

Some Things You May Not Know About
the Taxation of Revenue from Timber
Harvesting Operations

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Outline

- Retroactive basis determination
- Timber accounts (depletion block)
- Depletion allowance
- Capital gain treatment
- Casualty loss
- Deduction of site preparation and planting costs

What is my basis?



Retroactive Basis Determination

- “The following steps may be used for reconstructing basis. It is suggested that a qualified forester be consulted to assist in some of these determinations.” Timber Casualty Loss Audit Techniques Guide, 2011
- Step 1: When and how was the property acquired

Basis in property acquired by gift § 1015

- The basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift
- Except that if such basis is greater than the FMV of the property at the time of the gift, then for the purpose of determining loss the basis shall be such FMV
- The basis shall be increased (but not above FMV) by the amount of gift tax paid with respect to the appreciation § 1015(d)(6)

Basis for inherited property § 1014

- The basis of property in the hands of a person acquiring the property from a decedent shall be the fair market value of the property at the date of the decedent's death unless a 2032A or conservation easement election is made
- From a decedent: Will, revocable trust, life estate or general power of appointment

Basis of property acquired by sale - §1012

- The basis of such property shall be the cost of such property
 - The basis of real property includes settlement fees and closing costs such as abstract fees, charges for installing utility services, legal fees, recording fees, surveys, transfer taxes, owner's title insurance and amounts owed by the seller but paid by the buyer, such as back taxes or interest

Forest Inventory

- Each taxpayer claiming or expecting to claim a deduction for depletion is required to estimate with respect to each separate timber account the total units (feet board measure, log scale, cords, or other units) of timber reasonably known, or on good evidence believed, to have existed on the ground . . . on the date of acquisition of the property (IRS Reg. 1.611-3(e))

Forest Inventory

- This estimate shall state as nearly as possible the number of units which would have been found present by careful estimate . . . with the object of determining 100 percent of the quantity of timber which the area covered by the specific account would have produced on that date if all of the merchantable timber had been cut and utilized in accordance with the standards of utilization prevailing in that region at that time (IRS Reg. 1.611-3(e))

Forest Inventory

- The timber in each particular case will be valued on its own merits and not on the basis of general averages for region (Reg. 1.611-3(f)(2))
- No revaluation of a timber property whose value as of any specific date has been determined and approved will be made or allowed during the continuance of the ownership under which the value was so determined and approved, except in the case of misrepresentation or fraud or gross error as to any facts known on the date as of which the valuation was made (Reg. 1.611-3(g))

Basis allocation for land and buildings

- “In the case of the acquisition . . . of a combination of depreciable and nondepreciable property for a lump sum, as for example, buildings and land, the basis for depreciation cannot exceed an amount which bears the same proportion to the lump sum as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time.” Reg. §1.167(a)-5

Basis allocation for land and buildings

- Example:
 - Paid \$140 for land and timber and the appraisal states that the land is worth \$90 and the timber is worth \$60 or \$150 total
 - $90/150 * 140 = 84$ for land
 - $60/150 * 140 = 56$ for timber

Retroactive Basis Determination

- Step 2 What are the characteristics of the property
 - Current timber information
 - Stand-by-stand listing of species, volume, age, size, log grade
 - Improvements conducted by owner - reforestation, fertilization, thinning
 - Prior timber losses, cutting or sales
 - Timber or land acquired since original purchase

Retroactive Basis Determination

- Step 3: Determine timber growth rate
- Step 4: Calculate original values by property type
 - Volume: ungrow current volumes, by species, to date of original acquisition and make adjustments for purchases, reforestation, losses, sales or cuttings
 - Value: timber stumpage prices from that time period and land values

Retroactive Basis Determination

- Step 5: Allocate original basis
 - List all assets, "then" FMV, and percentage of total FMV
 - Multiply by original purchase price to get cost basis allocated to assets
- Step 6: Make subsequent basis adjustments to timber accounts
 - Calculate depletion rate
 - Reduce original basis for volumes removed
 - Increase original basis for cost of improvements made

