

Financial Aspects of Owning Timberland



Larry Camp

CA. RPF No. 1698 Feb. 8, 2020



My joy & passion
even though it is not
very fireproof



After mastication and
pre-commercial
thinning

DISCLAIMER

Today's discussion is educational, NOT legal or accounting advice.

Each taxpayer's circumstances need to be considered for the appropriate application of the tax law.

Topic Outline

- Expenses & Income
- TPZ zoning & the yield tax
- Ownership & Management goals
- Record Keeping
- Federal/ State income tax issues
- Audit issue management
- References

Forestland Expenses

- Purchase of the property – allocation of purchase to various assets for basis.
- Property taxes – an annual expense
- Management plan costs including professional expertise.
- Control of competing vegetation for fuels reduction & tree growth.
- Reforestation including site preparation & planting.

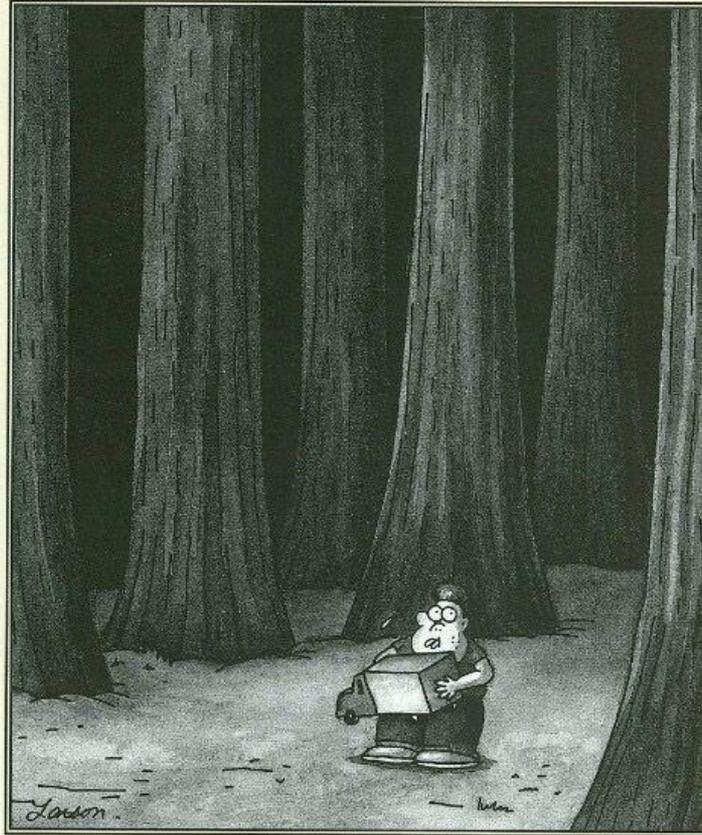
Expense con't.

- Infrastructure improvements i.e. fencing, culvert replacement, road maintenance.
- Tree pruning for fuel hazard reduction.
- Prescribed burning costs staffing & equipment.
- Purchase and maintenance of equipment.

Forestland Income

- Cost share payments (CFIP & EQIP) & more
- Forest products i.e. fire wood, Christmas trees, floral greenery, cone collection, mushrooms, honey, grazing, hunting leases.
- Grazing and/or hunting leases.
- Telecommunications site leases.
- Glamping sites.
- Timber harvesting.

11/13/85



Eventually, Stevie looked up: His mother was nowhere in sight, and this was certainly no longer the toy department.

Courtesy of
The Far Side by
Gary Larson

Eventually, Stevie looked up: His mother was nowhere in sight and this certainly no longer the toy department.

Timber Yield tax

- Timber Production or Timber Preserve Zone legislation (TPZ) was created in 1976.
- Created a dual taxation system
 - Land tax based on regional forest types and site productivity not FMV. Currently, \$ 190/ac for Site II Redwood & \$ 93/ac for Mixed Conifer

Timber Yield tax

- Property tax is 1% of Land value times property tax rate i.e. \$ 19 x local tax rate.
- Consider the automatic 10 year rolling renewal if want to convert land use, and permitted uses for TPZ zoned parcels.
- Cost of a management plan to meet Co. & state requirements.

Tip -- Check current zoning & consider requesting rezoning if it makes economic sense.

