Timber Tax Update:

Key Changes From the 2017 Tax Act

By Mark Megalos, Ph.D. and Rajan Parajuli, Ph.D.

Some taxpayers are still adjusting to the tax overhaul that resulted from the "Tax Cuts and Jobs Act" passed on December 20, 2017 by the U.S. Senate. Taxpayers have found that their taxes changed either a little or a good deal depending upon their tax brackets; extent or lack of itemized deductions; and their local and state-level tax burden.

Table 1 shows the changes in ordinary and long-term capital gain rates in various taxable income brackets. A single corporate tax rate of 21% was made permanent under the new tax act.

TABLE 1

Income*	Old Rate	New Ordinary Rate	Long-Term Capital Gain Rate**
$0-19,400	10%	10%	0%
$19,401-78,950	15%	12%	0%
$78,951-168,400	25%	22%	15%
$168,401-321,450	28%	24%	15%
$321,451-408,200	33%	32%	15% +3.8%
$408,201-612,350	35%	35%	15% +3.8%
$612,351 +	39.6%	37%	20% +3.8%

**Married filing jointly; **3.8% New Medicare surtax (high-income tax filers)*

The biggest change in the new tax act was in the standard deduction amount. The standard deduction was raised to $12,000 for single filers, $18,000 for heads of household and $24,000 for married couples filing jointly in 2018. The previous deduction amounts for single, head of household and jointly filing married couples were $6,300, $9,550 and $12,700, respectively. For 2019 and beyond, these amounts are linked to inflation and will be indexed according to a chain-weighted consumer price index for all urban consumers.

Timber Taxation

The ownership category of a forest property is a major determinant in timber taxation complexity. Three ownerships are defined in taxation: personal property (personal use, not for profit), investment property (for profit) and business property (for profit and more frequent and regular). While the tax rate could be up to 37% for ordinary income (**Table 1**), the tax rate for long-term capital gains (LTCG) ranges from 0 to 20%, depending on the taxable income brackets. LTCG income from standing timber sales in investment and business properties (held longer than a year) qualifies for long-term capital gain treatment. However, sales of felled timber from business properties are usually considered ordinary incomes.

Timber Basis

Depletion is a common deduction allowed in timber taxation, which is calculated using the timber basis. Timber basis is the cost paid for the purchased property or the fair market value of the inherited property on

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the date of the decedent's death. Establishing basis could be complicated specifically for the inherited properties. Use a forest consultant or Certified Public Accountant (CPA) working on timber taxation to establish the timber basis of your inherited property based on the fair-market-value rule.

The federal tax **reforestation deduction** applies to the first $10,000 (married filing jointly) of qualifying expenses. The excess amount over $10,000 can be deducted using an amortization schedule over the next eight tax years.

The new tax act offers significant changes in how **timber expense deductions** are handled, particularly for the investment properties. The miscellaneous itemized deductions, including timber expenses (fees paid for a forester, attorney, hired labor, property taxes, pre-commercial thinning, overnight travels), are no longer deductible in years without a timber harvest (to offset). For investment properties, expenses must be capitalized in a timber or land account and held until a sale year, and can be deducted upon the timber sales. For timber business properties, timber expenses are still deductible.

The 3.8% **net investment income tax** is applicable to high-income taxpayers and is usually added to the long-term capital gain tax rates (**Table 1**). Similarly, the Form T (Timber) must be completed if you are claiming a timber-depletion deduction, selling felled timber or timber harvested from the business properties. Occasional timber sellers (one or two sales every three or four years) are not required to file the Form T.

Casualty losses from natural calamities can be deducted on federal income taxes. The deduction amount from the investment or business properties should be the lesser of either the fair-market-value loss of your timber or the adjusted basis of your timber. The adjusted basis is calculated based on the adjustments made in the original basis over the term of the ownership. If the salvage harvest, court award or insurance claim exceeds the original timber basis, there will be gain; no deduction is allowed. Landscape tree damages are only deductible if the loss is related to a federally declared disaster event. Income taxes and deductions are usually complicated. Consider contacting professional foresters or CPAs working on timber taxation. ■

For more information, visit timbertax.org.