Tree\$ & Tax\$

by Geary N. Searfoss

B eing a forester as well as an Enrolled Agent, a Certified Public Accountant (licensed in Wisconsin) and a tree farmer, I get a lot of questions throughout the year related to the income tax issues

of growing trees. As an introduction to the topic, let's take a look at a few of the most common questions that new forest owners have.

Is income from the sale of timber taxable? Since the Internal Revenue Code does not specifically exclude income from the sale of timber, it is taxable. You will likely receive a 1099-S from the entity that purchased your timber. Keep in mind that if you received a 1099, so did the IRS.

Can I deduct anything against timber sale proceeds? Yes. Any expenses you had in relation to the sale such as consulting forester fees, the cost of tree marking paint or ribbon and other out-of-pocket expenses can be deducted from the timber sale proceeds. You may also have what is known as basis in the timber you sold. This basis can also be deducted.

What is basis and how is it determined? Basis is your tax cost in an asset. If you purchased your property, your basis is what you paid for it. If you received the property through an inheritance it is the fair market value on the date of the decedent's death (or alternate valuation date if the executor so chose).

If you received the property as a gift your basis could be the same as it was to the person who gave the property to you (if its fair market value exceeds that basis) or it could be the fair market value (if its fair market value is less than the donor's basis) or you could have a different basis depending upon whether you had a gain or loss on its sale.

That last one is a bit beyond the scope of this article.

So I can deduct the full cost of my property against a sale of timber? No. Your cost is the basis in the whole property. Keep in mind that in addition to timber you also purchased the land. You may also have purchased some improvements and the property may have some other attributes, such as a deposit of gravel. The basis needs to be allocated before you can deplete the portion related to the timber.

This allocation can be done one of two ways. The most advantageous is to allocate based on relative fair market values as of the date of acquisition. This requires you to determine the fair market values of the land, timber, improvements and other attributes on the date you purchased the property.

The other allocation method is easier but usually is less advantageous. If you have just land and timber you can subtract the land fair market value on the date of purchase from the purchase price. The remainder is the basis allocable to the timber.

Once you have made an allocation to timber you can deplete it to the extent that you harvest timber. For example, if you harvest 60% of the total timber available on the property then you can deduct 60% of the amount in your depletion allowance (cost) account.

Photo by Brenda Cooke

Anything else I should know about the sale of timber? Yes. Assuming you did not conduct the harvest yourself and also assuming you have held the property for at least a year and a day, the sale will likely qualify for long-term capital gains treatment. This will give you a lower tax rate than what you would pay if it were ordinary

If you did the logging yourself there is a special election you can make to get long-term capital gains treatment but that is a bit beyond the scope of this article. If the timber property is located in a State different from your home State, keep in mind that you will also need to file a tax return for the State in which the property is located. Your home State will likely give you a tax credit for taxes paid to other States though it may fall short of the tax actually paid if your home State has a lower tax rate

Can I deduct expenses of growing trees? A qualified yes. This topic is quite involved and would make its own article. As a summary, if the expenses are typical for growing trees and they are helpful in accomplishing that goal they will likely be deductible. If growing trees is a hobby, i.e. you do not have a profit motive, then deductible expenses are limited to income from the activity on a year-by-year basis. Also note that transportation expenses are subject to some special rules.

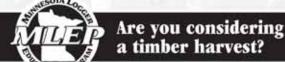
I'm planting trees this year. Can I deduct the cost of seedlings purchased? Yes, you can not only deduct the seedling cost but the cost of site preparation and planting as well. In fact, any cost to get the trees established, including protection from herbivores, qualifies. The only requirements are that the property is located in the United States, the trees are being planted for the production of commercial forest products and that you planted a sufficient number to fully stock at least one acre.

Up to \$10,000 of reforestation expenses can be deducted for each qualifying timber property. If you are treating the tree growing activity as a business the deduction will go on the business schedule. If not, the deduction goes on the front page of Form 1040 in the adjustments section. As an alternative, or to the extent your expenditures exceed \$10,000, you can amortize the cost over 84 months.

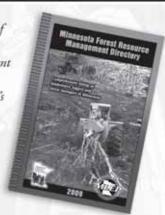
Have additional questions or want to explore some of these topics in a little more depth? The Minnesota Department of Natural Resources has contracted with Geary Searfoss to provide free forest related tax information to any eligible party. An eligible party includes any individual, business or other entity owning forestland in the State of Minnesota as well as tax preparers located in Minnesota and other

Minnesota residents. Geary can be contacted at 715-266-8290. You may also want to check out his web site at gscpa.biz.

> Geary N. Searfoss, CPA, EA, CF Geary N. Searfoss CPA, LLC P.O. Box 358 Winter, WI 54896-0358 715-266-8290 www.gscpa.biz gscpa@centurytel.net



MLEP members log more than 95% of the state's annual timber harvest. The Minnesota Forest Resource Management Directory provides a listing of logging business owners who have met MLEP's training and business requirements. Further, we have free landowner information manuals available that will provide you with the resources you need for a successful timber sale experience.



Minnesota Master Logger Certification

MLEP's Minnesota Master Logger Certification program provides added confidence to customers and the public that the person performing a harvest has the education and experience to do the job correctly. It is an independent, third-party audit of a logging business's harvest, safety and business practices.

For additional information or to receive a free directory and landowner information manual, contact our office or visit us on the web at: www.mlep.org

> Minnesota Logger Education Program 301 West First Street • Suite 510 Duluth MN 55802-1613 218-722-5442 • Fax: 218-722-5196 www.mlep.org