

Your Forester Should Help With Your Taxes

Many Tree Farmers work with a professional forester. If you are one of them, do you use your forester to help with your taxes? In some cases you won't be able to do your taxes correctly without their help. Let's review some of the ways they should help. In most cases this discussion is restricted to private consultants you pay for services. The foresters employed by your state forestry agency may not be able to provide for free the complete range of services discussed.

Recall that you recover your investment in timber purchased with land by allocating your acquisition cost between the land and timber. If you inherited the timberland you allocate the fair market value of the timberland between these two assets. This allocation is based on the separate fair market values of the land and merchantable timber. In most cases the IRS will expect you to use an experienced professional forester to provide these estimates. This is more critical if you do the allocation some years after your purchased or inherited the timberland. In such cases the forester needs to estimate the current volume of timber and then "grow it backwards" to estimate the quantity and quality of timber present on your date of acquisition. They use standard forest mensuration techniques for this. Then, they use their records of previous timber sales or other sources to find market values for your timber on the date of acquisition.

Some foresters specialize in basis allocations. You tell them what your total cost to acquire the property was and they'll do the calculations. If you inherited the property and have no record of its fair market value on the decedent's estate tax return, or there was no estate tax return filed, the forester can do an appraisal, on a historical basis if need be, and then do the allocation.

In some cases you'll want to get your accountant and forester talking to each other. They need to agree on what data is needed and your accountant must be able to defend how the data is used.

Help In Determining Basis

If you sell timber using a forester hopefully he or she asks you if you have a basis established for your timber. If you don't they should discuss the pros and cons of doing so. If you already have a basis, or you have established with their help, they can help determine the allowable basis for timber sold on the stump or depletion allowance for timber you cut or have cut for you. Unless you sell all your merchantable timber at one time your forester needs to tell you both the volume to be sold on the stump or cut, and the total volume of merchantable timber on your land. You need the total volume to calculate your depletion unit, dollars of basis per unit volume. This depletion unit is then

multiplied by the volume sold on the stump to get your allowable basis, or by the volume cut to get your depletion allowance.

Cut Timber for Capital Gain

Prior to signing a timber sale contract your forester should discuss how you'd qualify for capital gains treatment. If you're holding the timber primarily for sale to customers in the ordinary course of a business your forester will need to arrange a pay-as-cut contract that guarantees you get paid for all the timber harvested.

My opinion is that you should not be selling timber using a consultant who doesn't understand the capital gains rules. If you are, get this information elsewhere or find another consultant. There's nothing worse than losing out on capital gains treatment because the timber was sold the wrong way and you don't find out until you do your taxes.

Your consultant should also be prepared to "scope out" your timber investment. The deduction of operating costs requires that you hold the timberland for the production of income, more specifically to produce a profit. If you don't already know approximately how much your timber is increasing in value each year, get your forester to help you estimate this. Based on your site quality, stocking, and management system, what's your average annual increment in cords, cunits, board feet or other unit volume. Then get your forester to estimate an average unit value. This will give you an approximate value increment that can be compared with your average annual expenses.

Talk In Dollars and Sense

If your audited it's a whole lot easier to convince the auditor that you have a profit motive if you can discuss your Tree Farm in dollars and sense terms. Seriously, if your consulting forester can't talk to you in these terms, get one who can. I can't stress this strongly enough. Many Tree Farmers are afraid to deduct operating expenses because they don't make a profit each year because they don't sell timber each year. But that's not the issue. The issue is whether or not over the life of your investment your total expenses are less than the total value of the timber you grow over that period and the increase in the value of the land itself. Profit is defined very broadly. You don't have to be left out in the cold because you don't meet the presumptive test of the hobby loss rule. But, you do have to have some idea of how much your timber is growing and what it's worth. Your forester can include such estimates in a separate report or include it as part of making a timber sale or some other management activity.

You'll need your forester if you have a casualty to your timber. You must determine the basis of the timber destroyed, the depletion allowance. The forester can also find a salvage buyer, and find replacement property to purchase if you want to postpone tax on the involuntary conversion.

You as the owner are ultimately responsible for signing your tax return, but you should expect your professional forester to work with you in providing the correct data.

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