



Alabama Forest Owners' Association

# Forest Taxation Workshop



Cheaha State Park, Alabama

April 22, 2009

## Instructors

*Dr. Linda Wang*, Forest Taxation Specialist, USDA Forest Service

*Dr. John L. Greene*, Forest Economist, Southern Research Station, USDA Forest Service

## AGENDA

|       |   |                     |
|-------|---|---------------------|
| 9:30  | REGISTRATION  |                     |
| 10:00 | Welcome and Introduction                              | <i>Lee Laechelt</i> |
| 10:05 | Timber and Tax Overview — TAB 1                       | <i>Linda Wang</i>   |
| 10:30 | Basis, Capital Accounts & Record-keeping — TAB 2      | <i>John Greene</i>  |
| 11:15 | BREAK   |                     |
| 11:35 | Passive Loss Rules — TAB 3                            | <i>Linda Wang</i>   |
| 12:20 | LUNCH   |                     |
| 1:20  | Questions from the Morning Session                    |                     |
| 1:35  | Cost-share and Conservation Payments — TAB 4          | <i>Linda Wang</i>   |
| 2:30  | Reforestation Incentives — TAB 5                      | <i>John Greene</i>  |
| 2:45  | BREAK   |                     |
| 3:00  | Timber Sales & Income — TAB 6                         | <i>John Greene</i>  |
| 4:05  | Involuntary Conversions — TAB 7                       | <i>John Greene</i>  |
| 4:55  | Additional Questions /Other Tax Strategies            |                     |
| 5:15  | Adjourn to Wine & Cheese Reception at Bald Rock Lodge |                     |

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# Timber and Tax Overview

Dr. Linda Wang  
Forest Taxation Specialist  
USDA Forest Service

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## The Tax System: *In a Formula*

Total Income  
- Adjustment

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Adjusted Gross Income (AGI)

- Itemized Deduction/Standard Deduction  
- Personal Exemption

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Taxable Income Characteristics of Income  
x Tax Rate

---

Taxes  
+ Other Taxes  
- Tax Credit / Payment

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Taxes Due / Refund

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## Itemized Deduction: 2% AGI Reduction

Miscellaneous ID – 2% x AGI = Deduction Allowed

Tax Return Fee: \$500

Investment Counsel Fee: \$300

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Your Total Expenses: \$800

If Your AGI is \$25,000: You can only deduct \$300  
If Your AGI is \$40,000 or more: You can deduct \$0

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## Itemized Deduction: 3% Reduction Rule

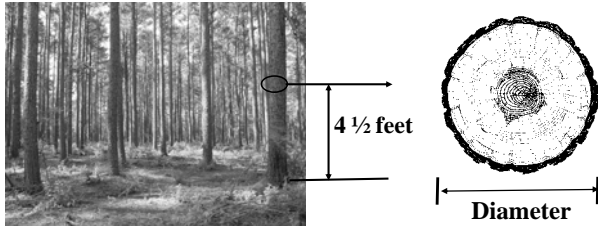
Certain ID – 3% x (AGI - \$145,950) = Deduction Allowed

✓ ID that are subject to the 3% reduction rule:

- Property taxes
- Home mortgage interests
- Charitable donations and
- Miscellaneous expenses

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## Diameter at Breast Height (DBH)



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## General Standard for Merchantable Southern Forest Products

| DBH             |            |
|-----------------|------------|
| Pulpwood        | 4"-9.4"    |
| Small Sawtimber | 9.5"-11.4" |
| Sawtimber       | 11.5"+     |

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## Timber Volume

| Unit            |             |
|-----------------|-------------|
| Pulpwood        | Ton or Cord |
| Small Sawtimber | Ton or Cord |
| Sawtimber       | Ton or MBF  |

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## Sources for Historical Timber Prices

- ❖ Timber Mart South
- ❖ Forest2Market
- ❖ Consultant's Data or Company Data

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## Brand New Tax Laws in 2007

### *Tax relief for business*

- ❖ In May 2007, the first major tax law was enacted
  - ❖ Timber *business* owners may write off \$125,000 for new equipment
  - ❖ Mom and pop timber *business* have the option not being taxed as partnership

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## Brand New Tax Laws for 2008

### *The Economic Stimulus Act of 2008*

#### New equipment cost deduction

- ❖ First year expensing
- ❖ Bonus Depreciation

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## Brand New Tax Laws for 2008

### *The Economic Stimulus Act of 2008*

- ❖ First year expensing
  - ❖ \$250,000 first year expensing is allowed
  - ❖ applies to properties purchased and placed in service in 2008

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## Brand New Tax Laws for 2008

### *The Economic Stimulus Act of 2008*

#### ❖ Bonus Depreciation

- ❖ Amount: 50% of the adjusted basis of property
- ❖ Applies to properties purchased and placed in service in 2008

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## Reference Materials

Forest Landowners' Guide to Federal Income Tax

National Timber Tax Website: [www.timbertax.org](http://www.timbertax.org)

State Agency and Extension Websites

J.K. Lasser's *Your Income Tax*

IRS Publication 17: Your Federal Income Tax

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## Forest Landowner's Guide to the Federal Income Tax *Ag. Handbook 718*

The best link is at the National Timber Tax website:

[http://www.timbertax.org/publications/aghandbook/  
aghandbook.asp](http://www.timbertax.org/publications/aghandbook/aghandbook.asp)

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## **Basis, Capital Accounts, and Record-keeping**

①

**Ag. Handbook 718, pages 21-26, 111-112  
Updated for Revenue Ruling 2004-62**

### **What Basis Is**

- ▶ A capital investment in income-producing property
- ▶ The law usually requires that basis be capitalized – held in a capital account – until the property is sold

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### **What Basis is Not**

- ▶ **Operating expenses and carrying charges:**
  - ✓ Consultant fees    ✓ Prescribed burning
  - ✓ Labor costs        ✓ Timber stand improvem't
  - ✓ Travel expenses\*   ✓ Protection
  - ✓ Property taxes    ✓ Precommercial thinning
  - ✓ Interest\*         ✓ Post-estab. fertilization  
(Rev. Rul. 2004-62)

\*Related to the income potential of the tract.

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### **What Basis is Not**

- ▶ As long as you are engaging in timber-growing for profit, operating costs and carrying charges can be deducted in the year they occur  
Timber qualifies as long as it produces income or *appreciates in value* in at least 3 of 5 years (page 39)
- ▶ Carrying charges also can be capitalized in years your tract produces no income, but it usually is more beneficial to deduct them

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## What Else Basis is Not

- ▶ Costs associated with the sale of timber or forestland:
  - ✓ Timber cruising
  - ✓ Advertising
  - ✓ Sale administration
- ▶ Deduct them directly from the sale proceeds

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## Original Basis

- ▶ Depends on how you acquired the property:
  - ✓ Purchase – Your total cost of acquisition  
*Not* just its purchase price and *not* its fair market value
  - ✓ Inheritance – Property’s fair market value on the date the decedent died OR the alternate valuation date (earlier of 6 months after death or date any estate asset is sold)  
Usually results in a “step-up” in basis

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## Original Basis

- ✓ Gift – Lower of donor’s basis or property’s fair market value (no “step-up” in basis)  
For gifts made after 1976, add the portion of any gift tax paid due to the difference between the donor’s basis and the property’s fair market value  
(For gifts made before 1977, add any gift tax paid)

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## Original Basis

- ▶ Ideally, determine original basis immediately after you acquire timber or forestland
  - ✓ If you postpone process for several years, you may need the help of a forester to determine the trees’ original volume and value ②
- ▶ Allocate original basis proportionately among your capital accounts – for example, Land Account, Timber Account

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## Adjusted Basis

- ▶ Adjust capital account balances to reflect changes in your capital investment:
  - ✓ Up by the amount of new purchases or investments
  - ✓ Down as you recover your investment
- ▶ Adjusted basis – The balance left in a capital account after one or more changes have been made to the original basis

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## Recovering Basis

- ▶ Use different ways for different types of assets:
  - ✓ Deductions when property is partially or completely sold
  - ✓ Depletion deductions as property is used up
  - ✓ Depreciation deductions over the property's useful life
  - ✓ Amortization of capitalized expenses

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## Capital Accounts

- ▶ Land Account
- ▶ Timber Account
- ▶ Depreciable Improvement Account
- ▶ Equipment Account
- ▶ Building Account

Will describe what goes into each type of account and how to recover your basis

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## Land Account

- ▶ What goes in:
  - ✓ Portion of original basis attributable to the value of the land itself
  - ✓ Original basis of new purchases
  - ✓ Cost of non-depreciable improvements – for example, roadbeds of permanent roads, land leveling
  - ✓ According to IRS, cost of defending title

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## **Land Account**

- ▶ **How to recover your basis:**
  - ✓ **The only way to recover the basis in your Land Account is to sell or dispose of the land**

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## **Timber Account**

- ▶ **You need to keep separate subaccounts for:**
  - ✓ **Merchantable Timber**
  - ✓ **Young Growth – Naturally seeded trees of premerchantable size**
  - ✓ **Plantation – Artificially planted or seeded trees of premerchantable size**

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## **Timber Account**

- ▶ **Further divisions – by tract, stand, species group, etc. – are fine if they help you manage**
  - ✓ **It does makes filling out tax forms a little more complicated, and**
  - ✓ **And in the event of an involuntary conversion, it may prevent you from getting the largest possible deduction**

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## **Timber Account**

- ▶ **What goes in (timber basis has two parts):**
  - ✓ **Value (cost) part – Portion of original basis attributable to the value of the timber, whether merchantable or premerchantable**
  - ✓ **Volume part – Timber volume at the time of acquisition**
    - Merchantable timber in standard units**
    - Premerchantable timber in acres**

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## **Timber Account**

- ▶ **Increase timber basis by the value, volume of:**
  - ✓ **New purchases of forestland or timber**
  - ✓ **Costs of timber establishment:**
    - Site preparation – including practices to encourage natural regeneration**
    - Planting or seeding – including the cost of hired labor and forester’s fee or salary,**
    - Replanting or reseeding after mortality**

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## **Timber Account**

- ▶ **IRS holds costs of timber establishment include:**
  - ✓ **Brush and weed control essential to the survival of a plantation – Test (from Rev. Rul. 66-18): whether done in first 2 years after planting; non-essential control can be expensed**

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## **Timber Account**

- ✓ **Weed and hardwood control essential to the survival of a natural stand – Test (from Rev. Rul. 76-290): whether done to ensure survival; if done to increase vigor, speed growth can be expensed**

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## **Timber Account**

- ▶ **As your timber grows:**
  - ✓ **Transfer the value and volume basis in your Young Growth or Plantation Subaccount to your Merchantable Timber Subaccount as it becomes merchantable**
  - ✓ **Also update the volume basis in your Merchantable Timber Subaccount for growth and ingrowth, if your utilization ...**

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## Timber Account

... standards improve, or if you change your unit of measure

- ▶ Update annually if your tract is large or you have frequent transactions
  - ✓ At a minimum, you need to update in years you sell or dispose of timber

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## Timber Account

- ▶ How to recover your basis:

- ✓ Take a depletion deduction when you sell or convert timber

Determine the depletion unit:

$$\text{Adjusted Basis} \div \text{Pre-harvest volume}$$

Multiply by the number of units harvested:

$$\text{Depletion Unit} \times \text{Number of Units Harvested}$$

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## Timber Account

You cannot take a depletion deduction for trees you cut for personal use – for example, for firewood or barn poles

- ✓ Deduct or amortize reforestation expenses

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## Depreciable Improvement Account

- ▶ What goes in:

- ✓ Portion of original basis attributable to the value of depreciable improvements to the land – for example, bridges, culverts, fences, temporary roads, and the surfaces of permanent roads

- ✓ New investments

- ▶ Recover your basis by depreciation deductions

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## Equipment Account

- ▶ What goes in:
  - ✓ Keep a separate subaccount with the portion of original basis attributable to each piece of equipment with a life expectancy of over 1 year – for example, chainsaws, trucks, planting machines
  - ✓ New purchases
- ▶ Recover your basis by depreciation deductions

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## Building Account

- ▶ What goes in:
  - ✓ Keep a separate subaccount with the portion of original basis attributable to each structure
  - ✓ New structures
- ▶ Recover your basis by depreciation deductions

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## Allocating Basis

- ▶ All costs of acquisition must be allocated proportionately among your capital accounts
  - ✓ *Not* all put into one account and *not* deducted as an expense
- ▶ Report original basis on Form T, Part I
- ▶ Report reforestation on Form T, Part IV
- ▶ Report adjustments to your timber basis on Form T, Part II

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**EXAMPLE:** Six years ago you bought 40 acres of forestland for \$50,000. A cruise you had done to help determine how much to offer showed that the tract consisted of two 20-acre loblolly pine plantations. One had 72 MBF of sawtimber, worth \$19,800, and 560 cords of pulpwood, worth \$14,000. The other stand was premerchantable, but you valued the trees at \$300 per acre. The fair market value of the land itself was \$14,000. In addition you paid \$800 for a boundary survey, \$300 for a title search, and \$800 for the cruise. Allocate the original basis among your capital accounts and report it on Form T, Part I.

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### Solution

✓ Cost of acquisition:

$$\$50,000 + \$800 + \$300 + \$800 = \$51,900$$

✓ Fair market value:

$$\$19,800 + \$14,000 + \$6,000 + \$14,000 = \$53,800$$

✓ The cost of acquisition and fair market value are not equal, so you must allocate the original basis proportionately among your capital accounts

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### Solution

| Asset              | Fair Market Value (FMV) | Proportion of FMV |
|--------------------|-------------------------|-------------------|
| Land . . . . .     | \$14,000                | 26.02%            |
| Sawtimber . . .    | \$19,800                | 36.80%            |
| Pulpwood . . . .   | \$14,000                | 26.02%            |
| Plantation . . . . | \$ 6,000                | 11.16%            |
|                    | <b>\$53,800</b>         | <b>100.0%</b>     |

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### Solution

| Capital Account    | Proportion of FMV | Original Basis  |
|--------------------|-------------------|-----------------|
| Land . . . . .     | 26.02%            | \$13,504        |
| Sawtimber . . .    | 36.80%            | \$19,100        |
| Pulpwood . . . .   | 26.02%            | \$13,504        |
| Plantation . . . . | 11.16%            | \$ 5,792        |
|                    | <b>100.0%</b>     | <b>\$51,900</b> |

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### Form T, Part I

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**EXAMPLE:** By the end of the past year, the younger plantation has become merchantable and carries 200 cords of pulpwood. The older plantation also has grown, and now carries 112 MBF of sawtimber and 390 cords of pulpwood. Adjust the basis in you Plantation and Merchantable Sawtimber subaccounts and report the changes using Form T, Part II.

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## Solution

▶ Plantation Subaccount –

✓ Subtract value basis:

$$\$5,792 - \$5,792 = 0$$

✓ Subtract volume basis:

$$20 \text{ acres} - 20 \text{ acres} = 0$$

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## Solution

▶ Merchantable Timber Subaccount –

✓ Add value basis from Plantation Subaccount:

$$\begin{array}{r} \$32,604 \text{ Original basis} \\ + \underline{5,792} \text{ From Plantation Subaccount} \\ \$38,396 \text{ Adjusted basis} \end{array}$$

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## Solution

✓ Update pulpwood volume basis:

$$\begin{array}{r} 560 \text{ cords Original basis} \\ + 200 \text{ cords From Plantation Subacc't} \\ - \underline{170 \text{ cords Grew into sawtimber}} \\ 590 \text{ cords Adjusted basis} \end{array}$$

✓ Update sawtimber volume basis:

$$\begin{array}{r} 72 \text{ MBF Original basis} \\ + \underline{40 \text{ MBF From pulpwood}} \\ 112 \text{ MBF Adjusted basis} \end{array}$$

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## Form T, Part II

③

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## Recordkeeping for Tax Purposes

- ▶ **Need to keep accurate, complete documentation, in order to support all entries on your tax forms, including:**
  - ✓ Written plan
  - ✓ Receipts
  - ✓ Maps
  - ✓ Canceled checks
  - ✓ Contracts
  - ✓ Mileage records
  - ✓ Invoices
  - ✓ Etc., etc., etc.

