



# Tax Tips for Forest Landowners for the 2022 Tax Year

Yanshu Li, Tamara L. Cushing, and Gregory E. Frey

As a private forest landowner, you may start to think about timber taxes only after having a timber sale. However, each forest activity you conduct can have tax implications. Generally, all income received is taxable unless excluded by tax law, and nothing is deductible unless a provision allows it. Understanding the forest-related provisions and integrating tax planning into your forest management can help lower your overall taxes and increase disposable income.

This publication is intended to be an informational and educational resource for you and your tax advisor, but is not intended as financial, tax, or legal advice. Please consult with your tax advisor concerning your particular tax situation. The information is current as of November 28, 2022.

## Know the Tax Classification of Your Forest Ownership

The classification of your forest ownership has important implications for applicable tax rates, availability of deductions, and filing requirements. Your forest property generally falls into one of the following three broad categories:

- 1) **Personal use or hobby.** Your primary purpose for owning the property is for personal enjoyment or hobby, rather than making a profit. Tax deductions are quite limited under this category.
- 2) **Investment.** You have a profit motive for the property; however, your activities don't rise to the level of a trade or business (see below). Specifically, your primary purpose for owning the property is to make money (such as timber income or property appreciation), but the activity on the property is not continuous or regular. Tax deductions are relatively limited.
- 3) **Trade or business.** You have a profit motive and your forestry activities are conducted in a business-like manner. Your involvement in the business may be material participation or a passive activity (determined on an annual basis). **Material participation** implies regular, continuous, and substantial activity and will result in more favorable tax deductions. Losses from passive activities are only deductible against passive income.

Some farmers may own forests as a small part of their farming business and receive periodic income from timber sales. Tax rules for timber sales generally apply in these cases. In general, income tax provisions do not treat forestry as part of the farming business with a few exceptions.

The Internal Revenue Service (IRS) has specific factors to determine whether an activity meets the for-profit test and the material participation test. Generally, more weight is given to objective facts than to a taxpayer's statement in the determinations. Record keeping is crucial to support your profit motive and level of involvement.

**Example 1.** You own a 40-acre forest property. Although you occasionally visit the property to stay close to nature, you own the property primarily to generate a profit from timber sales in the future. You have a forest management plan developed by a professional forester with timber production as one of the management objectives. You consistently follow the prescriptions in the plan but have the forester update and modify the plan every 5 years. You join the local landowner association to stay current with information on forest management, policy, and market. You may classify your forest property as an investment for Federal income tax purposes.

## Understand Timber Sale Income and Recovery of Timber Basis

Your taxes on a timber sale are determined by several factors, including classification of your forest ownership, holding period, and the method of selling timber. You pay taxes on the net, rather than gross, timber sale income. To find taxable net income, subtract the following from gross proceeds:

- Selling expenses (e.g., forester fees, appraisal, attorney).
- State/local severance, harvest, or yield taxes.
- Timber depletion allowance (or allowable timber basis) (see page 2 for more information on timber basis).

## Sale of Standing Timber

Usually, income from the sale of standing timber that has been owned for more than 1 year qualifies for the favorable long-term capital gains tax rate (0, 15, or 20 percent—depending on your taxable income). Inherited timber automatically meets the long-term holding period requirement.

**Example 2.** In 2022, you sold your standing timber for \$20,000 using a lump-sum contract. The timber was purchased 5 years ago and held as an investment with a cost basis of \$6,000. You can subtract the timber basis, selling expenses (\$2,500), and the yield tax (\$1,000) from the sale proceeds to get the net income of \$10,500 (\$20,000 - \$6,000 - \$2,500 - \$1,000). The income qualifies for long-term capital gains.

Dr. Yanshu Li is an Associate Professor of Forest Economics and Taxation at the University of Georgia.

Dr. Tamara L. Cushing is an Extension Assistant Professor of Forest Economics and Business at the University of Florida.

Dr. Gregory E. Frey is a Research Forester at the U.S. Department of Agriculture (USDA), Forest Service, Southern Research Station.

