

FEDERAL INCOME TAXES AND TIMBER SALES

Tax liability from timber sales can be substantial and, of course, rather complicated. This is a specialized area of tax preparation that not all CPAs, tax preparers, and consulting foresters are familiar with. However, tax preparation by a qualified tax preparer is strongly recommended. MSU Extension regularly offers workshops to introduce you to the concepts of timber and taxation and the basics of what are involved. Failure to follow IRS procedures could easily result in a larger tax liability and penalties if you are audited. Audits of forest industry, loggers, and brokers have become fairly common.

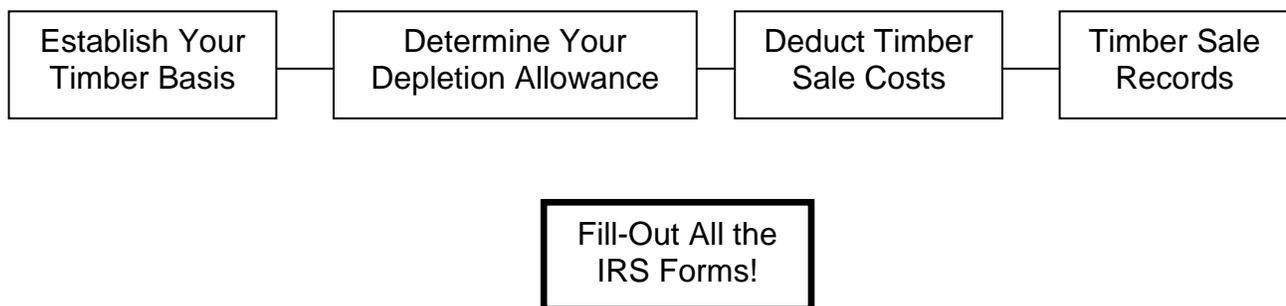
Some basic terms:

TIMBER BASIS: For the most part, timber basis is the monetary value of your timber at the time it was acquired or the last time the basis was adjusted. Timber basis is adjusted only through purchase of new timber, tree planting, and timber sales. Timber basis does NOT include the cost of the land. Applying as much value as reasonable to the timber serves as a tax advantage.

DEPLETION ALLOWANCE: This is an IRS approved method for deducting a part of the timber basis from timber sale income.

CAPITAL GAINS: “Capital” refers to capital property, usually things like land, timber, buildings, roads, etc. “Gains” refers to the increase in value over time. So, “capital gains” means the increase in value of real property over time. Generally, income treated under capital gains rules results in a lower tax burden. Timber is usually treated as *long-term* capital gains, rather than short-term.

The General Idea in Timber Sale Taxation



Some items you'll need or should have for the tax preparer are listed below.

Many of these items can be used for other purposes, such as entering your land into Michigan's Commercial Forest Program or Qualified Forest Program or applying for many cost-share programs. A management plan, in particular, will help you implement your wishes for your forest property.

1. A defensible cost for your timber when it was acquired.
2. A current volume estimation of the standing timber.
3. Volume of timber sold.
4. Timber sales receipts.
5. Receipts for costs applied to the timber sale.
6. A map of the timber stand(s).
7. Good ledger & journal sheets, or these kind of records.
8. A forest management plan.

IRS forms are generally not easy documents to fill out. The terms are often difficult to understand. Sometimes parts of a form may not apply to your situation. Even a simple timber sale can cause frustration with form preparation. This is part of the reason we recommend consulting a professional tax preparer familiar with forest activities. IRS forms that can apply to timber sales and related forest activities are:

1. **Form 1040:** the one we all know.
2. **Schedule A:** used for reporting personal itemized deductions.
3. **Schedule D:** used for reporting capital gains (& losses).
4. **Schedule C:** used for reporting income, deductions, etc. from sole proprietorship.
5. **Schedule F:** used for reporting income and expenses from farm operations.
6. **Form T-Forest Activities Schedules:** the worksheet for basis, depletion allowance and other forest-related activities. Not a fun form.
7. **Form 4797:** used to report sales, exchanges, & involuntary conversions of business property, including timber sales (as quality under Sec. 631A of IRS code).
8. **Form 3468:** Investment Tax Credit for tree planting.

If you use the Internet, an excellent source of timber tax information is the National Timber Tax Website, which offers assistance for timber sale income taxation, as well as a range of other tax-related issues that are pertinent to forest owners.

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