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## Recordkeeping for Tax Purposes

- ▶ **Keep a copy of your tax returns indefinitely**
- ▶ **Keep records that support current deductions for 6 years beyond the date the return was due**
- ▶ **Keep records that support capital accounts for 6 years beyond the period of ownership**

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## Recordkeeping Methods

- ▶ **Shoebox method: Routinely and systematically file records in folders, envelopes, shoeboxes labeled for each necessary tax category**
- ▶ **Tree farm journal: Business diary showing details of business transactions and time spent doing activities; should sort entries by category**
- ▶ **Tree farm journal with accounts: Business diary with dollar amounts posted to ledgers; uses double-entry bookkeeping**

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## **Accounting Methods**

- ▶ **Can adopt the accounting method that provides the most favorable tax treatment, as long as it “clearly reflects” your income**
  - ✓ **Cash method: Deduct expenses when paid, report income when received or constructively received – used by most farm, forest owners**
  - ✓ **Accrual method: Deduct expenses when incurred, report income when earned – used by large firms, incorporated tree farms**

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## **Tax Forms: Form T, Part I Form T, Part II**

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# **Tax Forms and Examples**



## **Basis, Capital Accounts and Record-keeping**

**EXAMPLE 1:** Six years ago you bought 40 acres of forestland for \$50,000. A cruise you had done to help determine how much to offer showed that the tract consisted of two 20-acre loblolly pine plantations. One had 72 MBF of sawtimber, worth \$19,800, and 560 cords of pulpwood, worth \$14,000. The other stand was premerchantable, but you valued the trees at \$300 per acre. The fair market value of the land itself was \$14,000. In addition you paid \$800 for a boundary survey, \$300 for a title search, and \$800 for the cruise. Allocate the original basis among your capital accounts and report it on Form T, Part I.

- a. Total cost of acquisition is:  $\$50,000 + \$800 + \$300 + \$800 = \$51,900$
- b. FMV of the forestland is  $\$19,800 + \$14,000 + \$6,000 + \$14,000 = \$53,800$
- c. Allocation of original basis:

| Capital Account             | Fair Market Value (FMV) | Proportion of Total FMV | Original Basis  |
|-----------------------------|-------------------------|-------------------------|-----------------|
| Land Account.....           | \$ 14,000               | 0.2602                  | 13,504          |
| Sawtimber .....             | 19,800                  | 0.3680                  | 19,100          |
| Pulpwood .....              | 14,000                  | 0.2602                  | 13,504          |
| Plantation Subaccount ..... | 6,000                   | 0.1116                  | 5,792           |
| <b>Total.....</b>           | <b>\$ 53,800</b>        | <b>1.0000</b>           | <b>\$51,900</b> |

- d. Form T, Part I

## Forest Activities Schedule

▶ **Attach to your tax return.**      ▶ **See separate instructions.**  
 For tax year ending \_\_\_\_\_, 20 \_\_\_\_\_

OMB No. 1545-0007

Attachment  
 Sequence No. **117**

Name(s) as shown on return

Identifying number

**(Your Name)**

**SSN : NNN-NN-NNNN**

**Part I Acquisitions**

**1** Name of block and title of account

**(Your Name) Timber Account**

**2** Location of property (by legal subdivisions or map surveys)

**(Legal description)**

|  |   |
|--|---|
| <b>3a</b> Name and address of seller or person from whom property was acquired<br><b>(Seller's name and address)</b> | <b>b</b> Date acquired<br><b>MM/DD/YY</b> |
| <b>4</b> Amount paid: <b>a</b> In cash . . . . .   | <b>50,000</b>                             |
| <b>b</b> In interest-bearing notes . . . . .   | --  |
| <b>c</b> In non-interest-bearing notes . . . . .   | --  |
| <b>5a</b> Amount of other consideration . . . . .  | --  |
| <b>b</b> Explain the nature of other consideration and how you determined the amount shown on line 5a.<br>.....      |   |
| <b>6</b> Legal expenses . . . . .  | <b>300</b>                                |
| <b>7</b> Cruising, surveying, and other acquisition expenses . . . . .   | <b>1,600</b>                              |
| <b>8</b> Total cost or other basis of property. Add lines 4a through 7 . . . . .                                     | <b>51,900</b>                             |

| 9 Allocation of total cost or other basis on books:  | Unit        | Number of units | Cost or other basis per unit | Total cost or other basis |
|--|-------------|-----------------|------------------------------|---------------------------|
| <b>a</b> Forested land . . . . .   | Acre        | <b>40</b>       | <b>337.60 / Acre</b>         | <b>13,504</b>             |
| <b>b</b> Other unimproved land . . . . .   | Acre        |                 |                              | --                        |
| <b>c</b> Improved land (describe) ▶ .....  | Acre        |                 |                              | --                        |
| <b>d</b> Merchantable timber. Estimate the quantity of merchantable timber present on the acquisition date (see Regulations section 1.611-3(e)). Details of the timber estimate, made for purposes of the acquisition, should be available if your return is examined. | <b>Cord</b> | <b>560</b>      | <b>24.11 / Cord</b>          | <b>13,504</b>             |
|  | <b>MBF</b>  | <b>72</b>       | <b>265.28 / MBF</b>          | <b>19,100</b>             |
|  |             |                 |                              | --                        |
| <b>e</b> Premerchantable timber. Make an allocation here only if it is a factor in the total cost or value of the land.  | <b>Acre</b> | <b>20</b>       | <b>289.60 / Acre</b>         | <b>5,792</b>              |
|  |             |                 |                              | --                        |
|  |             |                 |                              | --                        |
| <b>f</b> Improvements (list separately)<br>.....<br>.....<br>.....<br>.....  |             |                 |                              | --<br>--<br>--<br>--      |
| <b>g</b> Mineral rights . . . . .  |             |                 |                              | --                        |
| <b>h</b> Total cost or other basis (same amount as line 8). Add lines 9a through 9g . . . . .  |             |                 |                              | <b>51,900</b>             |

**EXAMPLE 2:** By the end of the past year, the younger plantation has become merchantable and carries 200 cords of pulpwood. The older plantation also has grown, and now carries 112 MBF of sawtimber and 390 cords of pulpwood. Adjust the basis in you Plantation and Merchantable Sawtimber subaccounts and report the changes using Form T, Part II.

a. Plantation Subaccount:

|                                     |                |  |
|-------------------------------------|----------------|--|
| 1) Subtract out value (cost) basis: | \$ 5,792       | <i>Original basis</i>                    |
|                                     | <u>- 5,792</u> | <i>To Merchantable Timber Subaccount</i> |
|                                     | \$ 0           | <i>Adjusted basis</i>                    |

|                               |                |  |
|-------------------------------|----------------|--|
| 2) Subtract out volume basis: | 20 Ac          | <i>Original basis</i>                    |
|                               | <u>- 20 Ac</u> | <i>To Merchantable Timber Subaccount</i> |
|                               | 0 Ac           | <i>Adjusted basis</i>                    |

b. Merchantable Timber Subaccount:

|  |                |                                   |
|--|----------------|-----------------------------------|
| 1) Add value (cost) basis from<br>Plantation Subaccount: | \$ 32,604      | <i>Original basis</i>             |
|  | <u>+ 5,792</u> | <i>From Plantation Subaccount</i> |
|  | \$ 38,396      | <i>Adjusted basis</i>             |

|                                  |                 |                                   |
|----------------------------------|-----------------|-----------------------------------|
| 2) Update pulpwood volume basis: | 560 Cd          | <i>Original basis</i>             |
|                                  | + 200 Cd        | <i>From Plantation Subaccount</i> |
|                                  | <u>- 170 Cd</u> | <i>Grew into sawtimber</i>        |
|                                  | 590 Cd          | <i>Adjusted basis</i>             |

|                                   |                |                             |
|-----------------------------------|----------------|-----------------------------|
| 3) Update sawtimber volume basis: | 72 MBF         | <i>Original basis</i>       |
|                                   | <u>+40 MBF</u> | <i>Grew out of pulpwood</i> |
|                                   | 112 MBF        | <i>Adjusted basis</i>       |

4) Form T, Part II

**Part II Timber Depletion** (see instructions)

1 Name of block and title of account ▶ (Your Name) Merchantable Timber Subaccount: Update quantity basis for growth and ingrowth; transfer basis from Plantation Subaccount to Merchantable Timber Subaccount

| If you express timber quantity in thousand board feet (MBF), log scale, name the log rule used. If another unit of measure is used, provide details ▶ <u>Doyle</u>                                  | (a)<br>Quantity              | (b)<br>Cost or other basis  |
|---|------------------------------|-----------------------------|
| 2 Estimated quantity of timber and cost or other basis returnable through depletion at end of the preceding tax year . . . . .  | 560 cd, 72 MBF               | 32,604                      |
| 3 Increase or decrease of quantity of timber required by way of correction . . . . .  | --                           |                             |
| 4a Addition for growth (number of years covered ▶ <u>5</u> ) . . . . .  | - 170 cd, + 40 MBF           |                             |
| b Transfers from premerchantable timber account . . . . .   | + 200 cd                     | + 5,792                     |
| c Transfers from deferred reforestation account . . . . .   | --                           | --                          |
| 5 Timber acquired during tax year . . . . .   | --                           | --                          |
| 6 Addition to capital during tax year . . . . .   |                              | --                          |
| 7 Total at end of tax year, before depletion. Add lines 2 through 6 . . . . .   | 590 cd, 112 MBF              | 38,396                      |
| 8 Unit rate returnable through depletion, or basis of sales or losses. Divide line 7, column (b), by line 7, column (a) . . . . .   |                              | 20.08/cd, 237.03/M          |
| 9 Quantity of timber cut during tax year . . . . .  | --                           |                             |
| 10 Depletion for the current tax year. Multiply line 8 by line 9 . . . . .  |                              | --                          |
| 11 Quantity of standing timber sold or otherwise disposed of during tax year . . . . .  | --                           |                             |
| 12 Allowable as basis of sale. Multiply line 8 by line 11 . . . . .   |                              | --                          |
| 13 Quantity of standing timber lost by fire or other cause during tax year . . . . .  | --                           |                             |
| 14 Allowable basis of loss plus any excess amount where decrease in FMV (before and after the casualty) exceeds the standard depletion amount, but not the block basis (see instructions) . . . . . |                              | --                          |
| 15 Total reductions during tax year:  | --                           |                             |
| a In column (a), add lines 9, 11, and 13 . . . . .  |                              |                             |
| b In column (b), add lines 10, 12, and 14 . . . . .   |                              | --                          |
| 16 Net quantity and value at end of tax year. In column (a), subtract line 15a from line 7. In column (b), subtract line 15b from line 7 . . . . .  | 590 cd, 112 MBF              | 38,396                      |
| 17 Quantity of cut timber that was sold as logs or other rough products . . . . .   |                              |                             |
| 18 Section 631(a):  |                              |                             |
| a Are you electing, or have you made an election in a prior tax year that is in effect, to report gains or losses from the cutting of timber under section 631(a)? (see instructions) . . . . .     | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| b Are you revoking your section 631(a) election (see instructions)? . . . . .   | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
|   | Effective date ▶             |                             |

## Passive Loss Rules

Agriculture Handbook 718,  
pages 40-43

4/15/2009

## Structure of Ownerships Are Important

The tax rules for deducting expenses will vary largely depending on:

- ❖ the different ownership types and
- ❖ the nature of the expense

2

## The Three Categories

1. Personal Use: Property owned for personal enjoyment, vs. for profit
2. Investment: Timber held for the production of income but is not part of a trade or business.
3. Business: Timber held for production of income; management activities are more regular and intensive

3

## Timber Business Ownerships

1. Active Business: Timber held as **part of a trade or business** in which you “materially participate”
2. Passive Business: Timber held as a **part of a trade or business** in which you do not “materially participate”

4

## Purpose

- ❖ The purpose of the passive loss rules is to restrict taxpayers from using losses from largely passive ventures solely to offset taxable income from active activities.
- ❖ Generally Loss from passive business can only offset passive income (with exceptions)

5

## Remember...

- The passive loss rules apply to activities carried out as a **business**, not to those carried out as an investment.

6

## Which Classification Applies?

- If your timber ownership is a “trade or business” it is subject to the passive loss rules.
- You must determine which of two classifications apply to you and your forest property.

7

## Timber Held As a Part of a Trade or Business in Which You Do “Materially Participate”

- Management expenses are fully deductible against income from any source.
- Property taxes are fully deductible against income from any source.
- Interest on indebtedness is fully deductible against any source.

8

## Tests for Material Participation

- To be considered “materially participating,” the taxpayer’s involvement must be “regular, continuous, and substantial”.
- According to the Internal Revenue Service, you will be considered to materially participate in your activity if you meet **at least one** of the following tests:

9

## Tests for Material Participation

1. **The “absolute” test:** you and your spouse participate in the management and operation of the activity for more than 500 hours during the tax year.

10

## Tests for Material Participation

2. **The “do it most of it yourself” test:** you and your spouse’s participation in the management and operation of the activity constitutes substantially all of the participation in the activity during the tax year (even if only a low level of activity is all that is required).

11

## Tests for Material Participation

3. **The “100-hour majority” test:** you and your spouse participate for more than 100 hours in the management and operation of the activity during the tax year, and no other individual participates more.

12



## Tests for Material Participation

4. **The “significant participation aggregate” test:** you and your spouse’s participation in all of your “significant participation activities,” including your timber activity, exceeds 500 hours during the tax year.

A “significant participation activity” is a trade or business in which you participate for more than 100 hours.

Hence, you can qualify under this test even if someone else participates more in the timber activity than you do.

13

## Tests for Material Participation

5. **The “five of the last 10 years” test:** you and your spouse materially participate in the management and operation of your timber activity for at least 5 of the preceding 10 tax years.

14

## Tests for Material Participation

6. **The “facts and circumstances” test:** all the facts and circumstances of the situation indicate that you and your spouse materially participate.

The specific rules to be followed in applying this case have not been fully defined.

Suggestion: do not use this test!

15

## Retired or Disabled Taxpayers

- If you are retired or become disabled and do not meet the material participation requirements, you will be treated as materially participating if you did so for at least 5 of the last 10 years immediately preceding your retirement or disability, which ever comes first.

16

## Surviving Spouses

- Surviving spouses, having acquired from a deceased spouse, forest property that qualified as a trade or business need only satisfy an “active management” test.
- Under this test, you will generally be required only to participate in general management decisions, and not be required to make daily operating decisions.

17

## Record Keeping

- Because of the passive loss-rules, record keeping is now even more important!
- Formal bookkeeping is not required—any reasonable means is okay. This includes appointment books, calendars, and narrative summaries.

18

## Record Keeping

- Records consist of :
  - ◆ Timber management plan
  - ◆ Receipts for business transactions
  - ◆ Odometer readings, diaries, time recording for the time spent managing the trade or business
  - ◆ Agendas to training meetings
  - ◆ Membership records in business related associations

19

## Reporting Expenses

- If your timber operations are established as a sole proprietorship and are incidental to farming activities, list your deductible timber expenses together with your deductible farming expenses on **Schedule F** of Form 1040, “Farm Income and Expenses.”

20

## Reporting Expenses

- If your timber operations are a separate sole proprietorship business or are incidental to a non-farm business, report your deductions on Schedule C of Form 1040, "Profit or Loss from Business (Sole Proprietorship)."

21

## Timber Held As a Part of a Trade or Business in Which You Do Not "Materially Participate"

- Management expenses are deductible only to the extent of passive income (such as timber sales).

22

## Restrictions

- The passive loss rules apply to:
  - ◆ individuals
  - ◆ estates
  - ◆ trusts
  - ◆ closely held C corporations
  - ◆ personal service corporations

23

## Timber Held As an Investment

- An **investment** is an undertaking entered into
  - ◆ with a profit motive
  - ◆ but which does not involve the same regularity or frequency of activities that a trade or business would require.

24

### **Timber Held As an Investment**

- Timber held as an investment, rather than as a trade or business, is not subject to the passive loss rules. However, deductibility of expenditures by non-corporate investors is limited.

25

### **Timber Held As an Investment**

- **Management expenses**, plus other “miscellaneous itemized deductions,” are deductible only to the extent they exceed 2% of adjusted gross income (AGI).

