Shane Knowlton Dec 19, 2022

ESTABLISHING A TIMBER TAX BASIS

In its simplest form, timberland value is comprised of two components (capital assets): bare land and standing timber. The amount invested in each component is called the “tax basis.”

The timber portion of the “tax basis” should be established as soon as possible after purchasing or inheriting property. Inherited property is assigned a “stepped-up” basis to fair market value as appraised for the decedent’s estate at the time of death. By establishing the timber’s tax basis, a landowner can sell timber and only pay taxes on the increase in the timber’s value (due to growth, inflation, market increases).

Standing timber and raw land should always be accounted for separately.

Example: In 2015, Mr. Smith purchased 100 acres of rural investment property at a fair market value of $375,000. The tract contained a 50-acre stand of 25-year-old loblolly pine. At the time of purchase, his consulting forester appraised the timber at $125,000 (timber tax basis). In 2020, Mr. Smith met with his consulting forester and decided it was time to sell (clearcut) the stand. His consultant handled the sale and received competitive bids. Mr. Smith received $175,000 in net revenues (sale price minus sale expenses).

To determine his taxable gain, Mr. Smith's accountant subtracted the timber basis from the net sale price.
$175,000 – $125,000 = $50,000 of taxable gain

Had the timber sale been a partial harvest (thinning, selective harvest), only a proportionate amount would have been depleted from the timber tax basis.

The depletion of his timber tax basis reduced his overall land and timber tax basis by $125,000. Were he to sell the property following the harvest, he'd pay capital gains tax on any sales amount over his new adjusted tax basis ($250,000 for the remaining raw land).

BACK CRUISING

What could Mr. Smith have done if he had not established a timber tax basis at the time of purchase? He could have had his consulting forester perform a back cruise. A back cruise determines present timber volumes, then regresses growth to the time of purchase. Those estimated quantities are then multiplied by historical timber prices to determine acquisition value. Tax law prohibits back cruising once the trees are cut, meaning you can't legally back up your harvest volumes.

GIFTED PROPERTY

A person who receives property as a gift also receives the giver's tax basis values. Before gifting or accepting property, you should always consider the tax ramifications. Often gifted property was acquired by the giver decades ago, meaning the timber tax basis is practically zero. Tracts acquired long ago are almost impossible to back cruise due to the extensive growth and mortality levels over that period.

CAPITAL GAINS TAX

A capital gain is a gain (or loss) on the sale of a capital asset (in this case, land or standing timber). To qualify for long-term capital gains tax rates the capital asset, one must own that asset for more than one year. For many landowners, it is an advantage to claim timber income as a capital gain. Tax laws and rates are subject to change, so always check with your accountant or tax attorney to see if filing timber income as a capital gain will benefit you.

For more information on timber taxation, visit:

www.timbertax.org

www.irs.gov

Note: This article is not, nor is it intended to be a comprehensive tax guide. Landowners are always encouraged to consult a professional tax attorney or accountant for answers to specific questions.