Timber Yield tax

- Yield tax
 - Payable at time of Harvest for all types of harvest including exemptions.
 - California Department of Tax and Fee Administration (CDTFA) administers the tax.
 - Tax rate is 2.9 % of value from Harvest Schedules. Link in the reference material.
 - Returns due Quarterly
 - Low Value Exemption (less than \$ 3,000) check the box. **Record retention for 4 years.**

Civics 101

- **Legislation – Congress** writes the law known as the Internal Revenue Code or IRC. (Title 26 of U.S. Codes)
- **Administration** – The IRS interprets the Code through regulations, revenue rulings, private letter rulings, and technical advice memoranda.
- **The Courts** – Cases may be brought by taxpayers in Tax Court, District Court, or the Court of Claims. Taxpayers may initiate court actions after audit or after exhausting other means of issue resolution.

IRC Code Sections that May Affect You

- IRC § 631(a) & 631(b) - Gains or Losses from sale of Timber
- IRC § 165 - Casualty losses, thefts, condemnations
- IRC § 1033 - Involuntary Conversions
- IRC § 194 Reforestation

- IRC § 162 Deductible Expenses
- IRC § 167 Depreciation
- IRC § 179 Deduction for Capital Expenses
- IRC § 611 Depletion (cost recovery for timber)

IRC Code Sections cont.

- IRC § 126 - Cost-share payments
- IRC § 469 - Passive Loss rules
- IRC § 170(h) - Conservation Easements
- IRC § 2001 etc. - Estate Taxation and Legacy Planning

Ownership Purposes

Why do you own the property?

- Primarily for personal use?
- Own & manage primarily for *investment* purposes?
- In the *trade or business* of managing, buying and selling timber?

Ownership Purposes (cont.)

Your ownership purpose is important as it can affect the amount and type of tax you pay as well as the deductions you can take.

Ownership Structure

- Tenants in Common
 - Limited Liability Co. / Partnership
 - Schedule C – sole proprietorship
 - Subchapter S corporation
 - C Corporation
 - Estate and Legacy planning issues
- **Work with legal advisor/
accountant to determine best
type of structure for you!**

Concept of Basis

What does the term basis mean for tax purposes?

Basis is the accounting term for what does something cost.

Basis can and should be adjusted for depreciation, depletion, tree growth, or additional capital expenditures.

Why is basis or adjusted cost important for taxation?

Basis is needed for

- ***Ordinary income gains/loss***
- ***IRC § 167 Depreciation & § 611 Depletion***
- ***IRC § 631 Capital gains/loss***
- ***IRC § 165 Casualty Losses***
- ***IRC § 1033 - Involuntary Conversion***
- ***Legacy & Estate planning (NOTE: for gifts currently there is no stepped up basis which may increase taxes for timber and land sales)***