26

### **Timber Held As an Investment**

- Alternatively, management costs may be capitalized as carrying charges instead of being currently deducted – provided the property is not “productive” during the tax year.

27

### **Timber Held As an Investment Property Taxes**

- Property and other **taxes** are deductible against income from any source (itemize deductions for individuals)
- You may elect to capitalize **property taxes** and recover them on the sale of the timber rather than deduct them in the year paid.

28

### **Timber Held As an Investment Severance and Yield Taxes**

- Severance and yield taxes are expensed in the year incurred
- They may not be capitalized

29

### **Timber Held As an Investment**

- **Interest** on indebtedness is deductible only to the extent of the “net investment income”
- You may
  - ◆ carry forward excess interests paid indefinitely and offset investment income in later years
  - ◆ elect to capitalize the interest paid to offset income realized from the sale of timber.

30

### **Timber As An Investment Cost Deduction**

- If in any tax year you do not itemize deductions, or alternatively you do not elect to capitalize these expenses, the costs are lost for tax purposes, and you will not be able to recover them.

31

## Do I Need to Report Cost Shares on My Return?

Agriculture Handbook 718,  
pages 58-61

4/15/2009

1

## Cost-share Payments Reporting Rule

- Generally, you are required to report Government cost-share payments as part of your gross income
  - to report income from all sources
  - To reconcile the Form 1099G you receive for the payment.

2

## Cost-Share Payments Section 126 Incentives

- However, under **Section 126** of the IRS Code, all, or part of, **certain** government cost-share programs **MAY be excluded** from gross income.

3

## Cost-share Payments Section 126 Incentives

- Nevertheless, even if you choose to exclude an approved government cost-share payment, **YOU MUST REPORT IT** on your return showing how the exclusion was determined.

4

## Requirements for Section 126 Exclusion

- In general, a portion or all of a cost-share payment is excludable from income if two conditions are met:

5

## Requirements for Section 126 Exclusion

- The payment is determined by the Secretary of Agriculture to be primarily for the purpose of
  - conserving soil and water resources
  - protecting or restoring the environment
  - improving forests, or
  - providing habitat for wildlife, and

6

## Requirement #1 Approved Federal Programs

- Forest Land Enhancement Program (FLEP)
- Conservation Reserve Program (CRP)
- Environmental Quality Incentives Program (EQIP)
- Wetland Reserve Program (WRP)
- Wildlife Habitat Incentive Program (WHIP)

7

## Approved State Programs

- Forestry Development Program\_\_\_\_\_NC
- Reforestation of Timberlands Act Program\_\_\_\_\_VA
- Forest Resource Development Program\_\_\_\_\_MS
- Forest Improvement Program\_\_\_\_\_CA
- Forest Renewal Program\_\_\_\_\_SC
- Forestry Development Program\_\_\_\_\_IL
- Forestry Productivity Program\_\_\_\_\_LA
- Texas Oak Wilt Suppression Program\_\_\_\_\_TX

8

### **Forest Health Management Program**

- Forest Health Management Cost Share is under the IRS review for income exclusion

9

### **Conservation Reserve Program**

- Conservation Reserve Program (CRP) cost-share payments are NOW excludable based on IRS Revenue Ruling 2003-59. (This reverses the previous IRS position.)
- The exclusion applies to cost-share payments only.

10

### **Conservation Reserve Program**

- Section 126 specifically eliminates any Government payment that is in the nature of rent or compensation for services from qualifying for exclusion from gross income.

Hence, recurring annual payments under CRP do not qualify for exclusion.

11

### **Conservation Reserve Program**

- CRP rental payment excluded from self-employment income for retirees and disabled taxpayers
- Effective for rental payment made after December 31, 2007

12



## Conservation Reserve Program

- CRP cost-share payments used for reforestation expenses are eligible for the \$10,000 write-off and 7-year amortization.

13

## Conservation Reserve Program

- Also, as an alternative to the amortization, qualified farmers may deduct annually CRP tree planting expenditures under Section 175 (with limit).

14

## Conservation Reserve Program

- CRP cost share is not subject to self-employment tax for retired and disabled persons.
  - ◆ It also will not reduce social security and disability payment

15

## TSI Cost-share Payments

- If the cost-share payment received is used for **Timber Stand Improvement (TSI)** practices, it **must** always be included in gross income.
- TSI payments, however, are generally eligible for deduction as a **current expense** in the year incurred.

16

## **Requirement #2 for Section 126 Exclusion**

- It is determined by the Secretary of the Treasury as not substantially increasing the annual income from the property.

17

## **Requirement #2 “Substantial” defined...**

- The IRS regulations define an increase in annual income as “substantial” if it exceeds the greater of:

18

## **Requirement #2 “Substantial” defined...**

- The present value of 10% of the average income from the affected acres for the last three tax years, or
- The present value of \$2.50 times the number of affected acres.

19

## **4-step Procedure to Compute the Excludable Portion**

- Step 1: Calculate 10 percent of the average annual income from the affected acres during the past 3 years
- Step 2: Multiply \$2.50 times the number of affected acres..

20

## 4-step Procedure to Compute the Excludable Portion

- Step 3: Calculate the present value of the larger number from steps 1 and 2
- Step 4: Compare the number from step 3 with your cost-share payment; the smaller of the amount you can exclude from your gross income.

21

## Determining the Excludable Portion

- If the cost-share payment is less than or equal to the computed value, it may be entirely excluded from gross income
- If the cost-share payment is greater than the computed value, only the amount from Step 3 can be excluded, and the excess must be included in gross income.

22

## Cost-share Example I

- ❖ Last year you harvested 40 acres and received **\$84,500** for the timber.
- ❖ This was the only income from the property in many years.
- ❖ This year, you replanted the 40 acres at a cost of \$6,000 (\$150/acre).
- ❖ You received \$3,900 in CRP cost-share payments to cover the cost of replanting.

23

## Cost-share Example I

- How much of \$3,900 cost-share payment can be excluded from your gross income?

24

## Solution

- Step 1:  
Compute 10% of the average annual income for the 3 previous years:  
 $0.10 \times (\$84,500/3) = \$2,817$
- Step 2:  
Multiply \$2.50 times the number of affected acres  
 $\$2.50 \times 40 = \$100$

25

## Solution

- Step 3:  
Compare the two values. \$2,817 is larger.  
Divide by the interest rate (assumed to be 9.32% -- a Farm Credit Bank rate)  
 $\$2,817/0.0932 = \$30,225$
- Step 4:  
\$30,225 is larger than \$3,900; you can exclude the entire FIP payment from your gross income.

26

## What Interest Rate Do You Use?

- The IRS regulations do not specify which interest rate to use, nor even suggest how to determine it.
- Taxpayers are responsible for choosing their own interest rate. **This is a very subjective determination.**

27

## What Interest Rate Do You Use?

- However, the rate should be a reasonable one—such as the rate the IRS charges for overdue taxes, or the rate charged for a fixed rate 30-year home mortgage.
- Other interest rates may be used if they are reasonable and you can justify them.

28

## Interest Rate Effects

- The interest rate used for calculating the present value will strongly affect the amount that may be excluded.
- The lower the interest rate used, the larger will be the exclusion.

29

## Reforestation Tax Incentives and Cost-share Payments

- To the extent that a cost-share payment is included in gross income, and is used for planting or seeding of trees for commercial production of timber products, it may **qualify for accelerated deductions** (the \$10,000 expensing in the first year and 7-year reforestation amortization deductions)

30

## Reforestation Tax Incentives and Cost-share Payments

- If the cost-share payments are excluded, however, they can not be included for the accelerated deduction (\$10,000 expensing and amortization)

31

## If You Exclude ...

- If you decide to exclude part or all of a cost-share payment from gross income, **attach a statement, on a plain piece of paper**, to your tax return stating specifically:

32

### **If You Exclude ...**

- The amount of the cost-share payment;
- The date you received it;
- The amount of the payment that qualifies for exclusion;
- The amount you choose to exclude; and
- An explanation of how you determined the excludable amount.

33

### **If You Include Cost-share Payments:**

- They may also be subject to self-employment tax when you're a timber business filer, since self-employment income includes all items of business income—including government conservation cost-share program payments.

34

### **If You Include Cost-share Payments:**

- They may also be subject to state income taxes.

35

### **Include or Exclude?**

- Whether to include or exclude cost-share payments depends on the “facts and circumstances” of each individual taxpayer.
- Some taxpayers will get a better tax advantage by including cost-share payments as income while others will get a better advantage by excluding them.

36

## Include or Exclude?

- Do whichever will give you the best tax advantage!

37

## Reporting on Your Return

- For taxpayers who report as investors: report as “miscellaneous income” on the front of Form 1040.
- For taxpayers whose timber holdings are treated as a business: report on **Schedule C, Form 1040**.
- For farmers: report on **Schedule F, Form 1040**.

38

## Recapture Provisions

- If the property established with an excluded cost-share payment is disposed of within 20 years, recapture provisions apply.

39

## Recapture Provisions

- The recapture amount during the first 10 years is the LESSER of:
  - the amount of the cost-share payment excluded, or
  - the amount of the gain from disposal.

40

## **Recapture Provisions**

- The base recapture amount is reduced by 10% for each year, or portion of a year, if the disposal occurs between 10 and 19 years.
- It is recaptured as ordinary income.



## **Reforestation Tax Incentives**

①

**Ag. Handbook 718, pages 26-29**  
**Updated for Revenue Ruling 2003-59 and**  
**the American Jobs Creation Act of 2004**

## **Reforestation Tax Incentives**

- ▶ **Incentives provided in the Internal Revenue Code reduce or eliminate the need to hold expenses associated with reforestation – or afforestation – in a capital account until you sell timber or timber products**
- ▶ **The American Jobs Creation Act of 2004 changed the nature of reforestation incentives**

2

## **Reforestation Tax Incentives**

- ▶ **For reforestation done before Oct. 23, 2004, you could take a 10-percent reforestation investment tax credit on and amortize (write off) up to \$10,000 of qualifying expenses per year over 8 tax years**
- ▶ **For reforestation done after Oct. 22, 2004, you can deduct outright the first \$10,000 per year of qualifying expenses and amortize *any* additional amounts over 8 tax years**

3

## **Who is Eligible**

- ▶ **Individual taxpayers, estates, partnerships, and corporations are eligible for both the deduction and amortization provisions**
  - ✓ **Trusts are not eligible for the deduction, but they are eligible for amortization**

4

## What Qualifies

- ▶ Reforestation expenses on tracts:
  - ✓ At least 1 acre in size
  - ✓ Located in the U.S.
  - ✓ Held to produce commercial timber products
  - ✓ Includes practices to encourage natural regeneration

5

## What Qualifies

- ▶ Reforestation expenses reimbursed under an approved public cost-share program that you *do not* elect to exclude from your taxable income
- ▶ Until 2003 this *always* included CRP cost-share payments, because all CRP payments had to be included in gross income

6

## What Qualifies

- ▶ Under Rev. Rul. 2003-59, you now can exclude CRP cost-shares from gross income, although you *cannot* exclude CRP rental or incentive payments
- ▶ NOTE: Under IRC Section 175, you also can deduct tree-planting expenses paid using a CRP cost-share, to a limit of 25 percent of your income from *farming*

7

## What Does Not Qualify

- ▶ The cost of planting non-timber trees:
  - ✓ Christmas trees
  - ✓ Nut trees
  - ✓ Shelterbelts
  - ✓ Fruit trees
  - ✓ Windbreaks
  - ✓ Ornamentals
- ▶ Reforestation expenses reimbursed under an approved public cost-share program that you *do* elect to exclude from your taxable income
- ▶ The cost of intermediate treatments

8

### **Expenses Up To \$10,000 per Year**

- ▶ **Deduct any direct expenses incurred in establishing a stand of timber, to a maximum of \$10,000 per year – \$5,000 for married couples filing separately – for each qualified timber property**

**NOTE: You cannot combine qualified timber properties for calculating timber depletion deductions or casualty loss deductions**

9

### **Expenses Up To \$10,000 per Year**

- ▶ **Investors take the deduction on the front of Form 1040, as an adjustment to income**
  - ✓ **Write RFST and the amount on the dots for the adjustments to income line (37 for 2007)**
- ▶ **Participants in a trade or business take the deduction on a business form**
  - ✓ **Form 1040, Schedule C for a business or Schedule F for a farm; use the “Other expenses” line**

10

### **Expenses Over \$10,000 per Year**

- ▶ **Reforestation expenses over \$10,000 per year must be amortized (written off)**
  - ✓ **The amortization period is nominally 84 months (7 years), but a half-year convention applies, so you:**
    - Take a half-deduction in year 1 (1/14th)**
    - Take a full 1/7th deduction in years 2–7**
    - Take the final 1/14th deduction in year 8**

11

### **Expenses Over \$10,000 per Year**

- ▶ **You must specifically elect to amortize reforestation expenses on a timely-filed return for the tax year in which they are incurred (including extensions)**
  - ✓ **Make the election and report the amount of deductions taken on Form 4562, Part VI**

12

## Expenses Over \$10,000 per Year

- ✓ You cannot make the election on an amended return, but once it is made, you can take amortization deductions you forgot about
- ▶ Investors again take the deduction on the front of Form 1040, as an adjustment to income
- ▶ Participants in a trade or business again take the deduction on a business form

13

## Recapture Provisions

- ▶ Any tax saved by using either reforestation tax incentive is subject to recapture if you dispose of the trees within 10 years
  - ✓ Disposals by gift are excepted
  - ✓ Like-kind exchanges, involuntary conversions, tax-free transfers, and transfers at death also are generally excepted

14

**EXAMPLE:** Say you reforested 80 acres last year at a cost of \$175 per acre, or \$14,000 in all. You received no cost-share payment, so your total expense is more than \$10,000. Calculate the reforestation incentives you are eligible for.

15

## Solution

- ▶ Deduct outright the first \$10,000 of your expenses
- ▶ And begin writing off the amortizable amount
$$1/14 \times (\$14,000 - \$10,000) = \$286$$

16

## Solution

- ▶ In your returns for years 2–7 you would write off a full 1/7th of the amortizable amount

$$1/7 \times (\$14,000 - \$10,000) = \$571$$

- ▶ And in your return for year 8 you would write off the final 1/14th

$$1/14 \times (\$14,000 - \$10,000) = \$286$$

17

**Form 4562, Part VI**

**Form T, Part IV**

**If you are required to file a Form T, you also should fill in and submit Form T, Part IV**

18

## Maximizing the Benefit

- ▶ Other reforestation strategies would enable you to better utilize the reforestation incentives, for example:

- ✓ You could divide the reforestation operation – and the expenses – between 2 tax years, or
- ✓ You could use excludable cost-share payments to bring your direct expenses below \$10,000

19

## Maximizing the Benefit

- ▶ *But remember*, you should base your forest management decisions on their full silvicultural, financial and planning implications, not just their tax effect

20

**Tax Forms: Form 4562, Part VI (Back)  
Form T, Part IV**

# **Tax Forms and Examples**



## **Reforestation Tax Incentives**

**Part V Listed Property** (Include automobiles, certain other vehicles, cellular telephones, certain computers, and property used for entertainment, recreation, or amusement.)

Note: For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete only 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.

