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Tax News You Can Use

Timber and Taxes

Tax Reform Issues for Forest Landowners And the Forest Products Industry

by **Dr. Linda Wang**

Taxes have been consistently listed as one of the top concerns for the nation's 10+ million individual and family private forest owners. Ultimately, taxes play an important role in influencing forest investment, land tenure, ownership structure, timber management, and rural jobs.

The following tax provisions are important to promote and encourage timber resource management and investment:

1. **Maintaining capital gain tax treatment of timber sales**
   Gains from qualified timber sales are taxed at the favorable long-term capital gain rates. Currently the max tax rate of long-term capital gains is 20 percent while the max rate for ordinary income is 39.6 percent. Current legislative status: House Tax Reform Blueprint ("Blueprint") released in June 2016 proposed to reduce the current the capital gains tax rates to be 3 tax rates: 6 percent, 12.5 percent and 16.5 percent.

Maintaining capital gain tax treatment of timber sales.

2. **Reforestation cost deduction**
   Forest owners may deduct the first $10,000 reforestation cost per timber property per year with the reminder deducted (amortized) over 84 months. Current legislative status: the House blueprint and President-elect Trump's campaign plan proposed to expense new capital investment, which could affect reforestation cost.
3. **Deduct timber management expense**
   Ordinary and necessary timber management expenses, such as insect and disease control cost and fire break maintenance cost, can be expensed currently in the year such expenses are incurred.
4. **Net investment tax of 3.8 percent**
   Beginning in 2013, investment income and "passive" income, including timber gains, are subject to a 3.8 percent tax if the taxpayer's gross income exceeds the income threshold (i.e., $200,000 if single taxpayers, or $250,000 if married filing jointly). This is an additional tax, on top of the capital gain taxes, in the case of timber sales. It was enacted as part of the health care reform legislation in 2010. Current legislative status: the House blueprint proposed to repeal the 3.8 percent tax.
5. **Loss of forest from casualty or severe insect damage**
   The deduction of casualty loss of timber due to events such as hurricane or fire is limited to the property's basis, which means little or no deductions for many forest owners with low basis in their timber property. Also, the majority of timber loss due to severe insect damage are not deductible.
6. **Timber depletion deduction**
   Depletion allows forest owners to take a deduction upon timber sales to recover their cost of investment in timber asset.
7. **Federal estate taxes**
   Under the current tax law, one may leave up to $5.45 million without paying federal estate taxes in 2016 (or $10.9 million for a couple), indexed for inflation. Heirs receive stepped-up basis to the fair market value for the property inherited. Timber owners may elect to value the timber property at its current use vs. its highest and best use. However, the provision should be modified so that a timber sale does not trigger a recapture of estate taxes. Current status: President-elect Trump's campaign proposal and the House blueprint proposed to repeal estate, gift and generation-skipping transfer taxes.

Loss of forest from casualty or severe insect damage.

For timber industry and REITs:

8. **Corporate tax rate reduction**
   The maximum tax rate for C corporation is 35 percent. Generally capital gain tax rates are not available for C Corporation. Capital gains for C corporations are taxed at ordinary corporate tax rates. However, a special 23.8 percent rate is allowed for timber gain in 2016 for timber C corporations if the timber is held for at least 15 years. Current status: The House blueprint and the President-elect Trump's campaign plan proposed to reduce the top corporate tax rate to be 20 percent and 15 percent, respectively.
9. **Maintain timber REIT status**
   A REIT is a tax efficient entity for holding real estate asset such as timberland: it essentially pay no federal income taxes on its income at the entity level and it passes its timber income to its shareholders as capital gains subject to the preferential tax rates. Maintaining REIT tax status for timber is important.

Other tax issues:

10. **Conservation easement deduction**
    Forest owners can take a deduction of conservation easement donation, up to 50 percent (or 100 percent if qualified) of their adjusted gross income in a year. Any excess donation amount over the 50- or 100-percent limit may be carried forward to 15 years.

11. **Biomass for energy production**
    Add biomass heating systems to the list of qualified renewable energy technologies that currently qualify for a 30-percent investment tax credit.

12. **Open loop biomass for electricity production**
    Revise Section 45 (Production Tax Credit) so that open loop biomass facilities built prior to the currently required construction start date can qualify for the production tax credit, extend the tax benefit to longer periods and get the same treatment as other renewable resource such as wind.

Biomass for energy production.

***Linda Wang** is the U.S. Forest Service national timber tax specialist, author and coauthor of numerous articles. For more information, visit the National Timber Tax website, www.timbertax.org.*