Capital or Expense

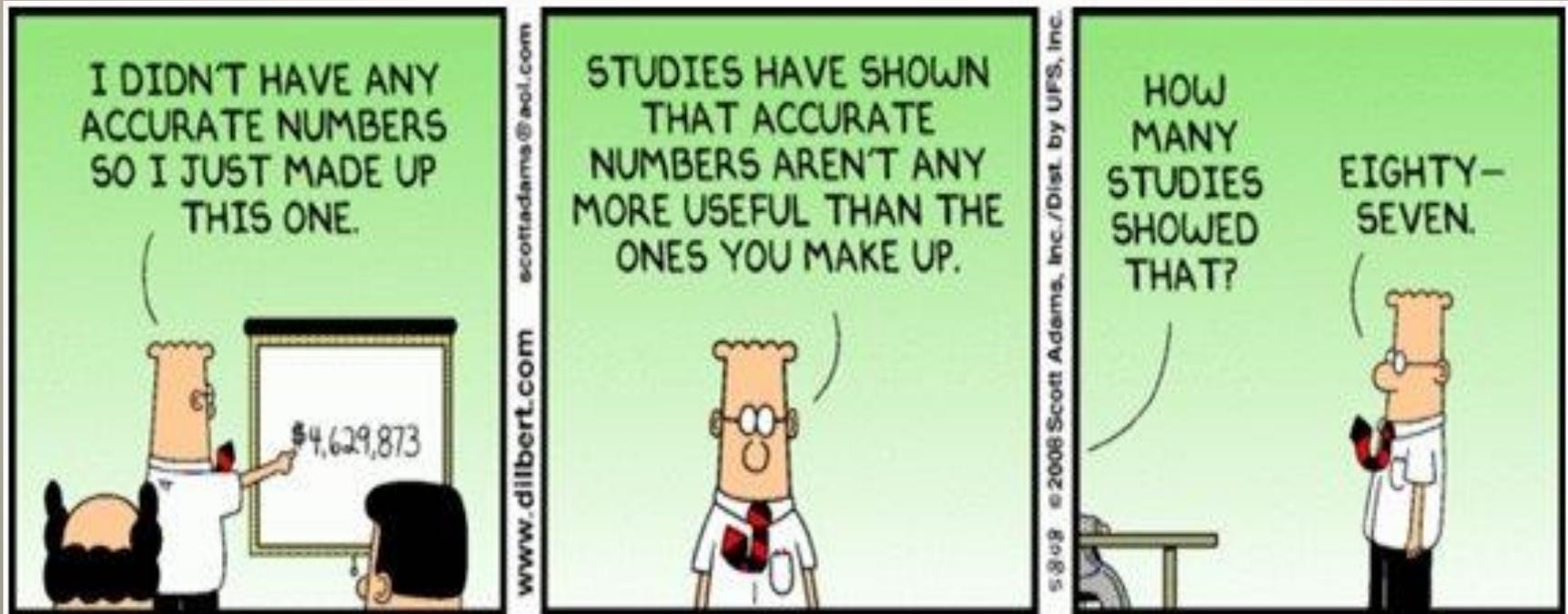
- Assets with a life generally greater than 1 year are considered Capital in nature subject to depreciation (IRC § 167), depletion IRC§ 611), or amortization.
- Ordinary trade/business expenses deductible in year incurred (IRC § 162).
- IRC § 179 business income deduction
- Safe Harbor (IRC § 162) \$ 2,500 limit.

Keeping Records

- Management information/plans including photos
- Accounting records
 - Shoebox, journal, journal with accounts
- Form T – Timber

These are important because they help you to document your ownership activities and income and expenses.

Do not use the following approach to your record keeping !



Dilbert cartoon by Scott Adams

Form T Forest Activities Schedule

Form **T (Timber)**
(Rev. December 2013)

Department of the Treasury
Internal Revenue Service

Forest Activities Schedule

▶ Attach to your tax return.

▶ Information about Form T (Timber) and its separate instructions is at www.irs.gov/timber.

For tax year ending _____, 20_____

OMB No. 1545-0007

Attachment
Sequence No. **117**

Name(s) as shown on return

Identifying number

Part I Acquisitions

1 Name of block and title of account				
2 Location of property (by legal subdivisions or map surveys)				
3a Name and address of seller or person from whom property was acquired				b Date acquired
4 Amount paid: a In cash				
b In interest-bearing notes				
c In non-interest-bearing notes				
5a Amount of other consideration				
b Explain the nature of other consideration and how you determined the amount shown on line 5a.				
6 Legal expenses				
7 Cruising, surveying, and other acquisition expenses				
8 Total cost or other basis of property. Add lines 4a through 7				
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			
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.				
e Premerchantable timber. Make an allocation here only if it is a factor in the total cost or value of the land.				
f Improvements (list separately)				
g Mineral rights				
h Total cost or other basis (same amount as line 8). Add lines 9a through 9g				

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 16717G

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



Lowell Fire 2015
Photo The Union 7-28-15 Laura
Mahaffy

Tree Mortality from Insects

photo Sac. Bee 5/3/16 E. Ortiz



IRC § 165 Casualty Losses – Do you have one?

- Prior to the tax bill approved in late 2017
Regulation §1.165-7. (a) In general. -
(1) **Allowance of deduction.** . . any loss arising from **fire, storm, . . .**
- For tax years 2018 through 2025, if you are an individual, casualty losses of personal-use property are **deductible only if** the loss is attributable to a **federally declared disaster** (federal casualty loss).

Casualty Loss con't.

