



Timber Basis

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Timber Basis

- Basis (*not base*) is the book value of your investment in timber for tax purposes
- Not everyone has a timber basis

Why do we care about basis?

- Timber sale income is taxed on net proceeds
- Gross proceeds
- Less sales expense
- Less basis in timber

Why do we care about basis?

- In case of a casualty or other loss, the amount of deductible loss is the loss in fair market value (FMV)
- Or basis
- Whichever is less.

No Basis . . .

No Deductible Loss

Basis Changes over Time

- Initial basis determined by how you acquire the property
- Additional investments, not recovered through deductions, increase basis
- Loss or use decreases basis. If you didn't use the basis when you cut timber, that basis is lost

Situations unlikely to have a basis

- If the timber was naturally regenerated while you owned it and all management costs were deducted
- Timber artificially regenerated during your ownership, but all costs were recovered (deducted) as allowed by law

Initial Basis is determined when. . .



- Inherited
- Received as Gift
- Purchased
- Regenerated

Inherited

- The value of an asset receives a “stepped up” basis
- Determined by an appraisal when it is inherited
- Basis is stepped up to fair market value
- Subject to estate tax

Gifted

- Gifted property has a “carry over” basis
- The donor’s basis becomes the recipient’s basis
- Unless the asset has depreciated under the giver’s ownership
- Some gift tax modifications

Purchased

- The total acquisition cost is the basis of the property—purchase price plus all other costs involved in acquiring the property
- Must divide between the various assets that make up the total asset, i.e. land and timber, based on the proportion each contributes to fair market value

Comprehensive Basis Example



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Mr. Rufus Alder

Comprehensive Basis Example

- Rufus Alder purchased 300 acres of crop land in 1962 for \$99 per acre.
- The associated legal and recording costs were \$1 per acre.
- Total acquisition cost: \$30,000.

What is Rufus Alder's timber basis in 1962?

- A. \$30,000
- B. \$36,600
- C. \$0
- D. \$20,000



And the answer is . . .

- C. \$0
- Rufus bought crop land with no timber present. All acquisition costs would be allocated into the land basis.

Mother Nature Reforests

- Rufus allows the land to naturally regenerate.
- In 2006, there are 8 MBF per acre with an estimated value of \$2,400 per acre.

What is his timber basis per acre on the naturally regenerated acres?

- A. \$2,400 per acre or \$72,000
- B. \$0
- C. \$100 per acre or \$30,000

Rufus' Timber Basis

- Rufus has \$0 basis in his timber since he invested no money in the regeneration of the forest.

Rufus makes a gift

- Rufus decides to give his grandson, Tag Alder, 100 acres of the naturally regenerated forest.
- He pays no gift tax on the gift, although he reports it to the IRS.

What is Tag's timber basis?

- A. \$1,500
- B. \$10,000
- C. \$0



And the answer is . . .

- C. \$0. Since the property was a gift and no gift tax was paid, the recipient has a “carry over” basis. Rufus had zero timber basis in his naturally regenerated property and that basis carries over to Tag.

Rufus sells 100 acres

- Rufus sells 100 acres to Tulip Poplar in 2008.
- The acquisition costs Tulip \$300,000.
- Appraisal indicates the land contributes $\frac{1}{3}$ and timber contributes $\frac{2}{3}$ to the value of the property.

What is Tulip's timber basis?

- A. \$300,000
- B. \$200,000
- C. \$0
- D. \$1,500



And the answer is . . .

- B. \$200,000
- Since the land contributes $\frac{1}{3}$ of the value and timber contributes $\frac{2}{3}$, the basis is split in similar proportion.

Rufus goes to the great forest in the sky

- By will, Rufus leaves his last 100 acres to daughter, Wendy Alder.
- FMV of land is \$10,000
- FMV of timber is \$300,000.

What is Wendy's timber basis?

- A. \$300,000
- B. \$310,000
- C. \$0
- D. \$155,000

And the answer is . . .

- A. \$300,000 because the value is “stepped up” to fair market value for an inheritance.

