

Timber Tax Tips For Landowners

Some Estate Planning Considerations

By Jim Burns

Poor Judd passed away! During his working life, he was able to purchase a number of timberland tracts, which now total 200-acres. He loved these lands and was proud of the good job of forest management he had done which had resulted in growing a large volume of high-quality sawtimber. The rest of his assets included life insurance, investments in stock, certificates of deposit and his house.

Since his wife passed away a few years ago, Judd Jr., his oldest son, had been working with him in the management of his timberlands. Judd always intended to leave the timberland to this son so the careful management of these assets would continue unchanged into the future. The remainder of Judd Sr.'s assets was to be split between his daughter, Sara and youngest son, Percy who had no interest in the timberlands.

Judd was always busy with work and never got around to having a will prepared by his attorney. He also envisioned "the kids will be reasonable and know what I want". Unfortunately, without a will, **the entire estate** is now going to the children as 1/3 undivided interests each. Fathers' intentions mean very little at this point. Are the children "reasonable"? Read on.

The quarrelling usually commences at the funeral or shortly thereafter. Judd Jr. and his son have been the only ones working with the timberlands and expected to inherit the timberlands. Percy, who lives in San Francisco, claims that Dad had given him (no deed) a favorite 40-acre tract and even called it "Percy's 40". Other than that, he wants a 1/3 interest in all remaining assets.

The biggest surprise is Sara, who hasn't seen her older brother or father in at least 25-years because she considered them "timber beasts" as they killed trees and called it management! Sara belongs to every loony "green" organization on the planet. She has completed her homework, however, and calculates that her 1/3 interest in the timber comes out to a cool \$200,000.00 for the right to clear-cut the 200-acres. She has a contract from Quick Bucks Logging Company to prove it! The other part to her plan is to then sell the cut-over acreage and other assets. Poor Judd is really rolling in his grave!

Three heirs, three different viewpoints and excellent paying work for three lawyers. Is this an unusual scenario about a dysfunctional family? No! Based upon my years of experience as a forester and timber tax preparer, I would say this is the usual outcome. Even with the existence of a will there can be problems.

In this example, splitting-up the investments, insurance, CD's and even equipment is not that big a problem, but real estate is. Anytime timberland is involved, all kinds of problems will transpire unless some legally binding direction has been pre-determined and codified.

There are numerous legal entities available which can be used to ensure that your future vision for the management and financial benefits of the timberland can be passed on to your heirs without causing an acrimonious end to the family. Trusts, LLC's and partnerships would be a few examples. My objective in this article is not to advise

which legal structure would be the best for you, but in realizing that one size does not fit all situations, I urge you to seek legal and accounting advice in this matter.

First of all, the advice I would like you to take to your attorney is the fact that timber is a capital asset and income from sales of timber should be reported as capital gain for federal and state income taxes. Reporting as such, you are entitled to take a **Timber Depletion Deduction** from the gross revenue to arrive at a **net profit** which is then taxed at the lower federal capital gain tax rates.

The depletion deduction is calculated from the cost basis of timberland, meaning; the higher the cost basis, the less income tax you will pay and, the lower the cost basis, the more income tax you pay. For example, if Judd's father had purchased the timberland in 1945 for \$100.00 – that would be his cost basis. Let's say, in 1970 the father **gives** the land to Judd. The original cost basis goes with the gift, so Judd's cost basis is only \$100.00. Now, if Judd **gifted** the land to Judd Jr. before his death, Junior would only have a \$100.00 cost basis in land that is worth a half million dollars today.

The better plan, tax-wise, would be to allow Judd Jr. to **inherit** the land which would give him a new cost basis of a half million dollars and little or no capital gain whenever he sold timber. Gifting timberland with a low cost basis is usually not a good idea.

The second tip you need to take to your lawyer concerns the actual future management of the timberland. Spell it out. If you have a written forest management plan, attach it as part of the legal document controlling the property. The other important part of this is to designate **one** person as the decision making authority. Timber sales are going to be made, contracts signed, property taxes incurred, easements, etc.

If two people are involved with decision making authority, the entire management process will go into slow-motion and perhaps cease. With three or more people involved, nothing will happen. Remember, when there are multiple heirs to timberland, the odds of having a ringer involved like "Sara" are high.

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