- Losses on business property and in-come-producing property aren't subject to these rules.
- **The manner of determining the amount of a casualty loss . . . is the same whether the loss has been incurred in a trade or business or in any transaction entered into for profit.**

The Potential Bad News

- The 2017 tax bill limits casualty losses for personal property.
- Casualty losses are limited to the **lower** of ***the adjusted basis of the property*** or the ***decrease in fair market value*** caused by the casualty.
- Concept of Single Identifiable Property (SIP)

The Really Bad News !!

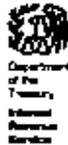
- There is a long history of Revenue Rulings and Court litigation that holds that losses due to insects in traditional timber stands

*are NOT repeat are
NOT* casualty losses.

- However loss of timber due to insect attacks may be a business loss if in a trade or business.

Casualty Losses cont.

- Death of trees and seedlings from drought generally not qualified as a casualty loss.
- Rev. Rules 81-2 & 90-61.



Publication 547
Oct. No. 12080K

Casualties, Disasters, and Thefts

For use in preparing
2018 Returns

Contents

What's New	1
Revisions	2
Introduction	2
Casualty	2
Theft	2
Loss on Depreciable	2
Proof of Loss	2
Figuring a Loss	4
Deduction Limits	13
Figuring a Gain	13
When To Report Gains and Losses	13
Disaster Area Losses	13
How to Report Gains and Losses	18
How to Get Tax Help	18
Index	21

What's New

Limitations on personal casualty and theft losses. Personal casualty and theft losses of an individual, sustained in a tax year beginning after 2017, are deductions only, to the extent they're attributable to a federally declared disaster. The new deduction is subject to the \$100 limit per casualty and 10% of your adjusted gross income (AGI) limitation.

An exception to the rule above, limiting the personal casualty and theft loss deduction to losses attributable to a federally declared disaster, applies if you have personal casualty gains for the tax year. In this case, you will reduce your personal casualty gains by any casualty losses not attributable to a federally declared disaster. Any excess gain is used to reduce losses from a federally declared disaster. The 10% AGI limitation is applied to any remaining losses attributable to a federally declared disaster. For more information, see **Disaster Area Losses**, later.

AMT adjustment for standard deduction. AMT adjustments are retroactively applicable to and specified standard losses. The AMT adjustment for the standard deduction doesn't apply to the increase in the standard deduction that is attributable to a real disaster loss. See taxpayers who also file the 2018 Form 6251, Alternative Minimum Tax for Individuals in the instructions for Form 4084, *Casualties and Thefts*, for more information.

No miscellaneous itemized deductions allowed. You can no longer claim any miscellaneous itemized deductions. Miscellaneous itemized deductions are those deductions that would have been subject to the 2% of AGI



Get facts and other information faster and easier at:

- [IRS.gov](#)
- [1-800-829-1040](#)
- [1-800-829-4829](#)
- [1-800-829-5830](#)
- [1-800-829-7797](#)
- [1-800-829-3366](#)
- [1-800-829-7870](#)

Casualties and Thefts



Information about Form 4684 and its separate instructions is at www.irs.gov/form4684. Attach to your tax return. Use a separate Form 4684 for each casualty or theft.

SECTION A—Personal Use Property (Use this section to report casualties and thefts of property not used in a trade or business or for income-producing purposes.)

1 Description of properties (show type, location, and date acquired for each property). Use a separate line for each property lost or damaged from the same casualty or theft.

Property A
Property B
Property C
Property D

2 Cost or other basis of each property

3 Insurance or other reimbursement (whether or not you filed a claim) (see instructions)

4 Gain from casualty or theft. If line 3 is more than line 2, enter the difference here and skip lines 5 through 9 for that column. See instructions if line 3 includes insurance or other reimbursement you did not claim, or you received payment for your loss in a later tax year.

5 Fair market value before casualty or theft

6 Fair market value after casualty or theft

7 Subtract line 6 from line 5

8 Enter the smaller of line 2 or line 7

9 Subtract line 3 from line 8. If zero or less, enter -0-

10 Casualty or theft loss. Add the amounts on line 9 in columns A through D

11 Enter the smaller of line 10 or \$100

12 Subtract line 11 from line 10

13 Add the amounts on line 12 of all Forms 4684

14 Add the amounts on line 4 of all Forms 4684

15 If line 14 is more than line 13, enter the difference here and on Schedule D. Do not complete the rest of this section (see instructions).

