

What You Need to Know About Timber Taxation and Forest Finance



By: Nathan Meiser, AgChoice Loan Officer and Forest Products Specialist

Recently, I attended two workshops conducted by Michael G. Jacobson, Associate Professor of the Penn State School of Forest Resources. The two seminars were: *Timber Taxation and Forest Finance*. The information I learned at the seminars is pertinent to: accountants, financial planners, foresters, tax preparers, loan officers and woodland owners. The key take-away points are summarized below:

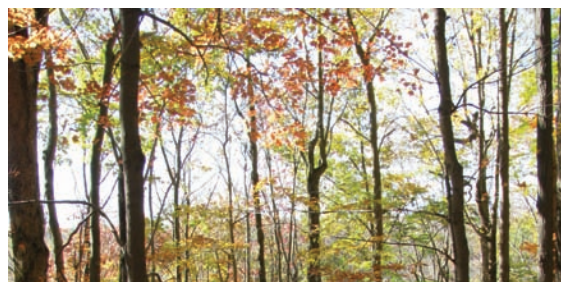
Timber Taxation and Forest Finance

- In Pennsylvania, there are approximately 500,000 private woodland owners. The average age of this group of landowners is 60+. Research has indicated that most woodland owners own their property for hunting, recreation and relaxing — not for timber production/financial investment. However, at some point woodland owners are faced with financial decisions about their property: timber sale, sale of property, estate planning, etc.

Key Point: *Woodland owners need to treat their property as an asset, think and act like an investor. By having this mindset, a woodland owner can avoid a poor timber sale experience, overpaying in taxes, not obtaining a market rate for their property or not being able to pass their property onto future generations.*

- After purchasing woodland, you want to establish your land and timber basis — what value are you going to associate to the land and timber? The following is a very simplified version of why establishing timber basis is so important:

- You purchase 50 Acres of woodland for: \$180,000
- Land Value Basis: \$130,000
- Timber Value Basis: \$50,000
- You sell timber 20 years later for: \$65,000
- You are responsible for paying capital gains taxes on \$15,000 (\$65,000-\$50,000), not the \$65,000



Let's assume a Capital Gains Rate of 15 percent to determine the amount of taxes you are responsible for: 15 percent of \$15,000 = \$2,250. Had you not established your timber basis you would have paid 15 percent of \$65,000 = \$9,750. That is a difference of \$7,500 that you do not need to pay!

Key Point: *Establish your land and timber value basis at the time of purchase. Your accountant will thank you in the future. Be sure to hire an accountant that understands expenses/revenues associated with forest management.*

You have now exhausted your timber value basis—you will have to pay capital gains tax on all future timber revenue. However, you still have \$130,000 left in the land value basis that you could utilize to minimize capital gains tax if you sold the land in the future.

Key Point: *Keep good records of your forest management activities. You do not want to find out later that a capital gains should have been treated as ordinary income and back taxes are due. If you need professional advice, seek out an accountant that understands the tax implications of forest management.*

- Converting standing timber into products for sale is ordinary income...not a capital gain. An example would be a landowner that harvests trees and processes those trees into firewood. The income received from the sale of firewood is ordinary income, not a capital gain.

• Landowners that invest into reforestation can deduct outright the first \$10,000 per year of qualifying expenses and amortize any additional amount over eight years. Individual taxpayers, estates, partnerships and corporations can qualify for this deduction. There are certain qualifications that you must meet to obtain this deduction:

- One acre or more of woodland, located in the United States
- Woodland being treated is going to be held to produce commercial timber, and includes practices to promote natural regeneration.

An example of reforestation that would qualify for a deduction would be a woodlot that is treated with herbicides and then fenced following a shelterwood harvest. The herbicide application and fencing would qualify for the reforestation deduction.

Key Point: *Don't spend \$3 to save \$1 in taxes. Base your forest management on sound silvicultural and financial decisions.*