Timber Sale

- In 2009, each of the three sell their timber for \$310,000
- A consulting forester was paid 10% to estimate volumes, market the sale, supervise sale and subsequent reforestation.
- What is their tax?

Comparison of Tax on Timber Sale

	Gifted Forest	Purchased Forest	Inherited Forest
Sales Proceeds	\$310,000	\$310,000	\$310,000
Consulting fee	\$31,000	\$31,000	\$31,000
Timber Basis	\$0	\$200,000	\$300,000
Gain or Loss	\$279,000	\$79,000	(\$21,000)
LT Capital gains tax	\$41,850	\$11,850	Loss

Part II Timber Depletion (see instructions)

1 Name of block and title of account ▶

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 ▶

	(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		
3 Increase or decrease of quantity of timber required by way of correction		
4a Addition for growth (number of years covered ▶)		
b Transfers from premerchtable 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		
8 Unit rate returnable through depletion, or basis of sales or losses. Divide line 7, column (b), by line 7, column (a)		
9 Quantity of timber cut during tax year <i>This is for</i>		
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		
12 Allowable as basis of sale. Multiply line 8 by line 11 <i>↑ This is for standing timber</i>		
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		
b In column (b), add lines 10, 12, and 14		
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		
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 ▶	

Retroactive Timber Basis

- If there is a timber basis and the timber has not been harvested. . .
- A consultant forester may be able to set a retroactive timber basis
- Guidance for foresters found at www.irs.gov
 - Search for Timber Casualty Loss Audit Techniques Guide.

Retroactive Basis Determination

- Landowner provides initial basis of entire property—either acquisition costs or estate tax return or basis records
- Forester determines current timber volume and estimated value and value back at time of acquisition

Retroactive Basis Determination

- Determines volume and value at time of acquisition
 - Growth and yield models, professional estimates of growth rates, or increment bores to establish growth rates
 - Growth rates used to “ungrow” volumes
 - Account for removals, mortality

What is Timber Value?

- Forester determines by cruising timber
- For IRS purposes use prices from a governmental or commercial timber price report for your area—from time of acquisition
 - Timber Mart South
 - Forest2Market

Allocate Basis

- The original basis of property must be allocated among land, timber, and other assets
- Once FMV of each asset is determined for date of acquisition, then initial basis can be allocated

Timber Cruise

- Systematic sample of the timber used to generate statistically valid estimate of timber
- Foresters are the appropriate professional



Reproduction Values

- Determined by establishment cost of new plantation for year when loss occurs
- Compounding costs using Farm Credit Bank District Rate for each year equal to age of plantation



Potential Problems with Retroactive Basis Determination

- Basis must be depleted as it is used
- Use it or lose it!
- Have a timber sale—and no basis used to offset proceeds—then that basis is forfeited



Retroactive Basis Determination

- Previous volumes can be determined by a stump cruise shortly after harvest
- Time limitations on stump cruises—how long will the stumps last?



Problem

- Many land appraisals do not consider the value of timber
- Purchase appraisals may lump unimproved land and timber
- Suggest proportion out land and timber

Do We Want to Keep a High Basis?

- Some people choose to accumulate expenses in the basis account rather than deduct them
- This is a BAD idea!

What does it save in taxes?

Deduction's value is deduction times the marginal tax rate—highest tax rate an individual pays

Capital gain is taxed at the lowest possible tax rate—the value of basis recovery is the depletion allowance (basis used) times the capital gains rate

Tax reduction value

- Reduction in taxes =
 Deduction x marginal tax rate
 A \$100 deduction is worth \$25

Tax Rate	Single	Married –Joint
10%	Not over \$ 8,500	Not over \$17,000
15%	\$ 8,501 – 34,500	\$ 17,001 – 69,000
25%	\$ 34,501 – 83,600	\$ 69,001 – 139,350
28%	\$ 83,601 – 174,400	\$139,351 – 221,300
33%	\$174,401 – 379,150	\$221,301 – 379,150
35%	Over \$379,150	Over \$379,150

Money today . . .

- Always better than money tomorrow
- Money has time value—especially important during periods of high inflation