Timber Accounts

- Every taxpayer claiming or expecting to claim a deduction for depletion of timber property shall keep accurate ledger accounts in which shall be recorded the cost or other basis provided by section 1012 of the property and land together (Reg. 1.611-3(c)(1))
- In such accounts there shall be set up separately the quantity of timber, the quantity of land, and the quantity of other resources, if any, and
- A proper part of the total cost or value shall be allocated to each after proper provision for immature timber growth (Reg. 1.611-3(c)(2))
- In cases in which immature timber growth is a factor, a reasonable portion of the total value or cost shall be allocated to such immature timber (Reg. §1.611-3(d)(3))

Records

- The taxpayer must retain records sufficient to substantiate the right of the taxpayer to claim the deduction, including a map, where necessary, to show clearly timber and land acquired, timber cut, and timber and land sold for as long as their contents may become material in the administration of any internal revenue law (Reg. 1.611-3(h)(2))

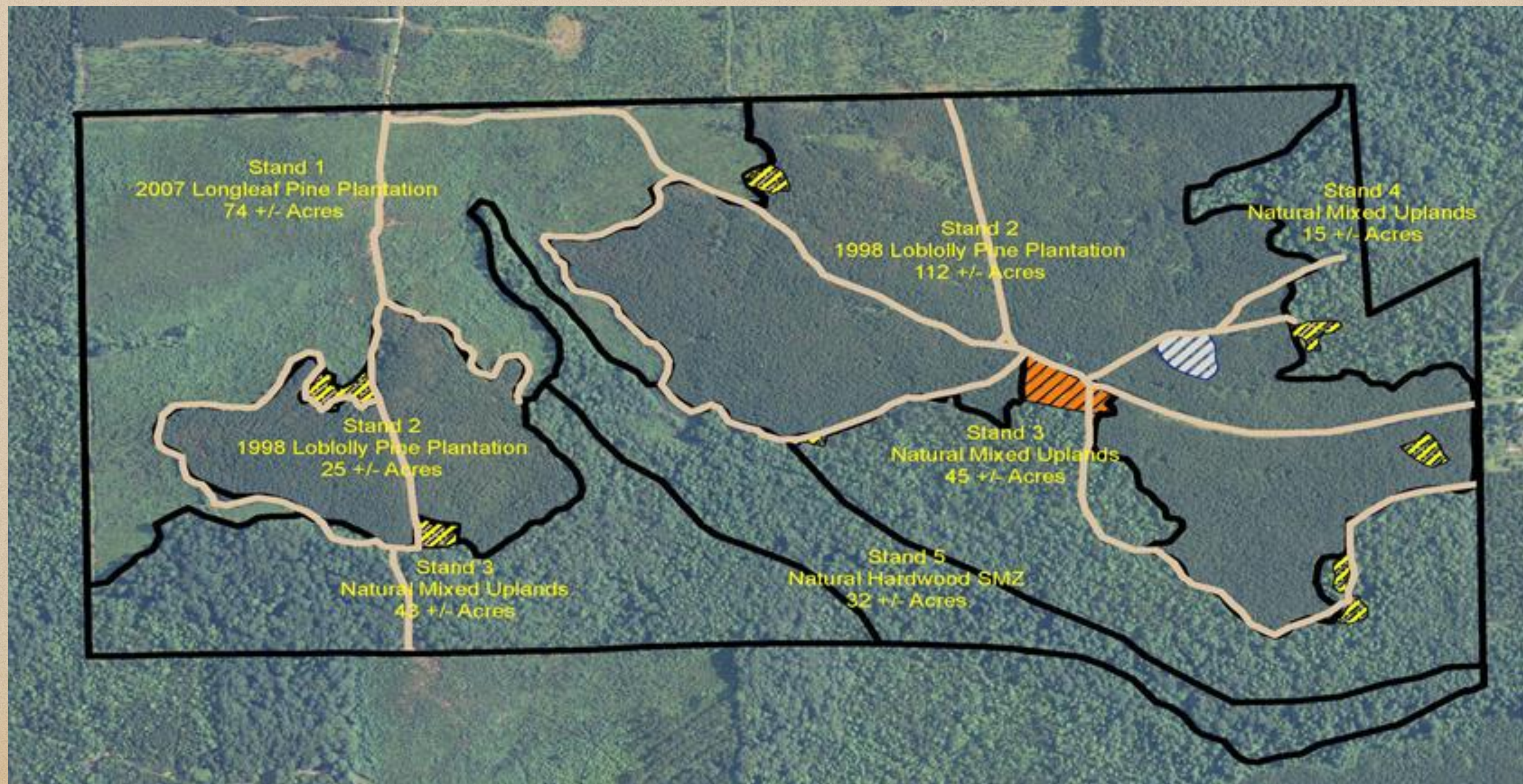
Timber Accounts

- With a view to logical and reasonable valuation of timber, the taxpayer shall include his timber in one or more accounts
- In general, each such account shall include all of the taxpayer's timber which is located in one block
 - Reg. 1.611-3(d)
- Timber acquired under cutting contracts should be carried in separate accounts and shall not constitute part of any block

Blocks

- Each such account shall include all of the taxpayer's timber which is located in one "block"
 - Timber which would go to a single point of manufacture
 - Logging unit which would be removed in a single logging development
 - Geographical or political boundaries
 - Logical management areas (Reg. §1.611-3(d))

Stand Map



				831,000
9 Allocation of total cost or other basis on books:	Unit	Number of units	Cost or other basis per unit	Total cost or other basis
a Forested land	Acre	340	1,581.99	537,875
b Other unimproved land	Acre			
c Improved land (describe) ▶ _____	Acre			
d Merchantable timber. Estimate the quantity of merchantable timber present on the acquisition date (see Regulations section 1.611-3(e)). Details of the timber estimate, made for purposes of the acquisition, should be available if your return is examined.	tons	18,677	14.923	278,715
e Premerchantable timber. Make an allocation here only if it is a factor in the total cost or value of the land.	acres	72	200.14	14,410
f Improvements (list separately) _____ _____ _____ _____				
g Mineral rights				
h Total cost or other basis (same amount as line 8). Add lines 9a through 9g				831,000

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 16717G