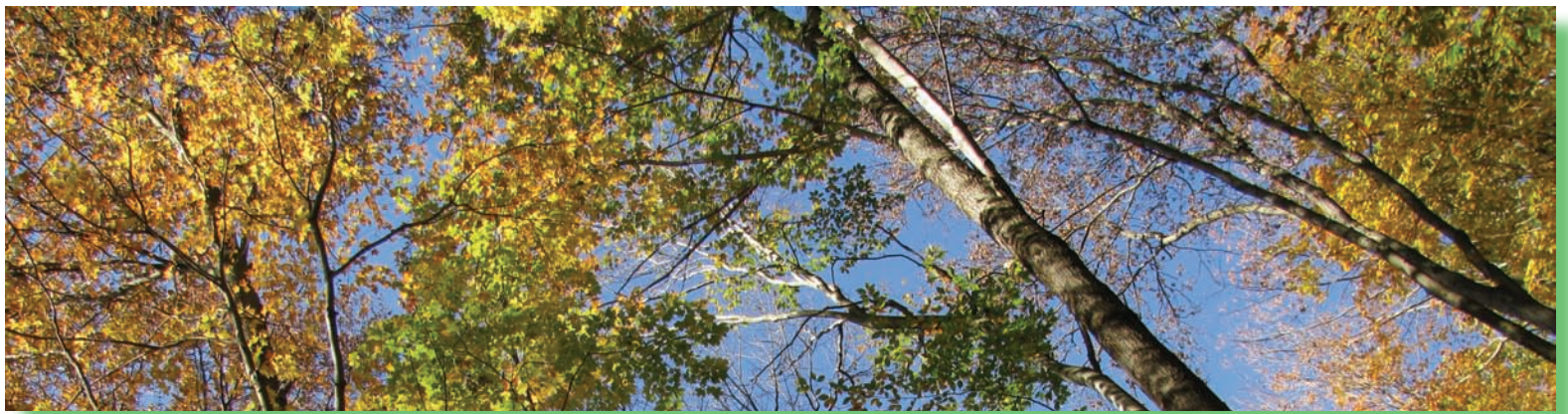
Key Point:
Take the time to establish a plan for your woodland; because if you don't have a plan, the government does.

- One of the most critical decisions that landowners make regarding their woodland is from an estate planning standpoint. What is the plan for your woodland? Are you going to sell the property to fund your retirement, are you planning on passing the property onto children, or is the woodland critical to continue a business enterprise? There are many decisions that need to be made and they can't wait till the end. If you hope to pass your property onto your children, but do not do any planning or communication, this is very difficult to do. Without the proper planning, your children may need to subdivide the property or sell the property in its entirety to pay the inheritance tax.

- The Pennsylvania forest products industry plays a critical role in the overall economy of Pennsylvania. Approximately 90,000 workers across 2,500 firms in Pennsylvania find employment in the forest products industry. In 25 of the 67 counties in Pennsylvania, the forest products industry is financially larger than traditional agriculture.

Key Point: *The Pennsylvania forest products industry is a major driving force of the overall economy of Pennsylvania -- despite being unknown by many citizens of Pennsylvania.*





- When analyzing forests from a financial investment standpoint, there are many factors to consider regarding the property and the timber. Some property questions to consider are: costs, interest rates, location, access, past management practices, timber markets and stand age. When analyzing the timber, you need to inspect: species (oak, cherry, poplar, maple, hemlock, pine, etc.), size (diameter and height), quality and volumes. All these questions need to be answered before you can make an informed decision about investing in forest land.

Key Point: *In Pennsylvania, most forest land takes 80 - 100 years to reach a marketable product; therefore, you must understand that forest management in Pennsylvania is a long-term commitment. Many management decisions that you make regarding your woodland are to ensure a sustainable forest 20, 50, 100 years from now.*

I would like to thank Michael G. Jacobson, Associate Professor of the Penn State School of Forest Resources, for conducting two fantastic workshops. I left both workshops having a better understanding and knowledge of Timber Taxation and Forest Finance. If you would be interested in attending future workshops done by Mike, please feel free to contact him (814) 865-3994 or mgi2@psu.edu.

Forest Products Credit by AgChoice FC offers a wide variety of loans, lines of credit and leases crafted specifically for the forest products industry. Contact the Forest Products Credit Team at (800) 327-6878 or coudersportinfo@agchoice.com today to discuss what we can do for you.



Useful Web sites for Timber Taxation and Forest Finance:

www.agchoice.com/forest-products - The home of Forest Products Credit by AgChoice FC. Read newsletters and reports written specifically about forestry and the forest products industry. Continually updated with new and pertinent information.

www.timbertax.org - A great resource for anyone looking for timber taxation information, terms and answers to questions. This would be a good Web site to bookmark. When you need timber taxation information, you're only a click away.

<http://rnnext.cas.psu.edu> - The Penn State Natural Resources Extension Web site. A great site to discover information regarding: timber taxation, forest finance, wildlife management, woodland stewardship, youth education and water resources management. A vast amount of information is available to the general public.

<http://pubs.cas.psu.edu/FreePubs/pdfs/uh131.pdf> - Timber Taxation - A General Guide for Forestland Owners. This free download gives landowners the basic knowledge regarding timber taxation and how it affects them.

<http://pubs.cas.psu.edu/freepubs/pdfs/uh150.pdf> - Keeping Records of Forest Management Activities. This is a useful tool that landowners can utilize to keep track of forest management expenses and activities over the years. It is very easy to lose track of activities if you're not documenting on a regular basis.

<http://rnnext.cas.psu.edu/PDFs/uh188.pdf> - To Cut or Not to Cut: Tree Value and Deciding When to Harvest Timber. An excellent report to help landowners determine the best time to sell timber — what makes the most financial sense.

<http://www.sfr.cas.psu.edu/TMR/TMR.htm> - The Pennsylvania Woodlands: Timber Market Report. This site is maintained by the Penn State Forestry School and is a fantastic resource for obtaining current and historical timber stumpage prices.