**Section A—Depreciation and Other Information** (Caution: See the instructions for limits for passenger automobiles.)

| 24a Do you have evidence to support the business/investment use claimed? <input type="checkbox"/> Yes <input type="checkbox"/> No   |                               |  |                            |  |                        | 24b If "Yes," is the evidence written? <input type="checkbox"/> Yes <input type="checkbox"/> No |                               |                                 |  |
|---|-------------------------------|--|----------------------------|--|------------------------|---|-------------------------------|---------------------------------|--|
| (a)<br>Type of property (list vehicles first)   | (b)<br>Date placed in service | (c)<br>Business/ investment use percentage | (d)<br>Cost or other basis | (e)<br>Basis for depreciation (business/investment use only) | (f)<br>Recovery period | (g)<br>Method/ Convention   | (h)<br>Depreciation deduction | (i)<br>Elected section 179 cost |  |
| 25 Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use (see instructions) |                               |  |                            |  |                        |   | 25                            |                                 |  |
| 26 Property used more than 50% in a qualified business use:   |                               |  |                            |  |                        |   |                               |                                 |  |
|   |                               | %  |                            |  |                        |   |                               |                                 |  |
|   |                               | %  |                            |  |                        |   |                               |                                 |  |
|   |                               | %  |                            |  |                        |   |                               |                                 |  |
| 27 Property used 50% or less in a qualified business use:   |                               |  |                            |  |                        |   |                               |                                 |  |
|   |                               | %  |                            |  |                        | S/L -   |                               |                                 |  |
|   |                               | %  |                            |  |                        | S/L -   |                               |                                 |  |
|   |                               | %  |                            |  |                        | S/L -   |                               |                                 |  |
| 28 Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1.   |                               |  |                            |  |                        |   | 28                            |                                 |  |
| 29 Add amounts in column (i), line 26. Enter here and on line 7, page 1.  |                               |  |                            |  |                        |   |                               | 29                              |  |

**Section B—Information on Use of Vehicles**

Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

|  | (a)<br>Vehicle 1 |    | (b)<br>Vehicle 2 |    | (c)<br>Vehicle 3 |    | (d)<br>Vehicle 4 |    | (e)<br>Vehicle 5 |    | (f)<br>Vehicle 6 |    |
|--|------------------|----|------------------|----|------------------|----|------------------|----|------------------|----|------------------|----|
|  | Yes              | No | Yes              | No | Yes              | No | Yes              | No | Yes              | No | Yes              | No |
| 30 Total business/investment miles driven during the year (do not include commuting miles) |                  |    |                  |    |                  |    |                  |    |                  |    |                  |    |
| 31 Total commuting miles driven during the year  |                  |    |                  |    |                  |    |                  |    |                  |    |                  |    |
| 32 Total other personal (noncommuting) miles driven  |                  |    |                  |    |                  |    |                  |    |                  |    |                  |    |
| 33 Total miles driven during the year. Add lines 30 through 32                             |                  |    |                  |    |                  |    |                  |    |                  |    |                  |    |
| 34 Was the vehicle available for personal use during off-duty hours?                       |                  |    |                  |    |                  |    |                  |    |                  |    |                  |    |
| 35 Was the vehicle used primarily by a more than 5% owner or related person?               |                  |    |                  |    |                  |    |                  |    |                  |    |                  |    |
| 36 Is another vehicle available for personal use?  |                  |    |                  |    |                  |    |                  |    |                  |    |                  |    |

**Section C—Questions for Employers Who Provide Vehicles for Use by Their Employees**

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who are not more than 5% owners or related persons (see instructions).

|   |     |    |
|---|-----|----|
| 37 Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees?  | Yes | No |
| 38 Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners |     |    |
| 39 Do you treat all use of vehicles by employees as personal use?   |     |    |
| 40 Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received?   |     |    |
| 41 Do you meet the requirements concerning qualified automobile demonstration use? (See instructions.)  |     |    |

Note: If your answer to 37, 38, 39, 40, or 41 is "Yes," do not complete Section B for the covered vehicles.

**Part VI Amortization**

| (a)<br>Description of costs  | (b)<br>Date amortization begins | (c)<br>Amortizable amount | (d)<br>Code section | (e)<br>Amortization period or percentage | (f)<br>Amortization for this year |     |
|--|---------------------------------|---------------------------|---------------------|--|-----------------------------------|-----|
| 42 Amortization of costs that begins during your 2008 tax year (see instructions): |                                 |                           |                     |  |                                   |     |
| Qualifying reforestation costs   | 07/01/2008                      | 4,000                     | 194(b)              | 84 mo.                                   | 286                               |     |
| 43 Amortization of costs that began before your 2008 tax year                      |                                 |                           |                     |  | 43                                | 571 |
| 44 Total. Add amounts in column (f). See the instructions for where to report      |                                 |                           |                     |  | 44                                | 857 |



**Part IV Reforestation and Timber Stand Activities** (see instructions)

| Account, block, tract, area, or stand ID for each Qualified Timber Property (QTP)  | Kind of activity (burning, chopping, spraying, planting, seeding, thinning, pruning, fertilizing, etc.) | Number of acres treated | Total expenditures |
|--|---|-------------------------|--------------------|
| <b>1</b> (Your Name) Timber Account  | Reforestation   | 80                      | 14,000             |
|  |   |                         | --                 |
|  |   |                         | --                 |
|  |   |                         | --                 |
|  |   |                         | --                 |
|  |   |                         | --                 |
|  |   |                         | --                 |
| <b>2</b> Total   |   | 80                      | 14,000             |
| <b>3</b> Total reforestation expenses  |   | 80                      | 14,000             |
| <b>4a</b> Amount to be expensed under section 194(b).<br>(See instructions for limitations)  |   |                         | 10,000             |
| <b>b</b> Amount to be amortized under IRC 194(a), including remaining reforestation expenditures not expensed under section 194(b) |   |                         | 4,000              |

**Part V Land Ownership**

Show all changes in land accounts. Attach as many additional sheets as needed, following the format of lines 1 through 6.

| 1 Name of block and title of account ▶<br>.....<br>.....                                | Acres | Total cost or other basis. Give amount of March 1, 1913 appreciation, if included | Average rate per acre |
|---|-------|---|-----------------------|
| 2 Balance at beginning of year  |       |   |                       |
| 3 Acquisitions during year  |       |   |                       |
| 4 Sales during year   |       |   |                       |
| 5 Other changes   |       |   |                       |
| 6 Balance at end of year. Add lines 2 and 3, subtract line 4 and add or subtract line 5 |       |   |                       |

**Additional Information.**

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## Timber Sales and Income

① ② ③

Ag. Handbook 718, pages 45-57  
Updated for the Economic Growth  
& Tax Relief Reconciliation Act of 2001,  
the Jobs & Growth Tax Relief Reconciliation  
Act of 2003, and  
the American Jobs Creation Act of 2004

## Timber Income

- ▶ When you sell or exchange standing timber, both the amount and type of income you receive are important
- ▶ Amount: *Price – Expense of Sale – Timber Basis*
- ▶ Type: Ordinary income or capital gain

2

## Type of Income is Important

- ▶ EGTRRA and JGTRRA set the tax rates for ordinary income at 10, 15, 25, 28, 33, or 35%, depending on income level
- ▶ JGTRRA set the tax rate for long-term capital gains to 15%, or 5% for amounts that would be in the bottom 2 brackets (0% for 2008)
- ▶ So there is a 5% to 20% tax rate differential favoring long-term capital gains

3

## Type of Income is Important

- ▶ But type of income is important for other reasons
  - ✓ If your forest qualifies as a trade or business, any ordinary income you earn from timber is subject to self-employment taxes – at rates up to 15.3% – but capital gains are not

4

## **Type of Income is Important**

- ✓ If you have large losses from capital investments you can only apply them against \$3,000 of ordinary income per year, but against any amount of capital gains
- ✓ If you are retired, capital gains do not count toward the amount of income you can earn before your Social Security benefits are reduced

5

## **Qualifying for Capital Gains Treatment**

- ▶ Three factors determine whether income you receive for timber qualifies for capital gain treatment:
  - ✓ Your primary purpose for holding the timber
  - ✓ How long you held it
  - ✓ What method you use dispose of it

6

## **Primary Purpose**

- ▶ Timber held for personal use or as an investment is Section 1221 property
  - ✓ It is a capital asset in your hands
  - ✓ Any gain from a sale or exchange of the timber qualifies as a capital gain, regardless of what method you use

7

## **Primary Purpose**

- ▶ Timber held for use in a trade or business is Section 1231 property
  - ✓ It is *not* a capital asset in your hands
  - ✓ But gain from a sale or exchange if the timber *can* qualify for treatment as a capital gain

8

## Holding Period

- ▶ The holding period for long-term treatment depends on how you acquired your timber:
  - ✓ By purchase: Over 12 months
  - ✓ By gift: Also over 12 months, but includes time the donor held it
  - ✓ By inheritance: No requirement
- ▶ The holding period is measured from the date of acquisition to the “date of disposal”

9

## Method Used to Dispose of Timber

- ▶ Basically three ways:
  - ✓ Outright sale or exchange
  - ✓ Disposal with economic interest retained
  - ✓ Convert standing timber into products for sale
- ▶ Will cover individually

10

## Outright Sale

- ▶ Direct sale of standing timber for a fixed total amount agreed upon in advance – for example, through a timber deed or sale contract
  - ✓ AKA “lump-sum” sale
  - ✓ Once the sale is complete, the buyer has title to the timber and bears all risk of loss
  - ✓ “Date of disposal” is the date ownership of the timber changes hands

11

## Outright Sale

- ✓ Outright sale doesn’t necessarily mean a clearcut – all timber can be sold, or only certain species, sizes, or trees
- ✓ Here and in the other methods, the contract doesn’t have to be written as long as it is enforceable (that is, written)

12

## Outright Sale

- ▶ Until recently, the outright sale of timber was pretty much limited to investors
- ▶ Income from the outright sale of timber held as an investment qualifies as a capital gain
  - ✓ Long-term if held for the required period
  - ✓ Short-term if not

13

## Outright Sale

- ▶ Income from the outright sale of timber held for use in a trade or business did not qualify for capital gain treatment unless the owner could demonstrate they *did not* hold the timber primarily for sale to customers
  - ✓ Four tests determined whether the timber was a capital asset in their hands (CG) or held primarily for sale to customers (OI)

14

## Four Tests

1. Purpose for acquiring and holding the timber:  
Investment (CG) or for sale (OI)
2. Number, continuity, and frequency of sales:  
Isolated events (CG) or frequent (OI)
3. Extent to which you solicit or promote sales:  
Wait for buyers (CG) or actively solicit (OI)
4. Facts and circumstances:  
Part of occupation, contribute to livelihood (OI)

15

## Outright Sale

- ▶ Problem was the tests were not determinative – seemingly similar cases resulted in opposite court decisions
- ▶ But since Dec. 31, 2004, income from the outright sale of timber held primarily for sale to customers *can* qualify for treatment as a capital gain
  - ✓ Accomplished by a change in the wording of Section 631(b) put in place by AJCA

16

## **Outright Sale**

- ▶ **Disposing of timber under Section 631(b) gives the seller – you – two important advantages:**
  - ✓ **First, any gain realized is treated as a capital gain regardless of whether you held the timber primarily for sale to customers – even if you are a dealer in standing timber**

17

## **Outright Sale**

- ✓ **Second, timber qualifying under Section 631(b) is Section 1231 property**
  - The gain (or loss) from disposal of the timber is aggregated with other Section 1231 gains and losses**
  - A net gain is treated as a long-term capital gain**
  - But a net loss is treated as ordinary income**

18

## **Outright Sale**

- ▶ **An outright sale of timber under Section 631(b) involves a few more definitions than under Section 1221**
  - ✓ **Language in AJCA indicates that this case, “owner” is defined as the landowner who makes the original sale**
  - ✓ **The owner – you – has an investment in the timber and must look to its cutting for a return on that investment**

19

## **Outright Sale**

- ✓ **“Timber” is defined as the parts of standing trees usable for wood products**
  - Includes evergreen (coniferous) trees more than 6 years old when cut and sold for ornamental purposes**
  - But not evergreen trees sold live, or the tops or other parts of standing trees used separately from the main stem**

20

**EXAMPLE:** This January a timber buyer approaches you and offers to buy the older plantation for \$37,000, lump sum. You agree. Your only expense is \$350 to have your lawyer check the sale contract. Show how to calculate and report your proceeds from the sale.

**Reminder:** The Merchantable Sawtimber sub-account contains 590 cords and 112 MBF of volume basis and \$38,396 of value (cost) basis; the older stand being sold contains 390 cords of pulpwood and all 112 MBF of sawtimber.

21

## Solution

- ▶ Calculate your timber depletion allowance and adjust your timber basis:

Form T, Part II

22

## Solution

- ▶ Allocate sale proceeds:

|                                     |                 |
|-------------------------------------|-----------------|
| Gross sale proceeds . . . . .       | \$ 37,000       |
| Minus cost of the sale . . . . .    | - 350           |
| Minus depletion allowance . . . . . | <u>- 34,379</u> |
| Section 1221 gain . . . . .         | \$ 2,271        |

23

Form T, Part III  
Form 1040, Schedule D

24

## Outright Sale

- ▶ Investors report a capital gain from the outright sale of timber on Form 1040, Schedule D, as in this example
  - ✓ Long-term on Part II, short-term on Part I
  - ✓ Will be combined with other capital gains and losses and the net amount transferred to Form 1040

25

## Outright Sale

- ▶ Participants in a trade or business report a capital gain (or loss) from the outright sale of timber on Form 4797
  - ✓ It will be combined with other Section 1231 gains and losses, with a net gain treated as a capital gain and a net loss treated as ordinary income
  - ✓ You are required to file Form T, Parts II and III

26

## Outright Sale

- ✓ You also can expect to receive a Form 1099-S
- ▶ Report any ordinary income from the outright sale of timber on a business form – Form 1040, Schedule C for a business or Schedule F for a farm, or other forms for partnerships, corporations, trusts, or estates

④

27

## Disposal with Economic Interest Retained

- ▶ Disposal of timber under a contract that requires payment at a specified rate for each unit of timber that is actually cut and measured
  - ✓ AKA “pay-as-cut” contract
  - ✓ Technically a “disposal with an economic interest retained” which means the seller – you – typically retains title to the timber and bears risk of loss until it is cut

28



## **Disposal with Economic Interest Retained**

✓“Date of disposal” is not the date the timber is actually cut, but when in the ordinary course of business, the volume of the cut timber is first definitely determined

This definition of “cut” may enable an owner who has held the timber for nearly the required period to qualify for long-term capital gain treatment

29

## **Disposal with Economic Interest Retained**

But the time of measurement cannot be artificially delayed to get a tax advantage – that’s tax evasion

30

## **Disposal with Economic Interest Retained**

### ▶ Fine points

✓Contract can include penalties for not cutting certain trees, but only amounts up to the trees’ stumpage value is a capital gain

Anything over that amount is ordinary income

31

## **Disposal with Economic Interest Retained**

✓The volume of timber cut usually is determined by scaling, but it also can be determined by a cruise of the standing timber (Rev. Rul. 78-104)

In this case, the amount disposed of is the cruise volume before the harvest, minus the cruise volume of any contract timber remaining after the harvest

32

## Disposal with Economic Interest Retained

- ✓ Advance payments are permitted

May be a single sum or even a series of payments under a long-term contract, as long as the contract specifies that they are partial payments for the timber

But the contract *must* require adjustments to be made after cutting is completed, so the total amount paid is determined by the volume of timber actually cut

33

## Disposal with Economic Interest Retained

If you include an advance payment from a disposal with economic interest retained as a capital gain on your return and the cutting right expires, is terminated, or abandoned before all the timber paid for is cut, you must file an amended return – payment for the amount of timber actually cut remains a capital gain, but any additional amount you are allowed to keep is ordinary income

34

## Disposal with Economic Interest Retained

- ▶ Until enactment of AJCA a disposal with economic interest retained was the only method to dispose of standing timber recognized under Section 631(b)

- ✓ Owners who held timber primarily for sale to customers had to use this method to ensure their timber income qualified for treatment as a capital gain

35

## Disposal with Economic Interest Retained

- ▶ A Section 631(b) disposal with economic interest retained involves some additional definitions:

- ✓ “Owner” is any person or legal entity who – before entering into the 631(b) contract – has the right to cut the timber for sale or use on their own account

Can be the holder or a sublease or cutting contract, as long as they meet the holding requirement

36

## Disposal with Economic Interest Retained

- ✓ Owner – you – again has an investment in the timber and must look to the cutting for a return from that investment
- ✓ “Timber” again is the parts of standing trees usable for wood products, including ever-green (coniferous) trees more than 6 years old when cut and sold for ornamental purposes

37

**EXAMPLE:** Say that instead of accepting the timber buyer’s offer, you decide to take bids for your timber. A consulting forester solicits the bids, structures the sale as a Section 631(b) disposal with economic interest retained, and administers it for 10% of the proceeds. The best bid you receive is \$295 per MBF and \$25 per cord. Show how to calculate and report the adjustments to your timber basis and your proceeds from the sale.