Form **T (Timber)** (Rev. 12-2013)

Declining depletion allowance with single account

Basis	Volume	Cut	Dep. unit	Depletion	Volume
\$ 278,715	18677	3735	\$ 14.92	\$ 55,743	14942
\$ 222,972	19070	3814	11.69	44,594	15256
\$ 178,378	19471	3894	9.16	35,676	15577
\$ 142,702	19880	3976	7.18	28,540	15904

				831,000
9 Allocation of total cost or other basis on books:	Unit	Number of units	Cost or other basis per unit	Total cost or other basis
a Forested land	Acre	340	1,581.99	537,875
b Other unimproved land	Acre			
c Improved land (describe) ▶ _____	Acre			
d Merchantable timber. Estimate the quantity of merchantable timber present on the acquisition date (see Regulations section 1.611-3(e)). Details of the timber estimate, made for purposes of the acquisition, should be available if your return is examined.	tons	9,771	7.81	76,268
	tons	287	16.76	4,811
	tons	872	24.02	20,943
	tons	4,253	14.21	60,435
	tons	3,494	33.27	116,258
e Premerchantable timber. Make an allocation here only if it is a factor in the total cost or value of the land.	acres	72	200.14	14,410
f Improvements (list separately) _____ _____ _____ _____ _____				
g Mineral rights				
h Total cost or other basis (same amount as line 8). Add lines 9a through 9g				831,000

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Cat. No. 16717G

Form **T (Timber)** (Rev. 12-2013)

Depletion Allowance

- § 611 provides that there shall be allowed as a deduction in computing taxable income in the case of mines, oil and gas wells, other natural deposits and timber, a reasonable allowance for depletion
- Cost depletion and not percentage depletion must be used for timber Reg. § 1.611-1(a)(1)
- The basis on which depletion is to be allowed shall be the adjusted basis as provided in § 1011

Cost Depletion

- First the tract is divided into depletion units, blocks or single identifiable properties
- Second, the number of units (tons, cords) in the depletion unit is determined
- Third, the adjusted basis of the property is divided by the number of units to determine the cost depletion per unit
- The cost depletion per unit is multiplied by the number of units harvested that year
- The cost basis of the property is reduced by the amount of depletion claimed that year. Reg. 1.611-3(b)(2)

Form T - Part II. Timber Depletion

- Complete this part for each timber account that has changed in quantity or dollar amount
 - A timber account may change in quantity or dollar amount as a result of acquisitions, dispositions, the cutting of timber, capitalized expenditures, casualty or theft losses, corrections, additions for growth, and transfers from other accounts
 - A depletion schedule is required to be maintained for all types of timber ownership.

