$53,393.14 – Depletion deduction

-\$3,285.22 - Loss on his taxes!!!

**Instead of paying \$ 22,323.08 or even \$9,645.77
on his timber sale, he will pay NO TAX
and take a \$3,285.22 loss!!!**

Can I amend my taxes???

- Landowners – YES – up to 3 years
- Loggers – NO – If you haven't filed yet for the previous year, get an extension!!!!

Don't file until you have your timber taxes prepared!!!

IN SUMMARY

- Whether you are a timber owner or purchaser, take advantage of the IRS's generous treatment of timber via using the 631(a) and (b) tax codes.
- Burns & Metcalfe Timber Tax Service can save you lots of \$\$\$\$. Fill out an information sheet and receive a free evaluation to see if we can save you money.

Susan Metcalfe 989-348-3596
metcalfetimbertax@hotmail.com
www.metcalfeforestry.com

References for Timber Tax Information:

Susan Metcalfe &
Jim Burn – Metcalfe Forestry &
Burns Timber Tax Service
metcalfetimbertext@hotmail.com
www.metcalfeforestry.com
989-348-3596

Linda Wang - USDAFS Forest Taxation
lwang@fs.fed.us

John Greene - USDAFS Forest Taxation
jgreen01@fs.fed.us
(504) 232-1699 Clarence

Russel Kidd – MSU Extension
989-275-4670

Additional Informational Websites:

- <http://www.irs.gov/>
 - In search box (top right), type in Form T & the word timber.
- <http://www.timbertax.org/> &
<http://www.timbertax.org/publications/aghandbook/aghandbook.asp>
- National Timber Tax website

Tax Resources - Magazines:

Tree Farmer
<https://www.treefarmssystem.org/>

National Woodland Owners
<http://woodlandowners.org/>