This publication is based on the *2019 Tax Tips for Forest Landowners* published by Dr. Linda Wang of the USDA Forest Service with updates for the current tax year. We greatly appreciate the insightful comments on the earlier version of this publication from Amanda Perry, Joseph Bruce, Andrew Bosserman, and Andrew Fast. All errors remain the authors'. The findings and conclusions in this publication are those of the authors and should not be construed to represent any official USDA or U.S. Government determination or policy.

*(Continued on second page of Tax Tips)*

Personal-use and investment owners use Form 8949 and Schedule D (Form 1040) to report a lump-sum timber sale. Use Form 4797 (section 1231 gains) and Schedule D (Form 1040) to report the sale if sold under a pay-as-cut contract.

Under section 631(b), gains on the sale of standing timber in a trade or business (for sale or for use) and held for more than 1 year may be treated as long-term capital gains (section 1231 gain). Both lump-sum and pay-as-cut timber sales qualify. The potential tax benefits include: (1) The gain is taxed at the lower capital gains tax rate rather than the ordinary income tax rate; (2) It is not subject to self-employment tax; and (3) When you have a net section 1231 loss, you can use it to offset your ordinary income. Use Form 4797 (Part I) and Schedule D (Form 1040) to report the sale. See page 3 of *Tax Tips* (next page) for filing requirement of Form T (Timber), “Forest Activities Schedule.”

**Example 3.** In 2022, you sold the merchantable timber on a 100-acre timber property held in your business using a lump-sum contract. Because you had owned the timber for more than 1 year before the sale, the lump-sum timber income is a section 1231 gain and qualifies for long-term capital gains tax treatment.

## Sale of Cut Timber

You may cut (or have it cut by someone) your timber (or timber held under a contractual right to cut) and sell the cut timber or use it in your trade or business. The income would be taxed as ordinary income unless it has been held for more than 1 year and a special “election” is in effect. You should make a section 631(a) election by indicating on Part II of Form T and performing the proper tax computation under the provisions of section 631(a) and section 1231. Once you have made the election, it is not necessary to do it again in future years unless you revoke it with consent from the IRS.

Under section 631(a), your net income from the sale of cut timber or further processed timber products includes two portions:

- 1) Income from holding standing timber is treated as a long-term capital gain. It is the difference between the adjusted basis of the standing timber and its fair market value (FMV) on the first day of the tax year in which it is cut. It is treated as if you have sold the standing timber to yourself when you have it cut.
- 2) Income from selling the cut timber or further processed timber products is ordinary income. Gain (loss) is determined by subtracting the FMV of the standing timber in (1), harvesting and processing costs, and selling expenses from the sale proceeds.

**Example 4.** You hired and directed a logger to cut your timber (owned more than 1 year) and sell the logs to a mill you specified for \$20,000. You paid the logger \$4,000 for cutting and hauling the timber. The FMV of the standing timber on January 1, 2022, was \$15,000, and your timber depletion (see below) was \$2,000. If you made a section 631(a) election, an amount of \$13,000 (\$15,000 – \$2,000) would be treated as long-term capital gains, and \$1,000 (= \$20,000 – \$15,000 – \$4,000) as ordinary income.

## Timber Basis and Depletion Allowance

To figure net gain or loss on a timber sale or exchange (or casualty or theft loss, or gifting), you need to determine your adjusted basis in the timber. Timber basis is generally the amount of capital investment in your timber for tax purposes. It starts from the original basis, can increase as you make capital improvements or capitalize expenditures, or decrease as you deduct timber depletion or allowable timber basis upon a sale, exchange, or other disposition of the timber. The adjusted basis is the remaining costs after those adjustments. Timber basis should not include the cost of your land.

Original basis depends on how you acquired the property. If the forestland was purchased, the original timber basis is the amount of your total acquisition costs allocated to the timber. If the property was inherited, timber basis generally is its FMV on the deceased person’s date of death. If the property was received as a gift, the basis is the donor’s basis plus the gift tax paid by the donor when the FMV of the property at the time of the gift is equal or greater than the donor’s adjusted basis.