Part II Timber Depletion (see instructions)

1 Name of block and title of account ▶ Floyd Tract, Stand 2

If you express timber quantity in thousand board feet (MBF), log scale, name the log rule used. If another unit of measure is used, provide details ▶ Tons

	(a) Quantity	(b) Cost or other basis
2 Estimated quantity of timber and cost or other basis returnable through depletion at end of the preceding tax year	10,058	81,079
3 Increase or decrease of quantity of timber required by way of correction		
4a Addition for growth (number of years covered ▶ <u>2</u>)	1,031	
b Transfers from premerchantable timber account		
c Transfers from deferred reforestation account		
5 Timber acquired during tax year		
6 Addition to capital during tax year		
7 Total at end of tax year, before depletion. Add lines 2 through 6	11,089	81,079

7	Total at end of tax year, before depletion. Add lines 2 through 6	11,089	81,079
8	Unit rate returnable through depletion, or basis of sales or losses. Divide line 7, column (b), by line 7, column (a)		7.312
9	Quantity of timber cut during tax year		
10	Depletion for the current tax year. Multiply line 8 by line 9		
11	Quantity of standing timber sold or otherwise disposed of during tax year	3,881	
12	Allowable as basis of sale. Multiply line 8 by line 11		28,377
13	Quantity of standing timber lost by fire or other cause during tax year		
14	Allowable basis of loss plus any excess amount where decrease in FMV (before and after the casualty) exceeds the standard depletion amount, but not the block basis (see instructions)		
15	Total reductions during tax year:		
a	In column (a), add lines 9, 11, and 13	3,881	
b	In column (b), add lines 10, 12, and 14		28,377
16	Net quantity and value at end of tax year. In column (a), subtract line 15a from line 7. In column (b), subtract line 15b from line 7	7,208	52,702
17	Quantity of cut timber that was sold as logs or other rough products		
18	Section 631(a):		
a	Are you electing, or have you made an election in a prior tax year that is in effect, to report gains or losses from the cutting of timber under section 631(a)? (see instructions)	<input type="checkbox"/> Yes	<input type="checkbox"/> No
b	Are you revoking your section 631(a) election (see instructions)?	<input type="checkbox"/> Yes	<input type="checkbox"/> No
	Effective date ►		

Depletion Allowance

- There may be multiple Part II's to account for different depletion blocks, species, etc.
- Each timber account will require a different Form T, Part II
- Taxpayers may need to keep much more detailed depletion records than those shown in Part II
- Owners of smaller timber holdings who have infrequent timber transactions generally make growth adjustments only in a tax year in which they cut, sell, or otherwise dispose of timber
- HATG

Apportionment of Depletion

- Life tenant and remainderman - In the case of property held by one person for life with remainder to another person, the deduction for depletion under section 611 shall be computed as if the life tenant were the absolute owner of the property so that he will be entitled to the deduction during his life, and thereafter the deduction, if any, shall be allowed to the remainderman.
 - Reg. 1.611-1(c)

Apportionment of Depletion

- Trust - The allowable deduction for depletion is to be apportioned between the income beneficiaries and the trustee on the basis of the trust income from such property allocable to each
 - No effect shall be given to any allocation of the depletion deduction which gives any beneficiary or the trustee a share of such deduction greater than his pro rata share of the trust income, irrespective of any provisions in the trust instrument
- Estate - shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of income of the estate from such property which is allocable to each

Timber as an Investment

- "Standing timber you held as investment property is a capital asset. Gain or loss from its sale is capital gain or loss reported on Form 8949 and Schedule D (Form 1040), as applicable." IRS Pub 225. Farmer's Tax Guide, p 55

Timber As a Business

- “If you held the timber primarily for sale to customers, it is not a capital asset. Gain or loss on its sale is ordinary business income or loss. It is reported on Schedule F, line 1 (if purchased timber) or line 2 (if raised timber).” IRS Pub 225. Farmer's Tax Guide, page 55

§ 1231 Property

- (b) Definition of property used in the trade or business. For purposes of this section--
 - (1) General rule
 - The term "property used in the trade or business" means property... which is not--
 - (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, ...
 - (2) Timber, coal, or domestic iron ore
 - Such term includes timber, coal, and iron ore with respect to which section 631 applies.