16 If line 14 is less than line 13, enter -0- here and go to line 16.

17 Enter 10% of your adjusted gross income from Form 1040, line 36, or Form 1040NR, line 37. Estates and trusts, see instructions

18 Subtract line 17 from line 16. If zero or less, enter -0-. Also enter the result on Schedule A (Form 1040), line 20, or Form 1040NR, Schedule A, line 6. Estates and trusts, enter the result on the "Other deductions" line of your tax return.

Table with columns A, B, C, D and rows 2-18 for reporting casualties and thefts.

SECTION B—Business and Income-Producing Property

Part I Casualty or Theft Gain or Loss (Use a separate Part I for each casualty or theft.)

19 Description of properties (show type, location, and date acquired for each property). Use a separate line for each property lost or damaged from the same casualty or theft. See instructions if claiming a loss due to a Ponzi-type investment scheme and Section C is not completed.

Property A
Property B
Property C
Property D

Table with columns A, B, C, D and rows 20-27 for reporting business and income-producing property.

20 Cost or adjusted basis of each property

21 Insurance or other reimbursement (whether or not you filed a claim). See the instructions for line 3

22 Gain from casualty or theft. If line 21 is more than line 20, enter the difference here and on line 29 or line 34, column (c), except as provided in the instructions for line 35. Also, skip lines 23 through 27 for that column. See the instructions for line 4 if line 21 includes insurance or other reimbursement you did not claim, or you received payment for your loss in a later tax year.

23 Fair market value before casualty or theft

24 Fair market value after casualty or theft

25 Subtract line 24 from line 23

26 Enter the smaller of line 20 or line 25

27 Subtract line 21 from line 26. If zero or less, enter -0-

28 Casualty or theft loss. Add the amounts on line 27. Enter the total here and on line 29 or line 34 (see instructions)

29 Subtract line 21 from line 26. If zero or less, enter -0-

Part II Summary of Gains and Losses (from separate Parts I)

(a) Identify casualty or theft (b) Losses from casualties or thefts (c) Gains from casualties or thefts

30 Totals: Add the amounts on line 29

31 Combine line 30, columns (b)(i) and (c). Enter the net gain or (loss) here and on Form 4797, line 14. If Form 4797 is not otherwise required, see instructions

32 Enter the amount from line 30, column (b)(ii) here. Individuals, enter the amount from income-producing property on Schedule A (Form 1040), line 28, or Form 1040NR, Schedule A, line 14, and enter the amount from property used as an employee on Schedule A (Form 1040), line 23, or Form 1040NR, Schedule A, line 9. Estates and trusts, partnerships, and S corporations, see instructions

Casualty or Theft of Property Held More Than One Year

33 Casualty or theft gains from Form 4797, line 32

34 Total losses. Add amounts on line 34, columns (b)(i) and (b)(ii)

35 Total gains. Add lines 33 and 34, column (c)

36 Add amounts on line 35, columns (b)(i) and (b)(ii)

37 If the loss on line 37 is more than the gain on line 36:

a Combine line 35, column (b)(i) and line 36, and enter the net gain or (loss) here. Partnerships (except electing large partnerships) and S corporations, see the note below. All others, enter this amount on Form 4797, line 14. If Form 4797 is not otherwise required, see instructions.

b Enter the amount from line 35, column (b)(ii) here. Individuals, enter the amount from income-producing property on Schedule A (Form 1040), line 28, or Form 1040NR, Schedule A, line 14, and enter the amount from property used as an employee on Schedule A (Form 1040), line 23, or Form 1040NR, Schedule A, line 9. Estates and trusts, enter on the "Other deductions" line of your tax return. Partnerships (except electing large partnerships) and S corporations, see the note below. Electing large partnerships, enter on Form 1065-B, Part II, line 11

38 If the loss on line 37 is less than or equal to the gain on line 36, combine lines 30 and 37 and enter here. Partnerships (except electing large partnerships), see the note below. All others, enter this amount on Form 4797, line 3

Note: Partnerships, enter the amount from line 38a, 38b, or line 39 on Form 1065, Schedule K, line 11. S corporations, enter the amount from line 38a or 38b on Form 1120S, Schedule K, line 10.