**Example 5.** You bought a tract of pine plantation for a total of \$33,000 (2,000 tons of pulpwood), including purchase price and other associated expenses. Assume the FMVs of the land and timber were \$10,000 and \$20,000, respectively. To figure out the original basis of each asset, you allocated the total acquisition costs proportionally among the land and the timber based on their FMVs. Therefore, the original basis for timber was \$22,000 [= \$33,000 x (\$20,000 / \$30,000)]. The basis for the land was \$11,000.

“Timber depletion allowance” and “allowable timber basis” refer to deduction of a portion of timber basis from the net proceeds of a timber sale. The allowed deduction is based on the portion of the timber that was sold. It is used to recover your investment in timber when you sell or otherwise dispose of the standing timber. Timber depletion is not allowed for timber cut for your personal uses, such as firewood for your home.

**Example 6.** You sold 500 tons of sawtimber and 3,000 tons of pulpwood on a tract held as an investment. Your timber account contained 1,000 tons of sawtimber (\$10,000 basis) and 6,000 tons of pulpwood (\$6,000 basis) before the sale. The depletion unit was \$10/ton (\$10,000 / 1,000 tons) for the sawtimber and \$1/ton (\$6,000 / 6,000 tons) for the pulpwood. Your allowable basis for the timber sale was \$8,000 (= 500 tons x \$10/ton + 3,000 tons x \$1/ton).

## Other Tax Issues Related to Timber Sales

**Net investment income tax (NIIT).** If you hold standing timber as an investment or a passive business activity, you may owe an additional 3.8-percent tax on the sale income. NIIT applies if modified adjusted gross income (MAGI) is over a stated threshold (\$200,000 for single taxpayer and \$250,000 for married couples filing jointly). Active business income (including timber sale income) is not subject to the NIIT.

**Form 1099-S.** After a lump-sum or a pay-as-cut standing timber sale, you should expect to receive from the buyer (e.g., logger, mill, or broker) a copy of Form 1099-S, “Proceeds from Real Estate Transactions.” Corporate and high-volume business sellers are exempt.

*(Continued from second page of Tax Tips)*

**Form T.** You need to file Form T if you do any of the following:

- Claim a timber depletion deduction.
- Sell cut products in a business [under section 631(a)].
- Sell standing timber held in a trade or business in a lump sum [under section 631(b)].

However, Form T is not required if you only have occasional timber sales (one or two sales every 3 or 4 years). It is good practice to keep as part of your records.

**Installment sale.** In some cases, it may be to your advantage to receive payments from a timber sale over 2 or more tax years. An installment sale (under a lump-sum contract) makes this possible. Income from the sale is prorated and recognized when received. You must treat part of each payment as interest and report as ordinary income. Note that irrevocable escrow accounts usually will preclude installment reporting.

## Consider the Reforestation Tax Incentives

You may deduct, in the year incurred, up to \$10,000 of qualifying reforestation expenditures (\$5,000 for married couples filing separately) per year per qualified timber property (QTP) [section 194(b)]. You can deduct (amortize) the remaining amount over 84 months [section 194(a)]. Both owned and leased lands qualify as long as it is used for commercial timber production. Trusts are eligible for the amortization deduction only. A recapture provision applies if you sell the property within 10 years at a gain.

Reforestation expenses are direct costs incurred for reforestation by planting or natural regeneration. They include costs for site preparation, seeds or seedlings, labor, tools, depreciation on equipment used in planting, and replanting. Your personal labor cannot be included.

Make an election to deduct the reforestation expenses on Schedule 1, line 24d (Form 1040), Part II for investment. Sole proprietors use Form T and Schedule C (Form 1040), Part V or Schedule F (Form 1040), Part II, as appropriate. The election to amortize is on Form 4562. If Form T is not required, attach a statement about the date, location, and amount of the eligible reforestation expenditures.

You are generally better off taking the election when the time value of money is considered. If you make the election, you need to maintain a separate account for each QTP and cannot combine them with other timber accounts until the timber is disposed. The QTP account should have zero balance immediately after the expensing and amortization are completed.