38

## Solution

► Allocate basis between pulpwood and

| ▶ Allocate basis between pulpwood and sawtimber: | Fair Market Value (FMV) | Proportion of FMV |
|--|-------------------------|-------------------|
| Pulpwood . . .                                   | \$14,750                | 0.3086            |
| Sawtimber . .                                    | \$33,040                | 0.6914            |
|  | \$47,790                | 1.0000            |

39

## Solution

|                | Proportion of FMV | Proportion of Basis |
|----------------|-------------------|---------------------|
| Pulpwood . . . | 0.3086            | \$ 11,849           |
| Sawtimber . .  | 0.6914            | 26,547              |
|                | 1.0000            | \$ 38,396           |

40

### Solution

- ▶ Calculate pulpwood depletion unit:

$$\$11,849 \div 590 \text{ cords} = \$20.08 \text{ per cord}$$

- ▶ Calculate sawtimber depletion unit:

$$\$26,547 \div 112 \text{ MBF} = \$237.03 \text{ per MBF}$$

- ▶ Calculate depletion allowance:

$$(\$20.08 \text{ per cord} \times 390 \text{ cords}) +$$
$$(\$237.03 \text{ per MBF} \times 112 \text{ MBF}) = \$34,379$$

41

### Solution

- ▶ Update value basis:

$$\$38,396 - \$34,379 = \$4,017$$

- ▶ Update pulpwood volume basis:

$$590 \text{ cords} - 390 \text{ cords} = 200 \text{ cords}$$

- ▶ Update sawtimber volume basis:

$$112 \text{ MBF} - 112 \text{ MBF} = 0 \text{ MBF}$$

42

### Form T, Part II

43

### Solution

- ▶ Calculate Section 1231 gain:

|                                     |                 |
|-------------------------------------|-----------------|
| Gross sale proceeds . . . . .       | \$ 42,790       |
| Minus cost of the sale . . . . .    | - 4,279         |
| Minus depletion allowance . . . . . | <u>- 34,379</u> |
| Section 1231 gain . . . . .         | \$ 4,132        |

44

**Form T, Part III\***  
**Form 4797**

**\* Include a note that your income is reported on Form 4797**

45

**Disposal with Economic Interest Retained**

- ▶ **Investors report a capital gain from a disposal of timber with economic retained on Form 1040, Schedule D, as before**
- ▶ **Participants in a trade or business report a capital gain (or loss) from a Section 631(b) disposal of timber with economic interest retained on Form 4797, Part I, as in this example**

46

**Disposal with Economic Interest Retained**

- ✓ **If the result is a net gain, it will be treated as a net long-term capital gain and transferred to Part II of Form 1040, Schedule D, to be combined with other long-term capital gains and losses**
- ✓ **But if it is a net loss, it will be treated as ordinary income and transferred to Form 4797, Part II, to be combined with other ordinary gains and losses**

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**Disposal with Economic Interest Retained**

- ✓ **You should file Form T, Parts II and III to support your status as a participant in a trade or business**
- ✓ **And again, you can expect to receive a Form 1099-S from the buyer**

⑤

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## Convert Standing Timber into Products

- ▶ If you cut standing timber and convert it into logs or other products for sale, all the income that results will be ordinary income unless you have a Section 631(a) election in effect

If you do, then the income that results from holding the timber will be a capital gain – just as if you had sold it outright – and the value added by converting the timber into products for sale will be ordinary income

49

## Convert Standing Timber into Products

**NOTE:** Profit that results from converting standing timber into products for sale is *always* ordinary income – it is *never* a capital gain

50

## Convert Standing Timber into Products

- ▶ If you have a Section 631(a) election in effect and you have met the Section 631(a) holding period, report a conversion of standing timber into products for sale in two parts:
    - ✓ Report the difference between your adjusted basis in the timber that was cut and its fair market value as a Section 631(a) gain
- It will be aggregated with other Section 1231 gains and losses, with a net gain treated as ...

51

## Convert Standing Timber into Products

... a long-term capital gain and a net loss treated as ordinary income

- ✓ Report the profit from conversion of the standing timber as ordinary income
- Determine the profit just as you would for any business operation: income received from the sale of the products, minus the fair market value of the timber and the cost of conversion

52

## **Convert Standing Timber into Products**

▶ **Definition requires 5 more definitions:**

- ✓ **“Owner” is the same as with a Section 631(b) disposal with economic interest retained**

**So again, can be the holder of a sublease or cutting contract**

**But not the holder of a cutting service contract who is obligated to deliver the logs to you or to a buyer you specify – even if ...**

53

## **Convert Standing Timber into Products**

**... your contract with them uses terms like “buy,” “sell,” or “stumpage charge”**

- ✓ **“Timber” also means the same as in a Section 631(b) disposal with economic interest retained**

54

## **Convert Standing Timber into Products**

- ✓ **“Timber cut by taxpayer” includes timber cut by other persons at your direction as well as timber you cut yourself**

**The products the timber is converted into can be rough – for example, logs, pulpwood, or firewood – or finished – for example, lumber, wooden toys, or furniture**

**But they must be for sale or for use in your trade or business, not for personal use**

55

## **Convert Standing Timber into Products**

- ✓ **“Holding period” runs from the date you acquired the timber – or the contract right to cut it – to the date it is considered “cut”**

**As with a Section 631(b) disposal this is when, in the ordinary course of business, the volume of the timber cut is first definitely determined**

56

## Convert Standing Timber into Products

- ✓“Fair market value” is the price at which the timber would have changed hands in a transaction between a willing, informed buyer and a willing, informed seller on the *first day of the tax year* in which it is cut
- The timber must be valued as it existed on that day regardless of any change that occurs to it or the timber market between that day and the time it is cut

57

## Convert Standing Timber into Products

- Best indicator is the actual price paid for similar timber, in the same area, at the same time of year, adjusted for differences in quality, quantity, accessibility and markets, discounted to the first day of your tax year
- A general average price is not sufficient

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## Convert Standing Timber into Products

- If you only cut a small amount of timber, information from local mill operators and timber buyers may suffice
- But if you cut a large amount, you need to use a qualified timber appraiser

©

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## Convert Standing Timber into Products

- ▶ Make a Section 631(a) election by checking the YES box on Form T, Part II, line 18a
  - ✓ You must make the election on an original, timely filed return (including extensions)
  - You cannot make it on an amended return
- ✓ A Section 631(a) election is binding on all timber cut and converted into products in the year you make the election and all later years

60



## Convert Standing Timber into Products

- ✓ Under AJCA owners who cut timber under a Section 631(a) election made before Jan. 1, 2005, can revoke it one time without IRS consent

This provision chiefly benefits corporations, but will also help non-industrial owners who would benefit because of their particular tax situation

61

## Convert Standing Timber into Products

- ✓ Revoke a Section 631(a) election by checking the YES box on Form T, Part II, line 18b
- ✓ No consent is required to reinstate a Section 631(a) election
- ✓ Any further revocation requires IRS consent, but remember you can dispose of standing timber by either of the other methods at any time

62

**EXAMPLE:** Say that instead of selling your timber as stumpage, you hire a master logger to harvest it, cut it into sawlogs and pulpwood, and deliver the cut products to a sawmill that you specify. The consultant charges you \$600 for soliciting the bids; from them you know the standing timber was worth \$295 per MBF and \$25 per cord. The master logger charges you \$22,500. You receive \$390 per MBF and \$60 per cord for the delivered products. Show how to calculate and report your gains.

63

## Solution

- ▶ Calculate your timber depletion allowance and adjust your timber basis:

Form T, Part II  
Section 631(a) election on line 18a

64

### Solution

- ▶ Calculate Section 1231 gain from holding the timber:

|  |                 |
|--|-----------------|
| Fair market value as of Jan. 1 . . . . . | \$ 42,790       |
| Minus consultant charges . . . . .       | - 600           |
| Minus depletion allowance . . . . .      | <u>- 34,379</u> |
| Section 1231 gain . . . . .              | \$ 7,811        |

65

**Form T, Part III**  
**Form 4797**

66

### Solution

- ▶ Calculate gain from selling the converted sawlogs and pulpwood:

|                                      |                 |
|--------------------------------------|-----------------|
| Sale proceeds . . . . .              | \$ 67,080       |
| Minus FMV of the timber . . . . .    | - 42,790        |
| Minus master logger charge . . . . . | <u>- 22,500</u> |
| Ordinary income . . . . .            | \$ 1,790        |

67

**Form 1040, Schedule C\***

**\* List the FMV of the timber cut and other costs associated with the harvest and sale as “other costs” on page 2**

68

## **Convert Standing Timber into Products**

▶ **Converting standing timber into products for sale is inherently a business operation**

✓ **Report the timber-cutting part of the transaction on Form 4797**

**It will be combined with other Section 1231 gains and losses, with a net gain treated as a long-term capital gain and a net loss treated as ordinary income**

69

## **Convert Standing Timber into Products**

✓ **Report the conversion part on a business schedule – Form 1040, Schedule C for a business or Schedule F for a farm**

**List the fair market value of the timber cut and the other costs associated with the harvest and sale as “other costs”**

70

## **Convert Standing Timber into Products**

**Give details about the cutting and sale using Form T, Parts II and III**

**Include information on how you estimated the fair market value of the timber cut**

⑦

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## **About the Revised Form T**

- ▶ **Form T was revised in Dec. 2005 to make it more compatible with electronic filing**
- ▶ **The “Who Must File” section addresses the confusion with earlier versions about who must file Form T and when**

**You must file Form T if you claim a timber depletion deduction, sell timber outright under Section 631(b), or make or use a Section 631(a) election – all of which involve only Part II**

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## About the Revised Form T

- ▶ If you do an activity covered by any other part of Form T you should fill out the associated part(s):
  - ✓ Part I if you buy timber, cutting contracts or forest land
  - ✓ Part III if you sell timber of forestland
  - ✓ Part IV if you do silvicultural practices
  - ✓ Part V if you adjust your land account

73

## About the Revised Form T

- ▶ But what you do with them depends:
  - ✓ If you claim a timber depletion deduction, sell timber outright under Section 631(b), or make or use a Section 631(a) election, file Part II, plus the part(s) associated with other forest-related activities you did during the year
  - ✓ If not, keep the part(s) associated with forest-related activities you did during the year as part of your records

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## About the Revised Form T

- ▶ The “Who Must File” section also includes the only written guidance available from the IRS on what constitutes an occasional timber sale:  
“... one or two sales every 3 or 4 years ...”  
So a sale every 2 or 3 years qualifies as an occasional sale
- ▶ Owners who only have occasional timber sales are not required to file Form T – although IRS foresters think it would be prudent to do so

75

## Information Returns

- ▶ Timber buyers in a Section 631(b) disposal are required to report payments on a Form 1099-S, unless the seller is a corporation
- ▶ Buyers of standing or cut timber in an outright sale are not (yet) required to file a Form 1099

®

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**Tax Forms: Form T, Part II**  
**Form T, Part III**  
**Form 1040, Schedule D**  
**Form T, Part II**  
**Form T, Part III**  
**Form 4797**  
**Form T, Part II, line 27**  
**Form T, Part III**  
**Form 4797**  
**Form 1040, Schedule C**  
**Form T, Instructions**

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# **Tax Forms and Examples**



## **Timber Sales and Income**

**EXAMPLE 1:** This January a timber buyer approaches you and offers to buy the older plantation for \$37,000, lump sum. You agree. Your only expense is \$350 to have your lawyer check the sale contract. Show how to calculate and report your proceeds from the sale.

As a reminder, the Merchantable Sawtimber Subaccount contains 590 cords and 112 MBF of volume basis and \$38,396 of value (cost) basis; the older stand being sold contains 390 cords of pulpwood and all 112 MBF of sawtimber.

- a. Calculate your timber depletion allowance and adjusted basis
  - 1) Your timber depletion allowance is \$34,379; see the Section 631(b) disposal example, below, for how to calculate it and adjust your timber basis
  - 2) Also see the Section 631(b) disposal example for how to report the adjustments on Form T, Part II

b. Allocate your sale proceeds

1) Calculation:

|                 |                                   |
|-----------------|-----------------------------------|
| \$ 37,000       | <i>Gross sale proceeds</i>        |
| - 350           | <i>Cost of the sale</i>           |
| <u>- 34,379</u> | <i>Timber depletion allowance</i> |
| \$ 2,271        | <i>Section 1221 gain</i>          |

- 2) Report the sale on Form T, Part III, and Form 1040, Schedule D

**Part II Timber Depletion** (see instructions)

**1** Name of block and title of account ▶ .....

|   |                 |                            |
|---|-----------------|----------------------------|
| If you express timber quantity in thousand board feet (MBF), log scale, name the log rule used. If another unit of measure is used, provide details ▶ .....<br>.....<br>..... |                 |                            |
|   | (a)<br>Quantity | (b)<br>Cost or other basis |

**2** Estimated quantity of timber and cost or other basis returnable through depletion at end of the preceding tax year .....

**3** Increase or decrease of quantity of timber required by way of correction .....

**4a** Addition for growth (number of years covered ▶ ..... ) .....

**b** Transfers from premerchantable timber account .....

**c** Transfers from deferred reforestation account .....

**5** Timber acquired during tax year .....

**6** Addition to capital during tax year .....

**7** Total at end of tax year, before depletion. Add lines 2 through 6 .....

**8** Unit rate returnable through depletion, or basis of sales or losses. Divide line 7, column (b), by line 7, column (a) .....

**9** Quantity of timber cut during tax year .....

**10** Depletion for the current tax year. Multiply line 8 by line 9 .....

**11** Quantity of standing timber sold or otherwise disposed of during tax year .....

**12** Allowable as basis of sale. Multiply line 8 by line 11 .....

**13** Quantity of standing timber lost by fire or other cause during tax year .....

**14** Allowable basis of loss plus any excess amount where decrease in FMV (before and after the casualty) exceeds the standard depletion amount, but not the block basis (see instructions) .....

**15** Total reductions during tax year:

**a** In column (a), add lines 9, 11, and 13 .....

**b** In column (b), add lines 10, 12, and 14 .....

**16** Net quantity and value at end of tax year. In column (a), subtract line 15a from line 7. In column (b), subtract line 15b from line 7 .....

**17** Quantity of cut timber that was sold as logs or other rough products .....

**18 Section 631(a):**

**a** Are you electing, or have you made an election in a prior tax year that is in effect, to report gains or losses from the cutting of timber under section 631(a)? (see instructions)  Yes  No

**b** Are you revoking your section 631(a) election (see instructions)?  Yes  No

Effective date ▶



**Part III Profit or Loss From Land and Timber Sales** (see instructions)

1 Name of block and title of account

**(Your Name) Timber Account**

2 Location of property (by legal subdivisions or map surveys)

**(Legal description)**

|  |      |                 |                              |                                |  |
|--|------|-----------------|------------------------------|--------------------------------|--|
| 3a Purchaser's name and address<br><b>(Buyer's name and address)</b>   |      |                 |                              | b Date of sale<br><br>MM/DD/YY |  |
| 4 Amount received: a In cash   |      |                 |                              | 37,000                         |  |
| b In interest-bearing notes  |      |                 |                              | --                             |  |
| c In non-interest-bearing notes  |      |                 |                              | --                             |  |
| 5a Amount of other consideration   |      |                 |                              | --                             |  |
| b Explain the nature of other consideration and how you determined the amount shown on line 5a:<br>.....   |      |                 |                              |                                |  |
| 6 Total amount received for property. Add lines 4a, 4b, 4c, and 5a.  |      |                 |                              | 37,000                         |  |
| 7 Cost or other basis of property:   | Unit | Number of units | Cost or other basis per unit | Total cost or other basis      |  |
| a Forested land  | Acre |                 |                              | --                             |  |
| b Nonforested land   | Acre |                 |                              | --                             |  |
| c Improved land (describe) ▶   | Acre |                 |                              | --                             |  |
| d Merchantable timber. Estimate in detail the quantity of merchantable timber on the date of sale or exchange. Include the quantity of timber in each species of timber by diameter at breast height (DBH) classes. State the log rule used if the unit of measure is thousand board feet (MBF), log scale. If another unit of measure is used, provide details. ▶ Doyle | Cord | 390             | \$20.08 / Cord               | 7,832                          |  |
|  | MBF  | 112             | 237.03 / MBF                 | 26,547                         |  |
|  |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
| e Premerchantable timber   |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
| f Improvements (list separately)   |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
|  |      |                 |                              | --                             |  |
| g Mineral rights   |      |                 |                              | --                             |  |
| h Total cost or other basis. Add lines 7a through 7g   |      |                 |                              | 34,379                         |  |
| i Direct sale expenses (cruising, marking, selling)  |      |                 |                              | 350                            |  |
| 8 Profit or loss. Subtract the sum of lines 7h and 7i from line 6  |      |                 |                              | 2,271                          |  |

**SCHEDULE D  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service (99)

**Capital Gains and Losses**

▶ Attach to Form 1040 or Form 1040NR. ▶ See instructions for Schedule D (Form 1040).  
▶ Use Schedule D-1 to list additional transactions for lines 1 and 8.