IRC § 1033 Involuntary Conversion

- **Purpose:** to permit a taxpayer to avoid paying gain on property that is disposed of involuntarily.
- An involuntary conversion occurs when property is destroyed, stolen, or condemned for public use. Destruction is often synonymous with a casualty such as a fire or wind storm but it need not be sudden.

Involuntary Conversion cont.

- Allows for reinvestment of income generally within a 2 year time period.
- Replacement property must be similar in nature
 - Reforestation on timberland owned by the taxpayer
 - Buying additional land for replanting
 - Acquisition of standing timber
 - Acquisition of timberlands

IRC § 194 - Reforestation

- IRC § 194(3) defines reforestation costs to include site preparation costs, seedling costs and labor and tool expense.
- Treas. Reg. 1.611-3(a) and Revenue Ruling 75-467 requires reforestation costs are to be capitalized.
- However, beginning in the fall 2004, IRC § 194(b) generally permits a deduction of up to \$ 10,000 for reforestation expenses per Qualified Timber Property (QTP).

Reforestation cont.

- Additional reforestation expenditures generally amortizable over 7 years (84 months) under IRC § 194(a)
- **What is a QTP?** Property \geq 1 acre used for growing production of timber products under IRC § 194(c)(1) & Treas. Reg. § 1.194-3(a).
- Does not include ornamental trees including Christmas trees.
- **Must make a timely election.**

Reforestation cont.

- Cost share payments are not includable for purposes of IRC § 194 unless included in gross income. IRC § 194(c)(3)(B)
- Must keep data to track the location and costs of each plantation.

IRC § 126 Cost Share Payments

- Treatment of Cost Share payments under programs like CFIP, EQIP, WHIP are generally includable as gross income under provisions of IRC § 126 and Treas. Reg. § 16A.126-1.
- A portion of the income can be excluded under the provisions of Treas. Reg. § 16A.126-1 and 2.

- CFIP payments can be excluded for CA. income tax under R&T Code § 17135.5 in 1994.

IRC § 469 - Passive Loss Rules

- Designed to prevent high income earners from using passive investments to reduce income.
- Passive activity = A trade or business in which TP does not materially participate.
- Passive Income & Passive Deductions
- Material Participation 7 tests (Reg 1.469-5T)
- **1000 Friends of Oregon v. McPherson**
89-1 USTC 9217, 63 AFTR2d 89-563 (D. Oreg. 1988)
- 500 hrs.; 100 hrs.; 5 out of 10 yr. test; facts & circumstances.

IRC §170 Conservation Easements

- IRC §170(f)(3)(B)(iii) provides an exception to this rule for a **qualified conservation contribution**.
- IRC §170(f) 170(h)(1) defines the term "**qualified conservation contribution**" as a contribution of a **qualified real property** interest to a **qualified organization** exclusively for **conservation purposes**.

- **Restriction granted in perpetuity on the use of real property.**
- **A qualified organization must have a commitment to protect the conservation purposes of the donation, and have the resources to enforce the restrictions.**
Reg1.170A-14(c)(1).

(A) In general -- the term "conservation purpose" means -

(i) the preservation of land areas for outdoor recreation by, or the education of, the general public,

(ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem.

(iii) the preservation of open space (including farmland and forest land) where such preservation is-

(I) for the **scenic enjoyment of the general public**, or

(II) pursuant to a **clearly delineated Federal, State, or local governmental conservation policy**,

and will yield a significant public benefit, or

(iv) the preservation of an **historically important land area** or a certified historic structure.

Caveats:

Do not retain surface mineral rights or may not qualify for donation

No quid pro quo -- i.e. easement in exchange for land use permit

Valuation:

1. The fair market value (fmv) of the donated easement is based on the sales prices of such comparable easements.
2. If no substantial record of market-place sales is available to use . . .the (fmv) of a perpetual conservation restriction is equal to the difference between the fmv of the property it encumbers **before** the granting of the restriction and the fmv of the encumbered property **after** the granting of the restriction.

- The amount of the deduction . . . of a charitable contribution of an easement covering a portion of the contiguous property owned by a donor . . . is the difference between the fair market value of the **entire contiguous parcel** of property **before and after** the granting of the restriction.

Reg 1.170A-14(h)(3) (i)

Appraisal. The due date, items to be included and definition of Qualified appraiser are included in Regulation 1.170A-13(c).