## Deduct Operating Expenses and Carrying Charges

If you meet the qualifications to be considered a material participant in your forestry business, you generally can fully deduct ordinary and necessary expenses associated with carrying on the business against all sources of income. Use Schedule C (Form 1040) or Schedule F (Form 1040), as appropriate. Such “operating expenses” may include those paid for insect control, disease prevention, prescribed burning, firebreak maintenance, overnight travel, pre-commercial thinning, vegetation-competition control, depreciation of equipment, and fees paid for a forester, attorney, or accountant.

Under section 212, investors can deduct the ordinary and

necessary expenses associated with management, maintenance, and conservation of the forest property. However, the 2017 Tax Cuts and Jobs Act (TCJA) has suspended “miscellaneous itemized deductions” for individual taxpayers through 2025. This is the category of deductions that investors would use to recover operating expenses. You still may fully deduct State and local property taxes on your forest property if you itemize (not subject to the \$10,000 State and local tax deduction limit), per section 164(b)(6)(B). However, many individuals who formerly itemized may now find it more beneficial to take the standard deduction. Under section 266, you may elect (on a year-by-year basis) to add carrying charges (e.g., property taxes and interest expenses) to the corresponding property basis (capitalize) in tax years when no income is produced from the property. This will result in a smaller capital gain and lower taxes when you produce income later. You may also elect to capitalize necessary development-related expenses (e.g., costs for silvicultural practices, timber stand improvement). Once you make the election to capitalize development costs, you must continue capitalizing these types of costs until the property is disposed.

Under the current law, you are generally not allowed to deduct the operating expenses if your forestland is held for personal use or as a hobby.

Starting with the 2020 tax year, businesses are required to report nonemployee compensation on the new Form 1099-NEC for payments of \$600 or more. Examples of nonemployee service providers include consulting foresters, loggers, attorneys, accountants, and contractors.

## Recover Other Major Capital Costs

Depreciation is a deduction for the cost (or basis) of long-lasting equipment or property (e.g., logging equipment, tractor, or temporary road). It is available to investors or business owners. Land is not depreciable. You can recover your costs in land only when you dispose of the land. However, you can depreciate land improvements such as bridges, culverts, fences, temporary roads, and surfaces of permanent roads.

Business taxpayers may immediately deduct up to \$1,080,000 for qualifying property in 2022, subject to phaseout and other limitations (section 179). You may also elect to apply the de minimis safe harbor to expense amounts paid for qualifying tangible properties costing less than \$2,500 per invoice or item rather than taking regular depreciation or the section 179 deduction.

Investors or businesses may take bonus depreciation for qualifying property. Bonus depreciation allows taxpayers to deduct 100 percent of the acquisition cost in the year placed in service. The amount of allowable bonus depreciation will be phased down from current 100 percent during 2023–2026 with no bonus depreciation allowed in 2027 and later years.

## Claim Casualty Loss Deduction When Natural Disaster Hits

Timber loss caused by a sudden, unusual, and unexpected (casualty) event may be tax deductible. Casualty events may include hurricane, fire, earthquake, tornado, hail, flood, or ice storm.

For investment and business owners, the deductible casualty loss is the lesser of the adjusted basis of the property or the decrease in FMV due to the casualty. Therefore, if the adjusted

*(Continued on fourth page of Tax Tips)*

(Continued from third page of Tax Tips)

basis is zero, you would not be able to deduct any casualty loss, regardless of your actual loss. For investors, use Section B of Form 4684 and Schedule A (Form 1040) to claim it under other itemized deductions (line 16). For timber in a trade or business, report it in Section B of Form 4684, then enter the loss on Form 4797.

Casualty loss deduction and salvage sales may be handled separately. You can claim a casualty loss deduction before the salvage sale. If your salvage sale results in a taxable gain, you may postpone taxes on the gain by claiming an involuntary conversion and electing to purchase qualifying replacement property.

**Example 7.** You own 200 acres of forestland (\$6,000 in adjusted timber basis) as investment. In 2022, the timber property was damaged by Hurricane Ian. A qualified professional assessed that the FMV of the timber block dropped from \$20,000 before the hurricane to \$2,000 after the disaster, an \$18,000 decrease. The amount of your casualty loss deduction is limited to the lesser of the adjusted basis and the FMV decrease, or \$6,000.