OMB No. 1545-0074

**2008**

Attachment  
Sequence No. 12

Name(s) shown on return  
(Your Name)

Your social security number  
NNN | NN | NNNN

**Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less**

| (a) Description of property<br>(Example: 100 sh. XYZ Co.) | (b) Date acquired<br>(Mo., day, yr.)   | (c) Date sold<br>(Mo., day, yr.) | (d) Sales price<br>(see page D-7 of<br>the instructions) | (e) Cost or other basis<br>(see page D-7 of<br>the instructions) | (f) Gain or (loss)<br>Subtract (e) from (d) |
|---|--|----------------------------------|--|--|---|
| 1   |  |                                  |  |  |   |
| 2   | Enter your short-term totals, if any, from Schedule D-1,<br>line 2 . . . . .   |                                  | 2  |  |   |
| 3   | Total short-term sales price amounts. Add lines 1 and 2 in<br>column (d) . . . . .   |                                  | 3  |  |   |
| 4   | Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824   |                                  |  |  | 4   |
| 5   | Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from<br>Schedule(s) K-1 . . . . .   |                                  |  |  | 5   |
| 6   | Short-term capital loss carryover. Enter the amount, if any, from line 8 of your Capital Loss<br>Carryover Worksheet on page D-7 of the instructions . . . . . |                                  |  |  | 6 ( )                                       |
| 7   | Net short-term capital gain or (loss). Combine lines 1 through 6 in column (f) . . . . .   |                                  |  |  | 7   |

**Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year**

| (a) Description of property<br>(Example: 100 sh. XYZ Co.) | (b) Date acquired<br>(Mo., day, yr.)   | (c) Date sold<br>(Mo., day, yr.) | (d) Sales price<br>(see page D-7 of<br>the instructions) | (e) Cost or other basis<br>(see page D-7 of<br>the instructions) | (f) Gain or (loss)<br>Subtract (e) from (d) |
|---|--|----------------------------------|--|--|---|
| 8 Merchantable Timber                                     | MM/DD/YY   | MM/DD/YY                         | 37,000   | 34,729   | 2,271                                       |
| 9   | Enter your long-term totals, if any, from Schedule D-1,<br>line 9 . . . . .  |                                  | 9  |  |   |
| 10  | Total long-term sales price amounts. Add lines 8 and 9 in<br>column (d) . . . . .  |                                  | 10   |  |   |
| 11  | Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or<br>(loss) from Forms 4684, 6781, and 8824 . . . . .                |                                  |  |  | 11  |
| 12  | Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from<br>Schedule(s) K-1 . . . . .  |                                  |  |  | 12  |
| 13  | Capital gain distributions. See page D-2 of the instructions . . . . .   |                                  |  |  | 13  |
| 14  | Long-term capital loss carryover. Enter the amount, if any, from line 13 of your Capital Loss<br>Carryover Worksheet on page D-7 of the instructions . . . . . |                                  |  |  | 14 ( )                                      |
| 15  | Net long-term capital gain or (loss). Combine lines 8 through 14 in column (f). Then go to<br>Part III on the back . . . . .                                   |                                  |  |  | 15  |

**EXAMPLE 2:** Say that instead of accepting the timber buyer's offer, you decide to take bids for your timber. A consulting forester solicits the bids, structures the sale as a Section 631(b) disposal with economic interest retained, and administers it for 10% of the proceeds. The best bid you receive is \$295 per MBF and \$25 per cord. Show how to calculate and report the adjustments to your timber basis and your proceeds from the sale.

- a. Allocate the value (cost) basis in your Merchantable Timber Subaccount between pulpwood and sawtimber:

| Capital Account                       | Fair Market Value (FMV) | Proportion of Total FMV | Proportion of Basis |
|---------------------------------------|-------------------------|-------------------------|---------------------|
| Pulpwood (590 cords x \$25 ea.) ..... | \$ 14,750               | 0.3086                  | \$ 11,849           |
| Sawtimber (112 MBF x \$295 ea.) ..... | 33,040                  | 0.6914                  | 26,547              |
| Total.....                            | \$ 47,790               | 1.0000                  | \$ 38,396           |

- b. Calculate your depletion allowance and adjusted basis

- 1) Pulpwood depletion unit:  $\$11,849 \div 590 \text{ cord} = \$20.08 \text{ per cord}$
- 2) Sawtimber depletion unit:  $\$26,547 \div 112 \text{ MBF} = \$237.03 \text{ per MBF}$
- 3) Depletion allowance:  $(\$20.08 \text{ per cords} \times 390 \text{ cords}) + (\$237.03 \text{ per MBF} \times 112 \text{ MBF}) = \$34,379$
- 4) Update value basis:  $\$38,396 - \$34,379 = \$4,017$
- 5) Update pulpwood volume basis:  $590 \text{ cd} - 390 \text{ cd} = 200 \text{ cd}$
- 6) Update sawtimber volume basis:  $112 \text{ MBF} - 112 \text{ MBF} = 0 \text{ MBF}$
- 7) Form T, Part II

- c. Calculate your Section 1231 gain

- 1) Calculation:
 

|           |                            |
|-----------|----------------------------|
| \$ 42,790 | Gross sale proceeds        |
| - 4,279   | Cost of the sale           |
| - 34,379  | Timber depletion allowance |
| \$ 4,132  | Section 1231 gain          |
- 2) Form T, Part III; include a note that the income is reported on Form 4797
- 3) Form 4797

**Part II Timber Depletion** (see instructions)

**1** Name of block and title of account ▶ (Your Name) Merchantable Sawtimber Subaccount: Disposal of timber with economic interest retained

| If you express timber quantity in thousand board feet (MBF), log scale, name the log rule used. If another unit of measure is used, provide details ▶ <a href="#">Doyle</a>                      |                              |                             |
|--|------------------------------|-----------------------------|
|  | (a)<br>Quantity              | (b)<br>Cost or other basis  |
| <b>2</b> Estimated quantity of timber and cost or other basis returnable through depletion at end of the preceding tax year  | 590 cd, 112 MBF              | 38,396                      |
| <b>3</b> Increase or decrease of quantity of timber required by way of correction  | --                           |                             |
| <b>4a</b> Addition for growth (number of years covered ▶ <u>0</u> )  | --                           |                             |
| <b>b</b> Transfers from premerchantable timber account   | --                           | --                          |
| <b>c</b> Transfers from deferred reforestation account   | --                           | --                          |
| <b>5</b> Timber acquired during tax year   | --                           | --                          |
| <b>6</b> Addition to capital during tax year   |                              | --                          |
| <b>7</b> Total at end of tax year, before depletion. Add lines 2 through 6   | 590 cd, 112 MBF              | 38,396                      |
| <b>8</b> Unit rate returnable through depletion, or basis of sales or losses. Divide line 7, column (b), by line 7, column (a)   |                              | 20.08/cd, 237.03 M          |
| <b>9</b> Quantity of timber cut during tax year  | --                           |                             |
| <b>10</b> Depletion for the current tax year. Multiply line 8 by line 9  |                              | --                          |
| <b>11</b> Quantity of standing timber sold or otherwise disposed of during tax year  | 390 cd, 112 MBF              |                             |
| <b>12</b> Allowable as basis of sale. Multiply line 8 by line 11   |                              | 34,379                      |
| <b>13</b> Quantity of standing timber lost by fire or other cause during tax year  | --                           |                             |
| <b>14</b> Allowable basis of loss plus any excess amount where decrease in FMV (before and after the casualty) exceeds the standard depletion amount, but not the block basis (see instructions) |                              | --                          |
| <b>15</b> Total reductions during tax year:  | 390 cd, 112 MBF              |                             |
| <b>a</b> In column (a), add lines 9, 11, and 13  |                              |                             |
| <b>b</b> In column (b), add lines 10, 12, and 14   |                              | 34,379                      |
| <b>16</b> Net quantity and value at end of tax year. In column (a), subtract line 15a from line 7. In column (b), subtract line 15b from line 7  | 200 cd                       | 4,017                       |
| <b>17</b> Quantity of cut timber that was sold as logs or other rough products   |                              |                             |
| <b>18 Section 631(a):</b>  |                              |                             |
| <b>a</b> Are you electing, or have you made an election in a prior tax year that is in effect, to report gains or losses from the cutting of timber under section 631(a)? (see instructions)     | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| <b>b</b> Are you revoking your section 631(a) election (see instructions)?   | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
|  | Effective date ▶             |                             |

**Part III Profit or Loss From Land and Timber Sales** (see instructions)

1 Name of block and title of account

(Your Name) Timber Account

2 Location of property (by legal subdivisions or map surveys)

(Legal description)

|  |      |                 |                              |                                |
|--|------|-----------------|------------------------------|--------------------------------|
| 3a Purchaser's name and address<br>(Buyer's name and address)  |      |                 |                              | b Date of sale<br><br>MM/DD/YY |
| 4 Amount received: a In cash   |      |                 |                              | 42,790                         |
| b In interest-bearing notes  |      |                 |                              | --                             |
| c In non-interest-bearing notes  |      |                 |                              | --                             |
| 5a Amount of other consideration   |      |                 |                              | --                             |
| b Explain the nature of other consideration and how you determined the amount shown on line 5a:<br>.....   |      |                 |                              |                                |
| 6 Total amount received for property. Add lines 4a, 4b, 4c, and 5a.  |      |                 |                              | 42,790                         |
| 7 Cost or other basis of property:   | Unit | Number of units | Cost or other basis per unit | Total cost or other basis      |
| a Forested land  | Acre |                 |                              | --                             |
| b Nonforested land   | Acre |                 |                              | --                             |
| c Improved land (describe) ▶   | Acre |                 |                              | --                             |
| d Merchantable timber. Estimate in detail the quantity of merchantable timber on the date of sale or exchange. Include the quantity of timber in each species of timber by diameter at breast height (DBH) classes. State the log rule used if the unit of measure is thousand board feet (MBF), log scale. If another unit of measure is used, provide details. ▶ Doyle | Cord | 390             | \$20.08 / Cord               | 7,832                          |
|  | MBF  | 112             | 237.03 / MBF                 | 26,547                         |
|  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
| e Premerchantable timber   |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
| f Improvements (list separately)<br>.....<br>.....<br>.....  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
|  |      |                 |                              | --                             |
| g Mineral rights   |      |                 |                              | --                             |
| h Total cost or other basis. Add lines 7a through 7g   |      |                 |                              | 34,379                         |
| i Direct sale expenses (cruising, marking, selling)  |      |                 |                              | 4,279                          |
| 8 Profit or loss. Subtract the sum of lines 7h and 7i from line 6  |      |                 |                              | 4,132                          |

**Sales of Business Property**

(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

▶ Attach to your tax return. ▶ See separate instructions.

Name(s) shown on return

(Your Name)

Identifying number

NNN-NN-NNNN

**1** Enter the gross proceeds from sales or exchanges reported to you for 2008 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions) . . . . . **1** **--**

**Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year** (see instructions)

| 2 | (a) Description of property | (b) Date acquired (mo., day, yr.) | (c) Date sold (mo., day, yr.) | (d) Gross sales price | (e) Depreciation allowed or allowable since acquisition | (f) Cost or other basis, plus improvements and expense of sale | (g) Gain or (loss) Subtract (f) from the sum of (d) and (e) |
|---|-----------------------------|-----------------------------------|-------------------------------|-----------------------|---|--|---|
|   | Merchantable Timber         | MM/DDYY                           | MM/DDYY                       | 42,790                | --  | 38,658   | 4,132   |
|   |                             |                                   |                               |                       |   |  |   |
|   |                             |                                   |                               |                       |   |  |   |

**3** Gain, if any, from Form 4684, line 45 . . . . . **3**

**4** Section 1231 gain from installment sales from Form 6252, line 26 or 37 . . . . . **4**

**5** Section 1231 gain or (loss) from like-kind exchanges from Form 8824 . . . . . **5**

**6** Gain, if any, from line 32, from other than casualty or theft . . . . . **6**

**7** Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows: . . . . . **7**

Partnerships (except electing large partnerships) and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.

Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.

**8** Nonrecaptured net section 1231 losses from prior years (see instructions) . . . . . **8**

**9** Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return (see instructions) . . . . . **9**

**Part II Ordinary Gains and Losses** (see instructions)

**10** Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):

|  |  |  |  |  |  |
|--|--|--|--|--|--|
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |

**11** Loss, if any, from line 7 . . . . . **11** ( )

**12** Gain, if any, from line 7 or amount from line 8, if applicable . . . . . **12**

**13** Gain, if any, from line 31 . . . . . **13**

**14** Net gain or (loss) from Form 4684, lines 37 and 44a . . . . . **14**

**15** Ordinary gain from installment sales from Form 6252, line 25 or 36 . . . . . **15**

**16** Ordinary gain or (loss) from like-kind exchanges from Form 8824 . . . . . **16**

**17** Combine lines 10 through 16 . . . . . **17**

**18** For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below:

**a** If the loss on line 11 includes a loss from Form 4684, line 41, column (b)(1), enter that part of the loss here. Enter the part of the loss from income-producing property on Schedule A (Form 1040), line 28, and the part of the loss from property used as an employee on Schedule A (Form 1040), line 23. Identify as from "Form 4797, line 18a." See instructions . . . . . **18a**

**b** Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Form 1040, line 14 . . . . . **18b**

**EXAMPLE 3:** Say that instead of selling your timber as stumpage, you hire a master logger to harvest it, cut it into sawlogs and pulpwood, and deliver the cut products to a sawmill that you specify. The consultant charges you \$600 for soliciting the bids; from them you know the standing timber was worth \$295 per MBF and \$25 per cord. The master logger charges you \$22,500. You receive \$390 per MBF and \$60 per cord for the delivered products. Show how to calculate and report your gains.

