

Timber Tax Tips For Loggers

Work Smarter, Not Harder

By Jim Burns

I have a machine that will do all your cutting and skidding at no cost. That's right; you get to keep that savings in your pocket! If you don't like that, how about one that will save the cost of your hauling? How much would you pay me for this magical machine?

Got your attention, didn't I? What if I told you that you can get this machine from the federal government absolutely free! Keep reading; I haven't flipped-out of reality.

This type of savings is available to you in the income tax code. If you have not been reporting timber income as a capital gain in the past, you've probably been paying more in federal and state taxes than required. Your net income after taxes could have been much higher by making a simple election to report timber income under Section 631(a) of the Internal Revenue Code. This section applies to people who own timber and use it in their trade or business – professional loggers.

Of course, landowners who sell timber cutting rights (stumpage) to loggers should always report their stumpage income as capital gain rather than ordinary income to get the tax reduction. This is covered under Section 631(b) of the tax code, which I have explained in other articles.

For loggers, Section 631(a) allows you to elect reporting timber you own, which includes stumpage you purchased from other landowners, as capital gain income. If you held the timber for one-year or longer before you cut it, this becomes a long-term capital gain for tax purposes, and is subject to a maximum tax rate of only 15%.

If you cut the timber in less than one-year, you have a short-term capital gain which can still give you a tax benefit.

In effect, this provision allows you to treat the cutting of your timber as a timber sale to your own business. The stumpage value as of the first day of the tax year is your **sale** price to the business. Your depletion deduction is what you paid for the timber when you originally bought it. The net value remaining is taxed at 15%. Self-employment tax of 15.3% or the alternative minimum tax **does not apply**.

As an example, let's say you bought some aspen timber awhile ago for \$5.00 per cord – this is your depletion deduction. The fair market value of the aspen is now **\$40.00** per cord and you cut it. The increase of \$35.00 per cord is all capital gain, just as if you invested in a stock market company.

From this example, you can see that if reported as ordinary income, you will be paying higher taxes on a built-in fictional profit that has nothing to do with your logging efficiency at all. As capital gain income you report the net gain of \$35.00. The only tax on this is 15% or \$5.25 per cord.

The second step in this tax reporting is where you will get to use the **\$40.00** per cord as a business expense in calculating your ordinary income. This is very important in reducing your total tax bill.

Continuing this example, let's say you were paid \$75.00 for the cord of aspen delivered to the pulpmill. This is your gross revenue. Now assume all your logging costs including depreciation, insurance, fuel, etc., are \$45.00 per cord:

Gross Sale	\$75.00
Less Logging Expense	- 45.00
Less Fair Market Value of Stumpage	- <u>40.00</u>
Net Loss	- \$10.00 Per Cord

This resulting loss or breakeven for ordinary taxes is not uncommon. In this example, there was a small capital gain which was more than offset by an ordinary **loss**.

In order to determine actual tax savings per cord cut, I analyzed the results obtained by four (4) of my logger clients last year. They all shared one thing in common – a loss for tax purposes on their business income.

Production levels of these clients ranged from a low of 170-cords for a hobby farm up to 6000-cords per year for a production logger that operates exclusively on purchased stumpage.

The fair market value tax provision gave each of them an impressive tax savings per cord cut. To determine this value I divided their tax savings by the volume in cords harvested:

Tax Savings
\$10.88/Cord
\$11.66/Cord
\$12.50/Cord
\$16.79/Cord

What kind of machine can give you results like this? Work smarter, not harder.

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.