

## ***U.S. TREASURY CIRCULAR 230 NOTICE***

*Any tax advice contained in this communication was not intended or written to be used, and cannot be used, for the purpose of (a) avoiding penalties that may be imposed under the Internal Revenue Code or by any other applicable tax authority; or (b) promoting, marketing or recommending to another party any tax-related matter addressed herein.*

### **Introduction**

You may have noticed that the fall foliage on the deciduous trees has been especially colorful this year. At present, you are free to enjoy the aesthetics of your forestland tax-free, but many other benefits of your forestland are, of course, taxable. I intend for this article to provide a quick overview of some relevant tax issues for forestland owners.

### **Tax Preparers**

As the calendar year comes to a close, it is time to start thinking about income tax return preparation. Many of you hire a CPA, attorney, or enrolled agent to prepare your tax return. These professionals are subject to strict and detailed rules on education and licensing. Nearly anyone, however, can call himself or herself a “tax preparer.” At this time, there are no education, training or licensing requirements for paid income tax preparers except that such preparers must register with the I.R.S. This will change in 2011. After this coming tax season, only people who have registered with the I.R.S., passed a test, and take continuing education courses can work as federal tax preparers. Keep this in mind as you choose a tax preparer. The new requirements may not, however, make it any easier to find a tax preparer who understands timber tax issues.

### **Income Tax Issues**

There are a few major issues to consider if you had income from forestry activities, or engaged in forest land transactions during the 2010 tax year. Because each taxpayer’s situation is different, you should consider talking with a tax professional about your own situation.

First, good record keeping is essential for your investment, business or farm. Because of the long-term nature of timber investments, it is important to keep track of your expenditures over time, as well as any annual income derived from your property. You also need to retain documentation of your basis, that is, the amount expended to buy land, to establish timber, or to buy equipment. Some of that information may be needed for as long as you own the asset.

Second, your level of participation in the forestry activity, and whether it is an investment or a business activity can impact your tax liability, and what tax forms you need file. Distinguishing between an active trade or business and passive investment is more complicated than it sounds, and depends on the circumstances.

Third, the nature of the timber sale transaction can affect your tax liability. Whether you sold timber in 2010, or plan to do so in the future, the details of the sale transaction can affect your taxes. Timber sales are often either for a lump-sum to cut a specified area, or a pay-as-cut

contract, where the buyer pays set prices per unit of timber cut. The latter requires log scaling or before and after timber cruises.

Land owners who engage in forestry as a business can be subject to ordinary income tax rates for timber sales. Passive investors are typically subject to capital gains rates. Long-term capital gains rates are lower than ordinary income tax rates. The Internal Revenue Code permits businesses (for example, land owners who are actively involved in forest management) to treat income from certain timber transactions as long-term capital gain if they meet all of the criteria specified in the Code and Treasury Regulations.

As Forest Stewardship Council (FSC) certified properties, NCF members need to track the species and volume of products removed from their land. Thus, your timber sale transactions may already be structured as pay-as-cut contracts, which would give the added benefit of potentially qualifying for long-term capital gain rates. Considering current market conditions, it is also relevant to consider that in qualifying circumstances timber sale losses can be treated as ordinary income losses.

There are other issues to consider, such as whether you qualify for certain special expense deductions or depreciation schedules. Many reforestation expenditures, for example, can be deducted in the year incurred.

The above items could be relevant to you this year, or alternatively you may need to take these items into account in planning future forest management activity.

## **Conclusion**

The above is a brief summary to get you thinking about tax year 2010—it would be impossible to cover all of the tax circumstances that NCF members face. I will attempt to present additional analysis in upcoming newsletters on the federal estate tax (an area of huge uncertainty going into 2011), the taxation of ecosystem services like carbon, and other pressing issues.

Michael Sterner is a forester (throughout the Northwest) and attorney (Oregon). You can reach him at (503) 358-8521, [www.sternerlaw.com](http://www.sternerlaw.com), or [mssterner@gmail.com](mailto:mssterner@gmail.com).