- a. Calculate your timber depletion allowance and adjusted basis
  - 1) See the Section 631(b) disposal example, above, for how to calculate your timber depletion allowance and adjust your timber basis
  - 2) Form T, Part II (Note lines 10–26 are a little different from the Section 631(b) disposal example; make your Section 631(a) election, Lines 27)
- b. Calculate your Section 1231 gain from holding the timber

1) Calculation:

|   |
|---|
| <i>\$ 42,790 Timber FMV as of Jan. 1</i>          |
| <i>– 600 Consultant charges</i>                   |
| <i><u>– 34,379 Timber depletion allowance</u></i> |
| <i>\$ 7,811 Section 1231 gain</i>                 |

2) Form T, Part III

3) Form 4797

- c. Determine your gain from selling sawlogs and pulpwood

1) Calculation:

|  |
|--|
| <i>\$ 67,080 Sale proceeds</i>               |
| <i>– 42,790 Timber FMV</i>                   |
| <i><u>– 22,500 Master logger charges</u></i> |
| <i>\$ 1,790 Ordinary income</i>              |

2) Form 1040, Schedule C

**Part II Timber Depletion** (see instructions)

**1** Name of block and title of account ▶ (Your Name) Merchantable Sawtimber Subaccount: Cut standing timber and convert into products for sale (Section 631(a) transaction)

| If you express timber quantity in thousand board feet (MBF), log scale, name the log rule used. If another unit of measure is used, provide details ▶ <u>Doyle</u>   | (a)<br>Quantity                         | (b)<br>Cost or other basis  |
|--|---|-----------------------------|
| <b>2</b> Estimated quantity of timber and cost or other basis returnable through depletion at end of the preceding tax year . . . . .  | 590 cd, 112 MBF                         | 38,396                      |
| <b>3</b> Increase or decrease of quantity of timber required by way of correction . . . . .  | --                                      |                             |
| <b>4a</b> Addition for growth (number of years covered ▶ <u>0</u> ) . . . . .  | --                                      |                             |
| <b>b</b> Transfers from premerchantable timber account . . . . .   | --                                      | --                          |
| <b>c</b> Transfers from deferred reforestation account . . . . .   | --                                      | --                          |
| <b>5</b> Timber acquired during tax year . . . . .   | --                                      | --                          |
| <b>6</b> Addition to capital during tax year . . . . .   |   | --                          |
| <b>7</b> Total at end of tax year, before depletion. Add lines 2 through 6 . . . . .   | 590 cd, 112 MBF                         | 38,396                      |
| <b>8</b> Unit rate returnable through depletion, or basis of sales or losses. Divide line 7, column (b), by line 7, column (a) . . . . .   |   | 20.08/cd, 237.03 M          |
| <b>9</b> Quantity of timber cut during tax year . . . . .  | 390 cd, 112 MBF                         |                             |
| <b>10</b> Depletion for the current tax year. Multiply line 8 by line 9 . . . . .  |   | 34,379                      |
| <b>11</b> Quantity of standing timber sold or otherwise disposed of during tax year . . . . .  | --                                      |                             |
| <b>12</b> Allowable as basis of sale. Multiply line 8 by line 11 . . . . .   |   | --                          |
| <b>13</b> Quantity of standing timber lost by fire or other cause during tax year . . . . .  | --                                      |                             |
| <b>14</b> Allowable basis of loss plus any excess amount where decrease in FMV (before and after the casualty) exceeds the standard depletion amount, but not the block basis (see instructions) . . . . . |   | --                          |
| <b>15</b> Total reductions during tax year:  | 390 cd, 112 MBF                         |                             |
| <b>a</b> In column (a), add lines 9, 11, and 13 . . . . .  |   |                             |
| <b>b</b> In column (b), add lines 10, 12, and 14 . . . . .   |   | 34,379                      |
| <b>16</b> Net quantity and value at end of tax year. In column (a), subtract line 15a from line 7. In column (b), subtract line 15b from line 7 . . . . .  | 200 cd                                  | 4,017                       |
| <b>17</b> Quantity of cut timber that was sold as logs or other rough products . . . . .   |   | 390 cd, 112 MBF             |
| <b>18 Section 631(a):</b>  |   |                             |
| <b>a</b> Are you electing, or have you made an election in a prior tax year that is in effect, to report gains or losses from the cutting of timber under section 631(a)? (see instructions) . . . . .     | <input checked="" type="checkbox"/> Yes | <input type="checkbox"/> No |
| <b>b</b> Are you revoking your section 631(a) election (see instructions)? . . . . .   | <input type="checkbox"/> Yes            | <input type="checkbox"/> No |
| Effective date ▶   |   |                             |



**Part III Profit or Loss From Land and Timber Sales** (see instructions)

**1** Name of block and title of account

(Your Name) Timber Account

**2** Location of property (by legal subdivisions or map surveys)

(Legal description)

|   |      |                 |                              |                                       |
|---|------|-----------------|------------------------------|---------------------------------------|
| <b>3a</b> Purchaser's name and address<br>(YOUR name and address)   |      |                 |                              | <b>b</b> Date of sale<br><br>01/01/YY |
| <b>4</b> Amount received: <b>a</b> In cash . . . . .  |      |                 |                              | <b>42,790</b>                         |
| <b>b</b> In interest-bearing notes . . . . .  |      |                 |                              | --                                    |
| <b>c</b> In non-interest-bearing notes . . . . .  |      |                 |                              | --                                    |
| <b>5a</b> Amount of other consideration . . . . .   |      |                 |                              | --                                    |
| <b>b</b> Explain the nature of other consideration and how you determined the amount shown on line 5a:<br>.....   |      |                 |                              |                                       |
| <b>6</b> Total amount received for property. Add lines 4a, 4b, 4c, and 5a. . . . .  |      |                 |                              | <b>42,790</b>                         |
| <b>7</b> Cost or other basis of property:   | Unit | Number of units | Cost or other basis per unit | Total cost or other basis             |
| <b>a</b> Forested land . . . . .  | Acre |                 |                              | --                                    |
| <b>b</b> Nonforested land . . . . .   | Acre |                 |                              | --                                    |
| <b>c</b> Improved land (describe) ▶ .....   | Acre |                 |                              | --                                    |
| <b>d</b> Merchantable timber. Estimate in detail the quantity of merchantable timber on the date of sale or exchange. Include the quantity of timber in each species of timber by diameter at breast height (DBH) classes. State the log rule used if the unit of measure is thousand board feet (MBF), log scale. If another unit of measure is used, provide details. ▶ Doyle<br>.....<br>.....<br>.....<br>..... | Cord | 390             | \$20.08 / Cord               | 7,832                                 |
|   | MBF  | 112             | 237.03 / MBF                 | 26,547                                |
|   |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
| <b>e</b> Premerchantable timber. . . . .  |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
| <b>f</b> Improvements (list separately)<br>.....<br>.....<br>.....  |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
|   |      |                 |                              | --                                    |
| <b>g</b> Mineral rights . . . . .   |      |                 |                              | --                                    |
| <b>h</b> Total cost or other basis. Add lines 7a through 7g . . . . .   |      |                 |                              | <b>34,379</b>                         |
| <b>i</b> Direct sale expenses (cruising, marking, selling). . . . .   |      |                 |                              | <b>600</b>                            |
| <b>8</b> Profit or loss. Subtract the sum of lines 7h and 7i from line 6 . . . . .  |      |                 |                              | <b>7,811</b>                          |

**Sales of Business Property**

(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

▶ Attach to your tax return. ▶ See separate instructions.

Name(s) shown on return

(Your Name)

Identifying number

NNN-NN-NNNN

1 Enter the gross proceeds from sales or exchanges reported to you for 2008 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions) . . . . . 1 --

**Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year** (see instructions)

| 2 | (a) Description of property | (b) Date acquired (mo., day, yr.) | (c) Date sold (mo., day, yr.) | (d) Gross sales price | (e) Depreciation allowed or allowable since acquisition | (f) Cost or other basis, plus improvements and expense of sale | (g) Gain or (loss) Subtract (f) from the sum of (d) and (e) |
|---|-----------------------------|-----------------------------------|-------------------------------|-----------------------|---|--|---|
|   | Merchantable Timber         | MM/DD/YY                          | 01/01/YY                      | 42,790                | --  | 34,979   | 7,811   |
|   |                             |                                   |                               |                       |   |  |   |
|   |                             |                                   |                               |                       |   |  |   |

3 Gain, if any, from Form 4684, line 45 . . . . . 3

4 Section 1231 gain from installment sales from Form 6252, line 26 or 37. . . . . 4

5 Section 1231 gain or (loss) from like-kind exchanges from Form 8824 . . . . . 5

6 Gain, if any, from line 32, from other than casualty or theft. . . . . 6

7 Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows: . . . . . 7

Partnerships (except electing large partnerships) and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.

Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.

8 Nonrecaptured net section 1231 losses from prior years (see instructions) . . . . . 8

9 Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return (see instructions) . . . . . 9

**Part II Ordinary Gains and Losses** (see instructions)

10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):

|  |  |  |  |  |  |
|--|--|--|--|--|--|
|  |  |  |  |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |

11 Loss, if any, from line 7 . . . . . 11 ( )

12 Gain, if any, from line 7 or amount from line 8, if applicable . . . . . 12

13 Gain, if any, from line 31 . . . . . 13

14 Net gain or (loss) from Form 4684, lines 37 and 44a . . . . . 14

15 Ordinary gain from installment sales from Form 6252, line 25 or 36 . . . . . 15

16 Ordinary gain or (loss) from like-kind exchanges from Form 8824. . . . . 16

17 Combine lines 10 through 16 . . . . . 17

18 For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below:

a If the loss on line 11 includes a loss from Form 4684, line 41, column (b)(1), enter that part of the loss here. Enter the part of the loss from income-producing property on Schedule A (Form 1040), line 28, and the part of the loss from property used as an employee on Schedule A (Form 1040), line 29. Identify as from "Form 4797, line 18a." See instructions . . . . . 18a

b Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Form 1040, line 14 . . . . . 18b

**SCHEDULE C  
(Form 1040)**

**Profit or Loss From Business**

(Sole Proprietorship)

OMB No. 1545-0047

**2008**

Attachment  
Sequence No. **09**

Department of the Treasury  
Internal Revenue Service (99)

▶ Partnerships, joint ventures, etc., generally must file Form 1065 or 1065-B.  
▶ Attach to Form 1040, 1040NR, or 1041. ▶ See instructions for Schedule C (Form 1040).

|   |  |   |
|---|--|---|
| Name of proprietor<br><b>Your Name</b>  |  | Social security number (SSN)<br><b>NNN   NN   NNNN</b>        |
| A Principal business or profession, including product or service (see page C-3 of the instructions)<br><b>Timber management for profit</b>  |  | B Enter code from pages C-9, 10, & 11<br><b>▶ 1 1 3 0 0 0</b> |
| C Business name. If no separate business name, leave blank.<br><b>--</b>  |  | D Employer ID number (EIN), if any<br>                        |
| E Business address (including suite or room no.) ▶ <b>(Your address)</b><br>City, town or post office, state, and ZIP code  |  |   |
| F Accounting method (1) <input checked="" type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ▶  |  |   |
| G Did you "materially participate" in the operation of this business during 2008? If "No," see page C-4 for limit on losses <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No |  |   |
| H If you started or acquired this business during 2008, check here <input type="checkbox"/>   |  |   |

**Part I Income**

|  |                            |   |        |  |  |
|--|----------------------------|---|--------|--|--|
| 1 Gross receipts or sales. Caution. See page C-4 and check the box if:<br><ul style="list-style-type: none"> <li>• This income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, or</li> <li>• You are a member of a qualified joint venture reporting only rental real estate income not subject to self-employment tax. Also see page C-4 for limit on losses.</li> </ul> | ▶ <input type="checkbox"/> |   |        |  |  |
| 2 Returns and allowances   |                            | 2 | --     |  |  |
| 3 Subtract line 2 from line 1  |                            | 3 | 67,080 |  |  |
| 4 Cost of goods sold (from line 42 on page 2)  |                            | 4 | 65,290 |  |  |
| 5 Gross profit. Subtract line 4 from line 3  |                            | 5 | 1,790  |  |  |
| 6 Other income, including federal and state gasoline or fuel tax credit or refund (see page C-4)   |                            | 6 | --     |  |  |
| 7 Gross income. Add lines 5 and 6  |                            | 7 | 1,790  |  |  |

**Part II Expenses. Enter expenses for business use of your home only on line 30.**

|  |     |  |  |  |  |     |  |  |  |
|--|-----|--|--|--|--|-----|--|--|--|
| 8 Advertising  | 8   |  |  |  | 18 Office expense  | 18  |  |  |  |
| 9 Car and truck expenses (see page C-5)  | 9   |  |  |  | 19 Pension and profit-sharing plans                          | 19  |  |  |  |
| 10 Commissions and fees  | 10  |  |  |  | 20 Rent or lease (see page C-6):                             |     |  |  |  |
| 11 Contract labor (see page C-5)   | 11  |  |  |  | a Vehicles, machinery, and equipment                         | 20a |  |  |  |
| 12 Depletion   | 12  |  |  |  | b Other business property                                    | 20b |  |  |  |
| 13 Depreciation and section 179 expense deduction (not included in Part III) (see page C-5)  | 13  |  |  |  | 21 Repairs and maintenance                                   | 21  |  |  |  |
| 14 Employee benefit programs (other than on line 19)   | 14  |  |  |  | 22 Supplies (not included in Part III)                       | 22  |  |  |  |
| 15 Insurance (other than health)   | 15  |  |  |  | 23 Taxes and licenses  | 23  |  |  |  |
| 16 Interest:   |     |  |  |  | 24 Travel, meals, and entertainment:                         |     |  |  |  |
| a Mortgage (paid to banks, etc.)   | 16a |  |  |  | a Travel   | 24a |  |  |  |
| b Other  | 16b |  |  |  | b Deductible meals and entertainment (see page C-7)          | 24b |  |  |  |
| 17 Legal and professional services   | 17  |  |  |  | 25 Utilities   | 25  |  |  |  |
| 26 Total expenses before expenses for business use of home. Add lines 8 through 27   |     |  |  |  | 26 Wages (less employment credits)                           | 26  |  |  |  |
| 29 Tentative profit or (loss). Subtract line 26 from line 7  |     |  |  |  | 27 Other expenses (from line 48 on page 2)                   | 27  |  |  |  |
| 30 Expenses for business use of your home. Attach Form 8829  |     |  |  |  |  |     |  |  |  |
| 31 Net profit or (loss). Subtract line 30 from line 29.  |     |  |  |  |  |     |  |  |  |
| <ul style="list-style-type: none"> <li>• If a profit, enter on both Form 1040, line 12, and Schedule SE, line 2, or on Form 1040NR, line 13 (if you checked the box on line 1, see page C-7). Estates and trusts, enter on Form 1041, line 3.</li> <li>• If a loss, you must go to line 32.</li> </ul>   |     |  |  |  |  |     |  |  |  |
| 32 If you have a loss, check the box that describes your investment in this activity (see page C-8).   |     |  |  |  |  |     |  |  |  |
| <ul style="list-style-type: none"> <li>• If you checked 32a, enter the loss on both Form 1040, line 12, and Schedule SE, line 2, or on Form 1040NR, line 13 (if you checked the box on line 1, see the line 31 instructions on page C-7). Estates and trusts, enter on Form 1041, line 3.</li> <li>• If you checked 32b, you must attach Form 6199. Your loss may be limited.</li> </ul> |     |  |  |  |  |     |  |  |  |
|  |     |  |  |  | 32a <input type="checkbox"/> All investment is at risk.      |     |  |  |  |
|  |     |  |  |  | 32b <input type="checkbox"/> Some investment is not at risk. |     |  |  |  |

**Part III** Cost of Goods Sold (see page C-8)

33 Method(s) used to value closing inventory: a  Cost b  Lower of cost or market c  Other (attach explanation)

34 Was there any change in determining quantities, costs, or valuations between opening and closing inventory? If "Yes," attach explanation  Yes  No

|  |    |        |
|--|----|--------|
| 35 Inventory at beginning of year. If different from last year's closing inventory, attach explanation | 35 | --     |
| 36 Purchases less cost of items withdrawn for personal use   | 36 | --     |
| 37 Cost of labor. Do not include any amounts paid to yourself  | 37 | --     |
| 38 Materials and supplies  | 38 | --     |
| 39 Other costs   | 39 | 65,290 |
| 40 Add lines 35 through 39   | 40 | 65,290 |
| 41 Inventory at end of year  | 41 | --     |
| 42 Cost of goods sold. Subtract line 41 from line 40. Enter the result here and on page 1, line 4      | 42 | 65,290 |

**Part IV** Information on Your Vehicle. Complete this part only if you are claiming car or truck expenses on line 9 and are not required to file Form 4562 for this business. See the instructions for line 13 on page C-5 to find out if you must file Form 4562.

43 When did you place your vehicle in service for business purposes? (month, day, year) ▶ \_\_\_\_/\_\_\_\_/\_\_\_\_

44 Of the total number of miles you drove your vehicle during 2008, enter the number of miles you used your vehicle for:

a Business ..... b Commuting (see instructions) ..... c Other .....

45 Was your vehicle available for personal use during off-duty hours?  Yes  No

46 Do you (or your spouse) have another vehicle available for personal use?  Yes  No

47a Do you have evidence to support your deduction?  Yes  No

b If "Yes," is the evidence written?  Yes  No

**Part V** Other Expenses. List below business expenses not included on lines 8-26 or line 30.

|  |    |  |
|--|----|--|
| .....  |    |  |
| .....  |    |  |
| .....  |    |  |
| .....  |    |  |
| .....  |    |  |
| .....  |    |  |
| .....  |    |  |
| .....  |    |  |
| .....  |    |  |
| .....  |    |  |
| .....  |    |  |
| 48 Total other expenses. Enter here and on page 1, line 27 | 48 |  |

# Instructions for Form T (Timber)

(Rev. December 2005)

## Forest Activities Schedule

Section references are to the Internal Revenue Code unless otherwise noted.



