

ACCOUNTING AND TAX FOR WOODLAND PROPERTY

Roy M. Henshaw, CPA, MBA





INTRODUCTION

Agenda

- Establishing the Business
- Accounting and Record Keeping
- Tax and Tax Reporting
 - Timber Activities
 - Deductibility of Losses
 - Timber and Forest Sales – Capital Gains
- Woodland Management
- Cost Sharing
- Loss Treatment
- Estate Planning
 - Gifting
 - Financial Planning



ESTABLISHING THE BUSINESS

Getting Started

- Selecting the right entity
- Federal Identification Number
- Open a separate checking account
- Setting up the QuickBooks accounting system



ACCOUNTING AND RECORDS

Record Keeping

- Setting up QuickBooks and Chart of Accounts
- Recording Sales and Deposits
- Recording Purchases and paying bills
- Importance of Memo field in QuickBooks



FINANCIAL REPORTING

Financial reporting for Banks and Investors

- Balance Sheet – Assets, Liabilities, Capital
- Income Statement – Revenue and Expenses
- Timber acquisition reports
- Separate Schedule of Qualified Expenditures
 - (Direct costs to establish a Stand)
- Statement(s) of qualified cost share programs for cost share exclusions



ACQUIRING AND RECORDING PROPERTY

Acquiring and reporting property

- Purchase – the amount paid is recorded as an asset on the balance sheet
- Allocate cost between land, timber and other
- Loans used to acquire property are recorded as liabilities on the balance sheet
- Inherited property – value of the property is recorded as an asset (allocation) and to owner's equity
- Gifted property – value of the property to the donor is recorded as an asset (allocation) and to owner's equity



TIMBER ACTIVITY AS PART OF A FARMING OPERATION

Woodland owners may engage in farming
Farmers may own timber

- Timber growing is not part of farming
- Farmers can deduct soil and water conservation expenses (deduction limit)
- Farmers can deduct endangered species expenses (deduction limit)
- Farmers can use “Income Averaging”
- As a woodland owner and farmer you can deduct reforestation expenses



WOODLAND MANAGEMENT AND EXPENSES

Reforestation expenses

- Take up to \$10,000 per year and amortize the rest over 84 months
 - Site preparation
 - Seedlings
 - Labor and tools
 - Forester fees
 - Post establishment brush control
- Depletion
 - Method used to recover the timber basis at time of timber sale



WOODLAND MANAGEMENT AND EXPENSES

Depreciation

- Method used to recognize a deduction for capital assets acquired and used in a trade or business
- Accelerated depreciation (Sec 179 and Section 168k)

Other timber operating expenses

- Advertising
- Timber cruising
- Overnight travel
- Marketing for harvesting
- Scaling
- Insurance
- Legal, professional and forester fees



COST SHARING

Cost Sharing

- The receipt of reimbursed expenses allowed by an agency or a government unit.
 - Considered part of gross income (with exceptions)
 - To be excluded it must come from a federal program
 - Must be used for a capital expenditure
 - Excluded amount is subject to present value limitations
- For investment property it is considered “Other Income”
- For business activities it is reported on the business tax schedule



TAXATION

Tax classifications of woodland property

- Person enjoyment
- Investment
- Trade or business

Tax reporting

- Personal use – Form 1040 and schedules
- Business tax filings – separate entity tax returns
 - Limited Liability Company
 - Corporation – Subchapter S or chapter C
 - Timber specific provisional trusts

Tax basis of property acquired

- Basis of purchased timber
- Basis of inherited timber
- Basis of timber received as a gift



TAXATION

Tax basis of property acquired

- Basis of purchased timber
- Basis of inherited timber
- Basis of timber received as a gift

Farmers use the federal form Schedule F for ordinary income

Farmers use Schedule D to report tree sales

Woodland property as a business use Form T (Timber)



TAXATION

Deductibility of losses

Passive investor

- Offsets other passive income only
- Real estate activities are passive



TAXATION

Non-passive participant

Considered non-passive participant if....

- 500 hours or more of active participation in the business
- Your participation is 100% of the total (just you)
- Your participation 100 hours and no one else has more hours
- Your participation in all activities is 500 hours or more
- Your participation was 5 out of the last 10 years

All facts and circumstances indicate material participation and you did 100 hours, you can offset W-2 earnings from other sources with timber loss.



TAXATION

Designation as a hobby

Installment sales – income received in other years from asset sales

Timber and forest product sales and expenses

- Holding period to qualify for gain classification
 - Long term capital gain – holding period is greater than 1 year. Taxed at 15% (20% if AGI is over \$450,000 in 2013)
 - Short term capital gain – holding period is less than 1 year. Taxed at ordinary income tax rates



TAXATION

Benefits of Capital Gain treatment of sales

- Taxed at lower rates
- Gains are not subject to social security in 2012 (Starting in 2013 will be subject to social security for taxpayers in higher tax brackets)
- Net capital losses can offset up to \$3,000 of other income

Personal use land

- Sale of timber is subject to capital gain treatment after deducting the cost
- Other expenses are recorded on Schedule A as miscellaneous itemized deductions



TAXATION

Investment sales

- Sale of timber is subject to capital gain treatment
- Costs are subtracted from the net selling price
- Timber and management costs are deducted on Schedule A as miscellaneous itemized deductions

Business sales – Section 631(b) standing timber

- Lump sum and pay-as-you cut sales qualify for capital gain
- You must be the owner of the property from more than 1 year
- Costs are reported on Form 4797 and are applied against the gain



TAXATION

Business sales of timber products and use in your business

- Two step process
 - Sale of standing timber
 - Sale of wood product (sale price to customer less fair market value already taxed)
- All timber management and protection expense are deductible in full against timber income

Types of timer losses reported on a tax return

- Casualty – deduction is lesser of Fair Market Value caused by casualty or your cost basis
- Theft – adjusted cost of the timber less reimbursement
- Condemnation – lesser of the Fair Market Value or your basis in the property



ESTATE PLANNING FOR TIMBER

Gift of timber property

- Family ownership transition
- Fulfill charitable goal

Timber as part of a personal or corporate financial plan

- Risk of ownership
- Investment rate of return
- Timber as an asset class in a balanced portfolio