§631. Gain or loss in the case of timber

- §631(b) Disposal of timber

- In the case of the disposal of timber held for more than 1 year before such disposal, by the owner thereof under any form or type of contract by virtue of which such owner either retains an economic interest in such timber or makes an outright sale of such timber, the difference between the amount realized from the disposal of such timber and the adjusted depletion basis thereof, shall be considered as though it were a gain or loss, as the case may be, on the sale of such timber

§631(b) Requirements

- The taxpayer must make a disposal of the timber under a contract
 - An owner must surrender cutting rights to another
 - The contract must be mutually binding and enforceable with respect to the sale and purchase of standing timber

Property Used in Trade or Business

- “In the case of such a disposal, the provisions of section 1231 apply and such timber shall be considered to be property used in the trade or business for the taxable year in which it is considered to have been sold, . . . as defined in section 1231(b), regardless of whether such timber is property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.” §1.631-2(a)(2)

Payments in Advance of Cutting

- “However, if the right to cut timber under the contract expires, terminates, or is abandoned before the timber which has been paid for is cut, the taxpayer shall treat payments attributable to the uncut timber as ordinary income and not as received from the sale of timber under section 631(b).” Section 1.631-2(d)(2)

Losses

- “There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.” §165(a)
- “For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.”
§165(b)

Amount of the casualty loss deduction

- Reg. 1.165-7(b) provides that in the case of any casualty, the amount of loss to be taken into account for purposes of §165(a) shall be the lesser of either
 - the amount which is equal to the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty; or
 - the amount of the adjusted basis prescribed in §1.1011-1 for determining the loss from the sale or disposition of the property involved
- Under Reg. 1.165-7(b)(2) business casualty losses shall be determined by reference to the "single, identifiable property damaged or destroyed"

Single Identifiable Property

- Revenue Ruling 99-56, accepts the “depletion block” as the SLP in timber casualty loss cases, and acknowledges that partial damage may be sufficient for claiming a casualty loss
- In general, a “depletion block” is an account for timber basis that may be defined as an operational unit or a logging unit, or may be established by geographical or political boundaries or logical management areas. § 611

Timber Losses

- The 'suddenness' element of a casualty loss is discussed in *Maher v. Commissioner*, 76 T.C. 593 (1981), aff'd, 680 F.2d 91 (11th Cir. 1982),
- The court reasoned that the suddenness of the loss itself, not the suddenness of its onset, determines whether the suddenness requirement is met.
- The lapse of time from infection to the death of the trees indicated not a sudden loss, but a loss resulting from gradual deterioration.
- Thus, for example, a loss resulting from deterioration of timber in trees killed by southern pine beetles in normal populations would not be a deductible loss, but would be recovered through depletion of the remaining timber in the account.

Ordinary Losses

- Section 1.611-3(e) provides that if, as the result of the growth of the timber, of changes in standards of utilization, of losses not otherwise accounted for, of abandonment of timber, or of operations or development work, . . . , then the original estimate (but not the basis for depletion) shall be revised
- Such an adjustment reflects the fact that no gain or loss is currently recognized for changes in the quantity of timber that reflect growth and yield expectations in the income-producing operation.

Should you claim a casualty loss?

