

Tax Tips for Loggers

TIMBER IS NOT A TAX SHELTER

By Jim Burns

Some taxpayers think that if they use capital gain tax treatment for their timber income to save money, they will be targeted for an audit by the IRS. Nothing could be further from the truth.

Timber tax laws recognize the legal fact that “standing trees, attached to the soil” are **capital assets** and have to be treated as such for tax purposes. Timber is not one of the areas targeted by the IRS as an “abusive tax shelter”. Neither does timber income fall under the list of “Tax Preference Items” which require the Alternative Minimum Tax calculation.

A lower capital gain tax rate for timber income is not some recent change in the law either. From the inception of the federal income tax in 1913, timber has been recognized with special rules and rates. Recognizing the production of timber is one of our most vital natural resources, the federal income tax laws have been structured to account for the relatively long time period between crops by providing lower tax rates and deductibility of management and operating expenses.

So what kind of tax savings am I talking about for timber income in 2008? As an example, here are the ordinary income tax rates and capital gain tax rates comparison for married taxpayers filing jointly:

2008 Income Tax Rates Comparison

Ordinary Income Rate	Social Security Rate	Total Rate As Ordinary Income	Ordinary Income Tax Per \$1000	Capital Gain Tax Per \$1000 Income
10%	15.3%	25.3%	\$253.00	\$50.00
15%	15.3%	30.3%	\$303.00	\$50.00
25%	15.3%	40.3%	\$403.00	\$150.00
28%	15.3%	43.3%	\$433.00	\$150.00
33%	15.3%	48.3%	\$483.00	\$150.00
35%	15.3%	50.3%	\$503.00	\$150.00

In order to calculate your approximate tax savings on a sale of timber, just multiply the gross sale value by the tax per \$1000 by the ordinary tax and compare to the capital gain tax for the same amount.

For example, assume the gross sale value of the timber was \$25,000.00 and you

are in the 15% tax bracket, then your tax reported as ordinary income would be: $\$25 \times \$303 = \$7,575.00$ versus a capital gain tax of $\$25 \times \$50 = \$1,250$, **a savings of \$6,325 on your tax bill!** In this same example, if you were in the **35%** tax bracket, the tax savings would be **\$8,825.00!**

But wait, there's more – you get to take a **timber depletion deduction** from the gross sale value before you calculate the capital gain tax due. Whether you have long or short-term gain, you start with the gross income received, and then deduct any expenses associated with making the sale, such as payments to a forester for services, travel expenses, logging expenses, etc., plus the timber depletion deduction for the volume of timber cut and sold.

The depletion deduction is a tax-free return of the cost basis in the trees growing on the land at the date you acquired the property. Arrived at by appraisal standards mandated in the tax code, this deduction is a very important part of minimizing the tax, if any, you will have to pay. Depending on the size of this deduction a **loss** for tax purposes is common.

Most of our clients that purchased property within the last 10-years usually end up with a loss because their depletion deduction is greater than the amount they received for the trees sold. In other words, they paid no tax, plus had a loss to deduct from other income.

The large tax savings described herein is available to both you the **logger** as well as the **landowner** you bought the timber stumpage from. Yes, you own the cutting rights to the trees and therefore can elect to report that income as capital gain. Don't let anyone tell you it isn't legal.

Large tax savings or refunds make for happy landowners and that's what you want for your business. An easy and inexpensive way to do this is simply to tell them about the timber tax law. You don't have to be an expert, just make a copy of this article and let them read it. Also, tell them that if their tax preparer says this is not legal, or they can't use it for any reason, they can contact me for a second opinion at no charge.

Jim Burns is a professional forester who owns and operates Burns Timber Tax Services and works in conjunction with Susan Metcalfe at Metcalfe Forestry LLC. For more information, call Susan at (989) 348-3596 with your questions.