



# Maximize Timber Basis Deductions to Minimize Taxes

By Andrew Bosserman

**M**y previous two articles in this three-part timber tax series discussed forest activity classification (*TreeLine Second Quarter 2022*) and utilizing capital gain taxation to save taxes on timber sales (*TreeLine Third Quarter 2022*). This third and final article will discuss how to maximize timber basis deductions to minimize taxes.

## Why Timber Basis Is Important

An accurate and maximum allowable timber cost basis is extremely important for a few reasons.

First, forest landowners must know the basis of their timber to determine profit or loss when they sell timber. Not only is an accurate profit calculation required for tax purposes, it also helps with planning for future plantings and harvests.

Second, forest landowners want the maximum allowable timber basis to lower any taxable profit. The IRS will tax landowners on the forest activity's net profit. A larger timber basis results in a larger tax deduction, which lowers landowners' taxable net profit.

However, this does not mean an individual should pay as much as possible for timberland to increase cost basis. The economics of the forestland investment must still make sense. Rather, forest landowners should make sure their timber basis is maximized and computed correctly after a purchase of forestland.

Finally, timber basis is used to calculate a tax deduction due to a casualty loss, such as a forest fire that destroys timber. Recent tax law changes have made deducting casualty losses more difficult; however, a casualty loss deduction is still available to forest landowners in some instances.

## Calculating Timber Basis

When forest landowners purchase timberland, they pay a single price and receive multiple assets: the land itself, any existing timber, and any land improvements. A forest landowner will

likely view the transaction as a single purchase and will often pay a single price for all the assets. However, for tax purposes, the transaction is viewed as separate purchases for each asset or type of asset. The forest landowner must allocate the purchase price among the different types of assets purchased.

## Example

*Tim Burr purchased 50 acres of forestland in 2022 for \$100,000.*

*The fair market value (FMV) of the land was \$50,000, the FMV of the existing timber was \$40,000, and the FMVs of existing logging roads were \$30,000 (FMV total = \$120,000).*

*How should Tim allocate the \$100,000 cost between the purchased assets?*

- Land cost basis =  $(\$50,000 / \$120,000) * \$100,000 = \$41,667$
- Timber cost basis =  $(\$40,000 / \$120,000) * \$100,000 = \$33,333$
- Land Improvements (logging roads) cost basis =  $(\$30,000 / \$120,000) * \$100,000 = \$25,000$

In the example above, all the timber Tim purchased was grouped together to calculate a timber basis value. In certain situations, forest landowners may benefit from separating timber into separate tracts or calculating basis by species.

Upon purchasing forestland, the forest landowner should have the timber appraised by a forester to calculate a maximum allowable timber cost basis. This will result in a lower tax bill when the timber is sold, as well as a larger tax deduction if the timber is unfortunately destroyed due to a casualty or theft.

An appraisal should also be performed when timberland is inherited. Tax law permits an individual who inherits timberland to "step up" their basis in the timberland to its fair market value, effectively exempting any appreciation in the hands of the decedent from taxation. Failing to properly calculate timber basis can result in thousands of dollars of unnecessary taxes when the timber is sold.

## Qualified Reforestation Expenditures

Generally, the cost of planting tree seedlings and related planting expenses are not deductible until the owner sells or harvests the timber. However, tax law permits a forest landowner to immediately deduct up to \$10,000 each year of "qualified reforestation expenditures."

Qualified reforestation expenditures include the cost of land preparation, the cost of the seeds or seedlings themselves, and the cost of planting labor. Despite the term "reforestation expenditures," the owner need not incur the expenses in replacing a harvested timber stand. A forest landowner can deduct qualified reforestation expenditures for establishing new timber stands.

This special tax treatment for such expenditures is not automatic. A forest landowner must make an election on their tax return to be eligible for the maximum \$10,000 deduction.

Any reforestation expenditures exceeding \$10,000 may be amortized (deducted) over 84 months.

## Conclusion

Maximizing timber cost basis is a critical component of tax savings for forest landowners. However, calculating timber basis for a forest landowner's individual situation can be complex; therefore, consulting a knowledgeable forest Certified Public Accountant (CPA) or attorney is strongly recommended. ■

### ABOUT THE AUTHOR

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