- **Baseline Documentation Report.** The Baseline Documentation Report, needs to be completed no later than the donation date.

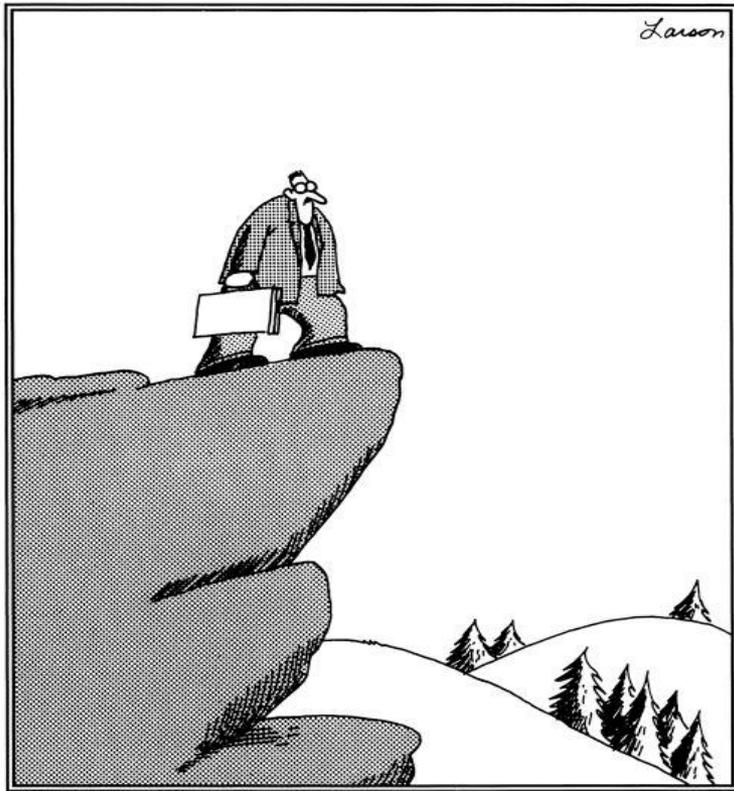
Federal Form 8283, “Noncash Charitable Contributions,” must be filed along with the return. When you donate a conservation easement.

CWA -- “contemporaneous written acknowledgement” or “gift letter” from the organization that received the easement. See <http://www.stevesmall.com/press/> for more info.

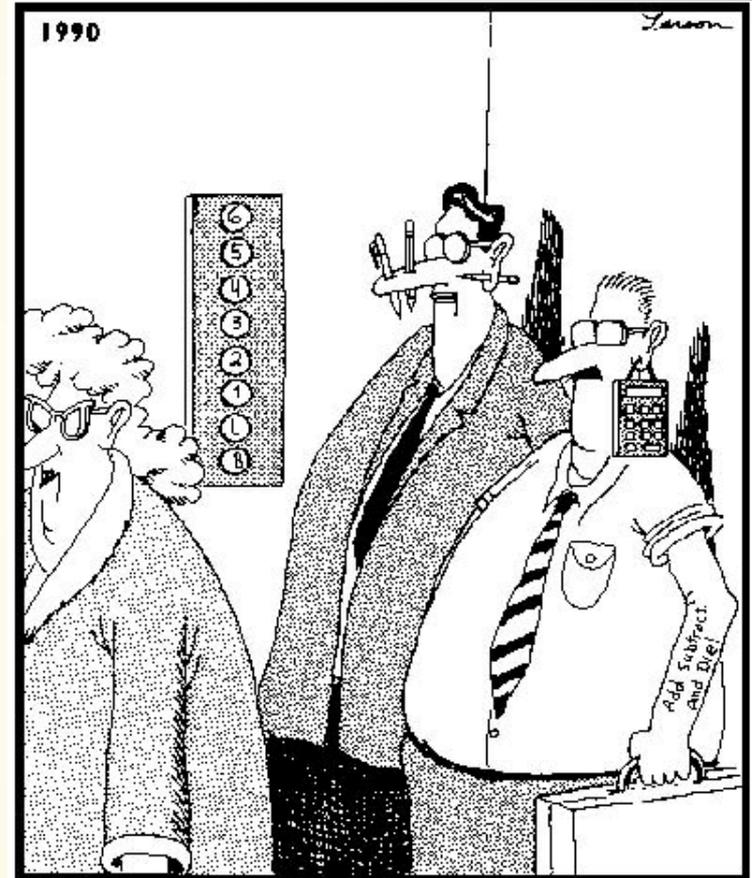
Other Things to Remember

- If you have a timber sale, you are allowed to deduct the direct timber sale expenses from the proceeds before calculating gains or losses.
- The tax laws and regulations change – remember to stay current.