- The benefit is that you may get to accelerate the depletion deduction
 - There is no additional deduction for the casualty--the total write-off over the life of the SIP is the basis
- The other benefit is that you can claim involuntary conversion and defer income from salvage operations
- The cost is that you have to have appraisals of the "single identifiable property" (SIP) both before and after the casualty to substantiate the diminution in value

Additional basis recovery pursuant to Rev. Rul. 99-56

- Rev. Rul. 99-56 allows the basis of the entire SIP to be considered
- For example, suppose the FMV of the SIP before the casualty was \$80,000 (8,000 tons with a FMV of \$10/ton) and the value after was \$72,000 (the 800 tons lost at a value of \$10/ton). Also, suppose the basis was \$5/ton. The basis in the SIP would be \$40,000 (8,000 tons at \$5/ton depletion allowance). Since the decrease in the FMV is \$8,000 and the basis is \$40,000, the allowable deduction is the lesser of the two values or \$8,000
- The remaining basis is \$32,000 and since there are 7,200 tons remaining the new depletion allowance is \$4.44/ton

Normal Loss Deduction

- Using the information in the example, the normal loss deduction would have been \$4,000 (\$5/ton basis times 800 tons)
- The difference is \$4,000

Audit Guidelines

- Timber Casualty Loss Audit Techniques Guide states that the initial data request will include:
 - The timber depletion schedule for the SIP identified as the property sustaining the loss
 - Appraisals of the SIP both before and after the casualty event to substantiate the diminution in fair market value of the affected SIP
 - This should include all data and/or assumption, projections, and limiting conditions used in computations to substantiate the claimed loss
 - The "before" appraisal should include timber inventory beginning balances for all timber sub-accounts in the affected block just prior to the casualty (i.e. sawtimber, pulpwood, reproduction, and pre-merchantable)

Audit Guidelines

- Timber Casualty Loss Audit Techniques Guide states that the initial data request will include (continued):
 - The “after” appraisal should include timber inventory beginning balances for all timber in the affected block just after the casualty
 - Maps showing location of the SIP and the area damaged by the casualty event
 - The original field data taken immediately after the casualty event and steps taken to mitigate the loss
 - Harvest data for damaged timber that was salvaged (include volumes and products by species)

Valuation of the SIP

- “The major problem in this area arises when taxpayers, contrary to the regulations, do not perform an appraisal of the SIP before and after the casualty. Instead, these taxpayers seek to extrapolate the loss in value from per-unit FMV's, multiplying that figure by the number of units lost or damaged. In essence, this method consists of determining the volume of lost timber and multiplying that volume by the market price per applicable unit.”

Salvage operations

- “The casualty loss and the subsequent sale of salvage timber are separate events, and need not be combined and set off for tax purposes . . . Precedent supports the ruling that gain from salvage of damage timber is independent of the casualty loss deduction . . . Congress has provided that casualty losses to business property are accorded an ordinary deduction even when the eventual disposition of the property may be treated as a capital gain.” *Weyerhaeuser Company v. United States*, 92 F. 3d 1148, 1152 (Fed. Cir. 1996)
- The salvage value will be taken into consideration when determining the FMV after the casualty
- However, the income from the salvage operation is separate and is not treated as casualty gain and should not be reported on line 25 of 4684

Involuntary conversion

- § 1033 allows a taxpayer to replace his property without realization of gain where he is compelled to give up that property due to circumstances beyond his control; provided, that it is converted into property similar or related in service or use
 - Property similar or related in service or use includes reforestation or afforestation on woodlands owned or leased by the taxpayer, the purchase or lease of timber, timberland, or land for purposes of reforestation or afforestation and the purchase of stock in the acquisition of control of a corporation owning such property
 - The taxpayer has 2 years after the close of the first taxable year in which any part of the gain is realized to reinvest in similar property

Involuntary Conversion

- You report your intention to postpone gain recognition by attaching a statement to your return which includes the date and details of the casualty, the insurance or other reimbursement you received from the casualty, and how you calculated the gain.
- If you do not replace the property in the same year, you should also include a statement that you plan to replace the property within the required replacement period.
- When you acquire replacement property you should include a statement with your return listing the replacement property, the postponed gain, the basis adjustment that reflects the the postponed gain and any gain you are reporting as income.

