

KEEPING GOOD TIMBER RECORDS

The public, particularly the forest owner, must be concerned with timber tax policies, because these policies directly relate to the financial well-being of the forest owner as well as all governmental conservation programs. An often overlooked fact is that nearly three-quarters of the nation's 766 million acres of commercial forest land is privately owned. More than five million Americans own timberlands throughout the country. Taxes that relate to forest products have a great impact on the forest owners, conservation practices and on the nine percent of the total US work force employed by the forest industry.

DISCUSSION:

Often timber owners do not understand the tax laws that relate to timber sales and certain conservation measures. The recent trends in laws that relate to forestry activities tend to favor the forest owners and have, in fact, created tax breaks and incentives for forest owners. This discussion relates to Section 631 (a) and (b) of the Internal Revenue Code of 1954, the Economic Recovery Tax Act of 1981 and 1986, the American Jobs Creation Act of 2004 and Public Law 96-451. Section 631 (a) and (b) relates to capital gain and loss treatment to the cutting or disposal of standing timber. The Economic Recovery Tax Act of 1981 and 1986 relates to general tax reductions. Public Law 96-451 provides incentives for conservation/reforestation capitalized expenditures.

The first step in taking advantage of forest tax laws is keeping good records. Good records will provide you with the information required to take full advantage of capital gains, timber depletion, conservation practice and estate planning.

In order to take advantage of tax law as it applies to forest owners, the first step is to establish a cost basis on your land and timber. The cost basis is usually determined by how you acquired the property. This cost basis can come from one of the following sources:

- 1) Purchase -- If you purchased the land/timber, your cost basis is the purchase price, plus any purchase expenses and any capital expenditures/improvements during your ownership.
- 2) a) Inheritance -- If you inherited the property, your cost basis will be the value established on the property for inheritance tax purposes, plus capital expenditures/ improvements during your ownership.
- 2) b) Inheritance -- If you inherited the property prior to the advent of inheritance taxes, your cost basis is the cost basis of the ancestor from whom you inherited the property.
- 3) Gift -- If you have been gifted the property, then your cost basis is the cost basis of the prior owner who gifted you the property, plus any capital improvements/expenditures made during your ownership.

Once an owner determines his or her cost basis, a formal record can be "set up". Values must be established for each category of property. You must assign a specific amount of costs to each of the primary categories of land, buildings and timber. Once these amounts of costs (dollars) are assigned, they can not be altered except by adding capital expenditure costs or by subtracting depletion by sales.

Capital Expenditure: These are non-deductible expenses that have a useful life of more than one year and are permanent improvements made to increase the value of the property, including drainage, roads, reforestation, buildings, gates, etc.

Ordinary Expense: These are deductible expenses against income, including interest expense, taxes, road maintenance, timber sale expenses, etc.

Depletion: This is the offsetting of income arising from the cost of timber/land. Cost depletion is simply a means for recovering investment in property.

Once your books are established, adjustments in your cost basis will be necessary each time a capital expenditure is made and each time any sale is made. Adjustments to the cost basis can not be made to Total Timber Value figures because of timber growth.

The following is an example of acceptable format for recordkeeping.

Assumptions:

Purchase Price (Land & Improvements) \$100,000.00
 Purchase Price (Timber) 23,340.00

COST BASIS (Year 2000)..... \$123,340.00

Breakdown of Values:

Lot - 1 ac \$5,000.00
 Farmland - 20 ac \$25,000.00
 Woodsland - 80 ac \$24,000.00

TOTAL LAND VALUE..... \$54,000.00

Buildings..... \$45,000.00

TOTAL BUILDING VALUE \$45,000.00

Pine Sawtimber - 500 tons @ \$22/ton \$11,000.00
 Hdwd Sawtimber - 50 M' @ \$150/M \$7,500.00
 Pine Pulpwood – 500 tons @ \$10/ton.....\$5,000.00
 Hdwd Pulpwood - 140 tons @ \$6/ton \$840.00

TOTAL TIMBER VALUE..... \$24,340.00

TOTAL TRACT VALUE \$123,340.00

In 2015, you sell a portion of the timber in the above example.

Pine ST sold - 400 tons..... \$16,000.00
 Pine ST Cost Basis - 400 tons.....- \$8,800.00
 Hdwd Sawtimber - 50M'\$10,000.00
 Hdwd Sawtimber cost Basis - 50M.....-\$7,500.00
 Costs of Sale in 2015.....-\$1,560.00

GAIN ON SALE..... \$8,140.00

(www.fs.fed.us/spf/coop/Forest-Tax-Guide)

Reference is made to the USDA Forest Service Agriculture Handbook No. 718 entitled *Forest Landowner's Guide to the Federal Income Tax* and the North Carolina Cooperative Extension Service pamphlet *Federal Income Taxes for Timber Grower*. Copies are available on the internet.

Good records are imperative to take advantage of the current tax laws. Set up a ledger page for each tract using accurate figures. Carefully assign cost basis to each of the categories mentioned and adjust your cost basis as each capital expenditure or depletion is made. It is important to assign a fair share of your cost to the timber value, especially if you are anticipating a timber sale. If you have not had your timber cruised to determine how much volume and value you have, it might be a good idea to have your timber cruised and evaluated by a Registered Consulting Forester prior to establishing your cost basis. Being sure of what you own will mean that you can take full advantage of the current tax law when you make a sale.

Keeping good records will make a big difference when tax time comes. Stay familiar with current tax laws that relate to land and timber. Make sure your CPA and attorney are aware of these laws, and use them to ease your tax burdens. Keeping good records may reap you sizable rewards.

If we can be of service to you with helping you set up your records, or with any of your forest management needs, please call.

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