Audit Advice



Seymour Frishberg:
Accountant of the Wild Frontier



Punk accountants

Courtesy of The Far Side by Gary Larson

- Keep good records and receipts to document your expenses and income.
- IRS has significant enforcement tools and an agent can do things the easy way or the hard way – the latter is usually going to cost you both time and money.

- Document all calls, meetings etc. and send a copy to the agent to verify your documentation.
- If you cannot reach agreement with an agent ask that an IRS forester be assigned to assist in resolving the issue(s).

- Be well prepared for meetings with applicable regs., rulings, and court cases.
- Consider going to Appeals if you have a supportable position.
- Remember IRS employees are people too!

References for TPZ & Timber Yield Tax

- Guide to the Calif. Timber Yield Tax pub. 87
<https://www.cdtfa.ca.gov/formspubs/pub87.pdf>
- TPZ land values
<https://www.cdtfa.ca.gov/taxes-and-fees/2020-Timberland-Production-Zone-Values-signed.pdf>
- Harvest Value Schedules
- <https://www.cdtfa.ca.gov/formspubs/cdtfa401hsvi.pdf>

References & Resources

- www.irs.gov
- www.timbertax.org a good non-government site sponsored by USFS, Univ. Georgia, American Tree Farm System
- www.fs.fed.us/spf/coop USDA Forest Service tax publications
- Cooperative Extension Services

The screenshot shows a web browser window with the URL <http://apps.irs.gov/app/picklist/list/formsPublic>. The page title is "Forms and Publications (PDF)".

Instructions:

1. Enter a term in the Find Box.
2. Select a category (column heading) in the drop down.
3. Click Find.

Tips:

- Click on the product number in each row to view/download.
- Click on column heading to sort the list.
- You may be able to [enter information](#) on forms before saving or printing.

More Information:

- [Downloading and printing](#)
- [File formats](#)
- [View and/or save documents](#)

Find in [Find Help](#)

Results: 1 - 1 of 1 files Show per page: [25](#) [50](#) [100](#) [200](#) « Previous | 1 | Next »

Product Number	Title	Revision Date	Posted Date
Inst 4684	Instructions for Form 4684, Casualties and Thefts	2012	10/05/2012

« Previous | 1 | Next »

[Get Adobe Reader](#)

Example of a search at www.irs.gov for forms, publications, and other documents.

Agricultural
Handbook 731
Forest Landowners'
Guide to the
Federal
Income Tax
(February 2013)
Available from
www.timbertax.org

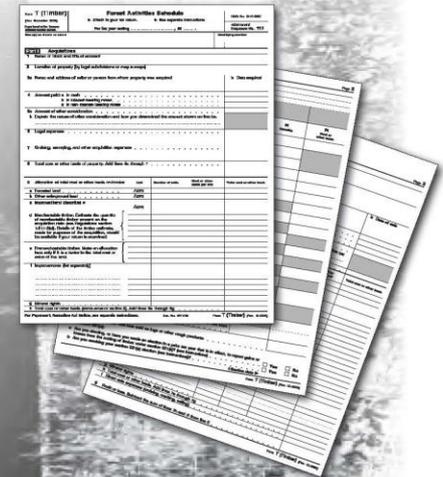


**Forest Landowners'
Guide to the Federal
Income Tax**

United States
Department of
Agriculture
Forest Service

Agriculture
Handbook
No. 731

February 2013





Courtesy of
The Far Side
by Gary Larson

The woods were dark and foreboding, and Alice sensed that sinister eyes were watching her every step. Worst of all, she knew that Nature abhorred a vacuum.

Thank you for your
time this morning.

Questions ?

Contact: LDCCAC@SBCGLOBAL.NET
510 305-5112