Site Preparation and Planting

- You must generally capitalize direct costs incurred in reforestation
 - Reforestation costs include
 - Site preparation, such as girdling, applying herbicide and clearing and controlling brush
 - The cost of seed or seedlings
 - Labor and tool expenses
 - Depreciation of equipment used in planting
 - Costs incurred in replanting to replace lost seedlings
- However, you can elect to deduct some forestation and reforestation costs

Site Preparation and Planting

- §194. Treatment of reforestation expenditures
 - Reforestation expenditures means direct costs incurred in connection with forestation or reforestation by planting or artificial or natural seeding including costs—
 - For the preparation of the site;
 - Of seeds or seedlings; and
 - For labor and tools, including depreciation of equipment such as tractors, trucks, tree planters, and similar machines used in planting or seeding

Treatment of reforestation expenditures

- In the case of any qualified timber property with respect to which the taxpayer has made . . . an election under this subsection, the taxpayer shall be entitled to a deduction with respect to the amortization of the amortizable basis of qualified timber property based on a period of 84 months
 - The term "amortizable basis" means that portion of the basis of the qualified timber property attributable to reforestation expenditures which have not been taken into account under subsection (b).
- The 84-month period shall begin on the first day of the first month of the second half of the taxable year in which the amortizable basis is acquired
IRC §194(a)
- There is no limit on the amount of your amortization deduction for reforestation costs paid or incurred during the tax year

Treatment of reforestation expenditures

- Treatment as expenses – §194(b)
 - In the case of any qualified timber property with respect to which the taxpayer has made an election under this subsection, the taxpayer shall treat reforestation expenditures which are paid or incurred during the taxable year with respect to such property as an expense which is not chargeable to capital account
 - The reforestation expenditures so treated shall be allowed as a deduction

Qualified Timber Property

- Qualified timber property is property that contains trees in significant commercial quantities.
- The property qualifies only if it meets all of the following requirements.
 - It is located in the United States
 - It is held for the growing and cutting of timber you will either use in, or sell for use in, the commercial production of timber products
 - It consists of at least one acre planted with tree seedlings in the manner normally used in forestation or reforestation

Qualified Timber Property

- Qualified timber property doesn't include property on which you have planted shelter belts or ornamental trees, such as Christmas trees

Treatment of reforestation expenditures

- Treatment as expenses - §194(b)
 - The aggregate amount of reforestation expenditures which may be expensed with respect to each qualified timber property for any taxable year shall not exceed
 - \$10,000 (\$5,000 if married filing separately)
 - except in the case of a trust the expense deduction shall be \$0
 - Controlled group
 - All component members of a controlled group shall be treated as one taxpayer
 - The dollar limitation shall apply with respect to the partnership and with respect to each partner
 - A similar rule shall apply in the case of an S corporation and its shareholders

How to make the election (Pub 535)

- If you are filing Form T (Timber), Forest Activities Schedule, also complete Form T (Timber), Part IV
- If Form T is not required, attach a statement containing the following information for each qualified timber property for which an election is being made
 - The unique stand identification numbers
 - The total number of acres reforested during the tax year
 - The nature of the reforestation treatments
 - The total amounts of qualified reforestation expenditures eligible to be amortized or deducted

Part IV Reforestation and Timber Stand Activities (see instructions)

Account, block, tract, area, or stand ID for each Qualified Timber Property (QTP)	Kind of activity (burning, chopping, spraying, planting, seeding, thinning, pruning, fertilizing, etc.)	Number of acres treated	Total expenditures
1 Thomas Tract, Stand 2	Herbicide spray and burn	134	14,740
2 Total			14,740
3 Total reforestation expenses			14,740
4a Amount to be expensed under section 194(b). (See instructions for limitations)			10,000
b Amount to be amortized under IRC 194(a), including remaining reforestation expenditures not expensed under section 194(b)			4,740

Treatment of reforestation expenditures

- If you make an election to deduct or amortize qualifying reforestation costs, you should create and maintain separate timber accounts for each qualified timber property
- The accounts should include all reforestation treatments and the dates they were applied
- Any qualified timber property that is subject to the deduction or amortization election can't be included in any other timber account for which depletion is allowed
- The timber account should be maintained until the timber is disposed of

How to make the election (Pub 535)

- To elect to amortize qualifying reforestation costs, complete Part VI of Form 4562 and attach a statement that contains the following information
 - A description of the costs and the dates you incurred them
 - A description of the type of timber being grown and the purpose for which it is grown
- Attach a separate statement for each property for which you amortize reforestation costs

Form **4562**

Department of the Treasury
Internal Revenue Service (99)

Depreciation and Amortization
(Including Information on Listed Property)

▶ Attach to your tax return.