The casualty loss deduction for personal-use owners (including landscape trees) has been suspended through 2026, except for losses in federally declared disaster areas. Use Section A of Form 4684 and Schedule A (Form 1040) to claim the loss as casualty and theft loss (line 15).

## Consider Excluding Qualified Cost-sharing Payments

In general, payments received from government programs are taxable ordinary income. However, some conservation-oriented cost-sharing payments qualify for income exclusion (section 126). The excludable amount may be all or part of the payment. To be eligible for the exclusion, the cost-sharing payment should be from a qualified program and be used for capital expenditure.

The excludable amount is the present value of the right to receive annual income of the greater of:

- 10 percent of the previous 3-year average annual income from the affected acreage or
- \$2.50 times the number of affected acres.

Currently, qualified programs for the section 126 income exclusion include but are not limited to:

- Forest Health Protection Program (FHPP).
- Conservation Reserve Program (CRP) (Annual rental payment and incentive payments do not qualify).
- Environmental Quality Incentives Program (EQIP).
- Certain preapproved State-administered programs.

Contact the program administrator to determine if the payments are qualified for income exclusion. If you choose to exclude the payment from your income, you cannot add the related

operating expenses to your basis. If you receive qualifying cost-sharing payment for reforestation, you could either 1) include the payment in your income and elect to deduct the qualifying reforestation expenses using the reforestation cost deduction rule mentioned earlier, or 2) exclude from your income the cost-sharing payment up to the excludable amount and recover the unreimbursed qualifying reforestation expenses. No simple rule exists as to whether you should exclude the income or elect to include it in your income. Taxes may be figured both ways to determine which option is more beneficial for you. If the payment is excluded, a recapture provision applies if the affected timber is sold within 20 years.

## Consider Conservation Easement Donation

A conservation easement is a voluntary legal agreement between a landowner and a government agency or land trust that restricts development or use. Under section 170(h), if you donate a qualified conservation easement to a qualified organization for qualified conservation purposes, it is eligible for a Federal charitable income tax deduction. You could use the charitable easement deduction to offset up to 50 percent (100 percent for some qualified forest landowners) of your AGI and could carry over any unused deductions for an additional 15 years.

## Defer Taxes With Like-kind Exchanges

Effective January 1, 2018, like-kind exchanges apply only to real property held for productive use in a trade or business or for investment. Exchanges of personal property no longer qualify for the tax deferral. Like-kind refers to the nature or character of the property, rather than its grade or quality. Standing timber and timberland are like-kind real property. Under the recently issued final regulations, timber cutting rights are real property if they are considered so under State or local law. However, not every exchange of real property interests meets the section 1031 like-kind requirement. Please speak with your tax advisor about the applicability of a 1031 exchange before making a property transaction.

## Qualified Business Income (QBI) Deduction

For tax years 2018 through 2025, noncorporate taxpayers can take the QBI deduction under section 199A for certain income earned through sole proprietorship or other pass-through entities, subject to limitations. However, net section 1231 gains (most timber sales, including Christmas trees) are treated as capital gains and are excluded from QBI for deduction purposes.

QBI does include the ordinary income portion of revenue from selling things such as cut timber products, pine straw, living trees, products gathered or collected, such as wildflowers, vines, edible or medicinal plants or fungi, or botanical samples.

Use Form 8995 (or Form 8995-A if applicable) to figure the amount of the deduction and report it on Form 1040.

### For More Information

- National Timber Tax website: [www.timbertax.org](http://www.timbertax.org).
- Greene, J.L.; Siegel, W.C.; Hoover, W.L.; Koontz, M. 2013. *Forest landowners' guide to the Federal income tax. Agriculture Handbook 731*. <https://www.fs.usda.gov/research/treesearch/42921>
- Wang, L. 2012. *Federal income tax on timber: a quick guide for woodland owners*. <https://timbertax.org/2012QuickGuide.pdf>