▶ Go to www.irs.gov/Form4562 for instructions and the latest information.

OMB No. 1545-0172

2019

Attachment
Sequence No. **179**

Name(s) shown on return Thomas Floyd	Business or activity to which this form relates Timber	Identifying number 123-45-6789
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Part I Election To Expense Certain Property Under Section 179

Note: If you have any listed property, complete Part V before you complete Part I.

1 Maximum amount (see instructions)	1	
2 Total cost of section 179 property placed in service (see instructions)	2	

Part VI Amortization

(a) Description of costs	(b) Date amortization begins	(c) Amortizable amount	(d) Code section	(e) Amortization period or percentage	(f) Amortization for this year
42 Amortization of costs that begins during your 2019 tax year (see instructions):					
Qualified Reforestation Costs	7/01/2019	4,740	194(a)	84	339
43 Amortization of costs that began before your 2019 tax year				43	
44 Total. Add amounts in column (f). See the instructions for where to report				44	339

Reporting Amortization

- Report the total amortization, including the allowable portion of forestation or reforestation amortization, on the applicable "Other Deductions" or "Other Expenses" line of your return
- If you are reporting the amortization of costs that began before your 2020 tax year and you are not required to file Form 4562 for any other reason, do not file Form 4562
- Partnerships (other than electing large partnerships) and S corporations, report the amortizable basis of any forestation or reforestation expenses for which amortization is elected and the year in which the amortization begins as a separately stated item on Schedules K and K-1 (Form 1065 or 1120-S)

Recapture

- If a taxpayer disposes of qualified timber property within ten years of the year in which the amortizable basis was created and the taxpayer has claimed amortization deductions under section 194, part or all of any gain on the disposition may be recaptured as ordinary income
 - Reg 1.194-1(c)

Recapture of reforestation expenses

- Section 1245 property includes any property that is or has been subject to an allowance for depreciation or amortization and that is any of the following types of property
 - K. Certain reforestation expenditures
- Depreciation and amortization that must be recaptured as ordinary income include (but are not limited to) the following items
 - 5. Deductions for all the following costs
 - e. Certain reforestation expenses

Alabama does not allow reforestation expenses for pass-through entities

- CHANGES IN GULF OPPORTUNITY ZONE ACT.
IRC § 1400N increases the amount of expensing allowed by IRC § 194, concerning reforestation expenditures. For individuals and pass-through entities such as Subchapter K entities and S corporations, Alabama income tax law does not recognize the expensing allowed by IRC § 194... [Ala. Dept. Rev. Notice: Alabama Income Tax Law Compliance With Federal Hurricane Relief Provisions]
- Since Alabama conforms the corporate income tax to the federal income tax system under Ala. Code §40-18-33, Alabama conforms to the provisions of IRC § 194 concerning the expensing of certain reforestation expenditures for corporations

Who Must File a Form T

- A taxpayer claiming a deduction for depletion of timber on a return filed for a taxable year beginning after December 31, 2001, shall attach to the income tax return of the taxpayer a filled-out Form T (Timber) for the taxable year covered by the income tax return. § 1.611-3(h)(2)
- In addition, the taxpayer must retain records sufficient to substantiate the right of the taxpayer to claim the deduction, including a map, where necessary, to show clearly timber and land acquired, timber cut, and timber and land sold for as long as their contents may become material in the administration of any internal revenue law.

Who must file Form T

- Complete and attach Form T to your income tax return only if you:
 - Claim a deduction for depletion of timber
 - Elect section 631(a) treatment, or
 - Make an outright sale of timber under section 631(b)
- Exceptions.
 - You are not required to file Form T if you only have an occasional sale of timber (one or two sales every 3 or 4 years)
 - However, you must maintain adequate records of these transactions and other timber-related activities

References

- Instructions for Form T
- Publication 225 Farmer's Tax Guide
- Hardwood Timber Industry Audit Technique Guide (HATG)
- Timber Casualty Loss Audit Techniques Guide
- www.timbertax.org
- The Forest Landowners Guide to the Federal Income Tax - Ag. Handbook No. 731 (2013)

Conclusion

- Questions or comments?