Department of the Treasury  
Internal Revenue Service

## What's New

- If you are required to file Form T (see *Who Must File* below), you can elect to deduct a limited amount of qualifying reforestation costs (up to \$10,000 per qualified timber property per year) by entering an amount on Part IV, line 4a. For more information, see the instructions on page 3 and section 194.

Even if you are not required to file Form T, you can elect to deduct on your tax return up to \$10,000 of qualifying reforestation costs per year for each qualifying timber property. Attach a statement to your return for the year in which reforestation costs were paid or incurred and provide the following information.

1. The Unique Stand Identifier;
2. The total number of acres reforested during the tax year;
3. The nature of the reforestation treatments; and
4. The total amounts of the qualified reforestation expenses eligible to be amortized under section 194(a) or deducted under section 194(b).

- Certain timber producers who hold not more than 500 acres of qualified timber property located in the Gulf Opportunity Zone for Hurricane Katrina, Rita, or Wilma are allowed an increased reforestation expense deduction. For more information, see Pub. 4492, *Information for Taxpayers Affected by Hurricanes Katrina, Rita, and Wilma*.

- If you previously elected for any tax year ending before October 23, 2004, to treat the cutting of timber as a sale or exchange under section 631(a), you may revoke this election without the consent of the IRS for any tax year ending after October 22, 2004. The prior election (and revocation) is disregarded for

purposes of making a subsequent election.

If you are required to file Form T, you may revoke this election by checking the "Yes" box in Part II, line 18b. If you are not required to file Form T, attach a statement to your return.

- Outright sales of timber by landowners will qualify for capital gains treatment after 2004. For more information, see the instructions for Part III.

## General Instructions

### Purpose of Form

Use Form T (Timber), Forest Activities Schedule, to provide information on timber accounts when a sale or deemed sale under sections 631(a), 631(b), or other exchange has occurred during the tax year.

For additional information regarding federal income tax rules for reporting forest-related activities, see the following publications:

- Pub. 225, *Farmer's Tax Guide*,
- Pub. 535, *Business Expenses*, and
- Pub. 544, *Sales and Other Dispositions of Assets*.

### Who Must File

Complete and attach Form T to your income tax return **only** if you:

- Claim a deduction for depletion of timber,
- Elect under section 631(a) to treat the cutting of timber as a sale or exchange, or
- Make an outright sale of timber under section 631(b).

Complete Form T in accordance with sections 194, 611, 631, and 1231, and the related regulations.

**Exceptions.** You are not required to file Form T if you only have an occasional sale of timber (one or two

sales every 3 or 4 years). However, you must maintain adequate records of these transactions and other timber-related activities during the year, as discussed in *Recordkeeping*, below. These transactions may be treated as an investment for tax purposes if your property is not held for use in a trade or business.



*If you are required to file Form T for the current tax year (as discussed above under Who Must File), complete all the parts of the form that apply. However, if you are not required to file Form T but have other forest-related activities (reportable in Part I (Acquisitions), Part IV (Reforestation and Timber Stand Activities), or Part V (Land Ownership), complete and attach the appropriate tax form (for example, Form 4562 to claim depreciation) or statement to your income tax return to report these activities. Also, maintain adequate records as discussed in Recordkeeping, below.*

## Recordkeeping

**Maps.** Do not attach maps of your timber properties to Form T to substantiate any claimed deduction for depletion of timber. Instead, you are required to retain records sufficient to substantiate your right to claim the deduction, including a map (where necessary) to show clearly the location(s) of timber and land acquired, timber cut, and timber and land sold for as long as their contents may become material in the administration of any Internal Revenue law.

**Other business records.** You must also keep business records to support other items reported on your tax return such as expenses incurred during the tax year for road construction and for building drainage structures.

**Note.** Maintain separate cost accounts for road construction and drainage structures, such as ditches and canals. For example, for roads constructed for logging timber or to conduct management activities on fee land or land held under long-term cutting contracts, maintain records showing the number of miles constructed and how the total expenditures were either (a) capitalized, (b) amortized, or (c) claimed as an ordinary expense.

Keep separate records for each unique stand identifier, depletion account, block, tract, or geographic area tributary to a mill or mill complex. Also, keep records that verify the basis in property for as long as they are needed to figure the basis of the original or replacement property.

---

## Specific Instructions

### Part I. Acquisitions

Complete this part if you acquired timber, timber-cutting contracts, or forest land during the tax year, whether the acquisition was by purchase, exchange, gift, or inheritance.

#### How to Report Acquisitions

Report acquisitions during the tax year (whether taxable or not) of timber, timber-cutting contracts, or forest land. Report separately each acquisition of \$10,000 or more.

You may combine acquisitions of less than \$10,000 for each account and omit lines 2 and 3. For an acquisition by gift or inheritance, skip lines 4 through 7.

For an acquisition or lease of timber-cutting rights on a pay-as-cut basis, except for those under which all cutting is completed within the tax year, do not complete lines 4 through 8. Instead, list the provisions of the purchase or lease agreement, including the number of years from the effective date to the expiration date, annual minimum cut or payment, and the payment rates for different kinds of timber and forest products. Follow the format of lines 1 through 9 on additional sheets if necessary.

### What Is Included in Each Account

You must include your timber in one or more accounts. Generally, each account must include all your timber that is located in one "block." A block may be:

1. An operational unit that includes all timber that would logically go to a single point of manufacture,
2. A logging unit that includes all timber that would logically be removed by a single logging development, or
3. An area established by the geographical or political boundaries of logical management areas. Timber acquired under a cutting contract may not be included in part of a block, but should be kept in a separate account.

For exceptional cases, the timber in a given block may be divided into two or more accounts. See Regulations section 1.611-3(d) for more information.

### Part II. Timber Depletion

Complete this part for each timber account that has changed in quantity or dollar amount. A timber account may change in quantity or dollar amount as a result of acquisitions, dispositions, the cutting of timber, capitalized expenditures, casualty or theft losses, corrections, additions for growth, and transfers from other accounts. Use this part to figure depletion for timber cut or the basis for timber sold or lost during the tax year. A depletion schedule is required to be maintained for all types of timber ownership.

#### Lines 1 through 6

Provide data for each timber account separately. Account for any changes that have occurred during the tax year. Attach as many additional pages as needed. If you deplete on a block basis, combine new purchases with the opening balances and use the average depletion rate shown on line 8, column (b), for all timber cut or sold, regardless of how long held.

#### Line 14, column (b)

The casualty loss limitation is determined by the decrease in fair market value (FMV) of the Single Identifiable Property (block) before

and after the casualty event, not to exceed the basis in the affected block. Keep FMV appraisals in your records to support the claimed loss (see *Recordkeeping*, earlier).

#### Line 18a

If you are making the 631(a) election, or have made the election in a prior tax year, check the "Yes" box on line 18a.

**Note.** The 631(a) election cannot be made on an amended return.

You must maintain the following records.

#### Adjusted basis for depletion.

Maintain records that show the adjusted basis for depletion, fair market value (FMV), and gain or loss for each sale or exchange of standing timber for which you have a section 631(a) election. The records must show the adjusted basis for depletion and the FMV of the timber as of the first day of the tax year in which timber was cut. The records must show these amounts by species and unit rates if these transactions are reported on a species basis. The gain or loss on standing timber is reported on Form 4797, Sales of Business Property.

**Date of acquisition.** The records must provide the date of acquisition of timber that was cut in the tax year, if acquired after March 1, 1913; the quantity of timber remaining (adjusted for growth, correction of estimates, changes in use, and any change in the log rule or other measure used); and the adjusted basis at the beginning of the tax year. The records must state the acreage cut, the amount of timber cut from the applicable block during the tax year, and the log rule or other method used to determine the quantity of timber cut. If depletion accounts are kept by separate tracts or purchases, give the information separately for each tract or timber purchase.

If an average depletion rate based on the average value or cost of a timber block was used in earlier years, the adjusted basis referred to in section 631(a) is the average basis shown on line 8, column (b), after adjustment.

**Characteristics of the timber.** The records must describe in detail the characteristics of the timber that

## Involuntary Conversion

①

Ag. Handbook 718, pages 67-74,  
Updated for Revenue Ruling 99-56

## Involuntary Conversion

- ▶ If you lose timber in an involuntary conversion, you may be entitled to an income tax deduction; talking about
  - ✓ Casualty loss      ✓ Theft loss
  - ✓ Noncasualty loss    ✓ Condemnation
- ▶ Not talking about net operating loss, where your expenses exceed your income in a given year

2

## General Rules

- ▶ Deductions are available to all owners who hold timber to produce income, whether as an investment or as a trade or business
- ▶ For the loss of shade trees or timber held for personal use see these IRS publications:
  - No. 547: *Casualties, Disasters, and Thefts*
  - No. 584: *Non-Business ... Loss Workbook*
  - No. 2194 *Disaster Losses Kit* (547, 584, forms)

3

## General Rules

- ▶ A deduction is allowed only if the trees are destroyed or so severely damaged that you have to remove them and start over
- ▶ Lesser levels of damage – natural mortality and “normal” losses from disease and insects – are a cost of doing business and cannot be deducted
- ▶ The amount you can deduct is limited to your adjusted basis in the timber, which almost never equals its value

4

## General Rules

- ▶ The loss must be physical in nature
- ▶ It must be fixed in time by an identifiable event or combination of events
- ▶ The event or combination of events that caused the loss must have run its course

Taken together, these rules mean the loss of potential income is not deductible

5

## General Rules

For example, if an ice storm damages rather than destroys timber, so its growth is slowed or its future value is diminished, you do not have a deductible loss

*or*

If a fire destroys pulpwood-sized trees you were managing for sawtimber, you must base your loss deduction on their value as pulpwood, not on a discounted value for sawtimber

6

## Casualty Loss

- ▶ Caused by natural or outside forces
- ▶ Must meet three tests:
  - ✓ Sudden – Swift, not gradual or progressive
  - ✓ Unexpected – Not intended or anticipated
  - ✓ Unusual – Not a typical day-to-day occurrence

7

## Casualty Loss

- ▶ Includes: Ice, fire, hurricane, tornado, high wind, earthquake, volcanic eruption, sleet, hail, plane or auto crash, shipwreck, etc.
- ▶ Usually does not include: Disease, insect infestation, drought, or combinations of factors
  - ✓ SPB infestation killed yard trees in 5–10 days
  - ✓ SPB attack killed timber trees over 9 months

8



## Casualty Loss

- ▶ If the losses are heavy and the timber is not salvageable, you should adjust your timber accounts to reflect the loss of volume
- ▶ Unless the timber is completely destroyed you are obliged to make a genuine effort to salvage it
  - ✓ This is a separate transaction from the loss
  - ✓ If you can't sell salvageable timber, keep records to show you made a *bona fide* attempt

9

## Casualty Loss Deduction

- ▶ To take a casualty loss deduction, you must determine the “single identifiable property” destroyed or damaged beyond use
- ▶ Before 1999, IRS Rev. Rul. 66-9 and 73-51 defined the “single identifiable property” as the individual trees suffering mortal injury

10

## Casualty Loss Deduction

- ▶ But in lengthy cases against the IRS, three forest industry firms successfully argued that the correct measure of timber they lost in natural disasters was the district or “block” they used to keep track of adjusted basis
- ▶ In response to the cases the IRS issued Rev. Rul. 99-56, which revoked the earlier revenue rulings and defined the “single identifiable property” as the “block” directly affected by the casualty

11

## Casualty Loss Deduction

- ▶ Used to teach both traditional and “block” methods, so you could use the one you felt more comfortable with during the transition period
- ▶ But in 2002 the IRS won a court case in which it argued that only the “block” method is correct – the transition period is over
- ▶ The “block” method is easier to use than the traditional method and usually allows for a larger casualty loss deduction

12

### 3 Steps to Use the “Block” Method

1. Determine your adjusted timber basis in the “block” on which the loss occurred  
If you keep track of the adjusted basis of all your timber in one account, use the total amount in the account
2. Determine the difference in the fair market value of the “block” immediately before and immediately after the loss

13

### 3 Steps to Use the “Block” Method

- The figure for fair market value immediately after the loss should include the value of any salvageable timber in the “block”
3. Compare the results from Steps 1 and 2; your deduction is the smaller amount

14

**EXAMPLE:** 10 years ago you acquired a 40-acre loblolly pine plantation for a total cost of \$20,600. The trees were just 8 years old, but you assigned value to their years of growth and allocated \$15,840 to your Land Account and \$4,760 to your Timber Account. Last year, 17 acres of the trees were completely destroyed by a fire. Immediately before the fire, the entire plantation contained 640 cords of pulpwood, of which the 17 acres that burned contained 272 cords. Also last year, a neighbor sold similar pulpwood for \$14 per cord. Calculate your casualty loss deduction and your new adjusted timber basis in the “block.”

15

### Solution

- ▶ Determine your adjusted basis in the “block” on which the loss occurred:

*\$4,760*

- ▶ Determine the difference between the fair market value of the “block” immediately before and immediately after the loss:

*272 cords x \$14 per cord = \$3,808*

16

## Solution

- ▶ Your deduction is the smaller amount:

*\$3,808*

- ▶ Your new adjusted timber basis in the “block” is:

$\$4,760 - \$3,808 = \$952$

17

## Casualty Loss Deduction

- ▶ Because the “block” method generally allows for a larger deduction than the traditional method, the next time you harvest timber from the block, your adjusted basis in the timber harvested will likely be lower than under the earlier revenue rulings, and your taxable income higher

18

## Casualty Loss Deduction

- ▶ Destruction of a premerchantable stand or plantation may result in a deductible loss if:
  - ✓ You keep a separate account for it, *and*
  - ✓ You have costs allocated to the account
- ▶ The unit of measure will be acres
- ▶ You have no deductible loss if the death of seedlings is not due to a casualty (Rev. Rul. 81-2)

19

## Casualty Loss Deduction

- ▶ You ordinarily deduct a casualty loss in year it occurs
  - ✓ If the loss resulted from a Presidentially declared disaster, you can choose to deduct the loss on an original or amended tax return for the year immediately before the year the disaster took place
- This prevents you from having to wait a year to take the deduction

20

## Casualty Loss Deduction

- ✓ In addition, the IRS may postpone for up to 1 year certain tax deadlines – for example, the deadlines for filing tax returns or making IRA contributions – for taxpayers affected by a Presidentially declared disaster

21

## Casualty Loss Deduction

- ✓ If you receive a federal disaster relief grant or have a federal disaster loan cancelled as partial reimbursement for a casualty loss, subtract the amount of assistance from your loss; do not report it as income or pay taxes on it

22

## Noncasualty Loss

- ▶ Also caused by natural or outside forces
- ▶ Must meet two tests:
  - ✓ Unexpected
  - ✓ Unusual
- ▶ Can be gradual or progressive: Disease, insect infestation, drought, or combination of factors

23

## Noncasualty Loss Deduction

- ▶ Follow the same steps as with a casualty loss
- ▶ Difference is in the tax treatment:
  - ✓ Casualty losses are deducted from ordinary income
  - ✓ Noncasualty losses are deducted first from capital gains, a disadvantage because capital gains receive favorable tax treatment

24

## Theft Loss

- ▶ AKA timber trespass
- ▶ To take a deduction for a theft loss, follow the same steps as with a casualty loss, except ...

25

## Theft Loss Deduction

- ▶ Deduct a theft loss in the year you discover it
  - ✓ You don't have to determine when the loss occurred and file an amended tax return for that year
  - ✓ Also, the quantity of timber used to calculate your depletion unit is the quantity at the time you discover the theft – this boosts your depletion deduction

26

## Theft Loss Deduction

- ▶ Treatment of reimbursements may be more complicated
  - ✓ If you identify and successfully prosecute the guilty party, you must treat a court award of multiple damages as two parts for taxes:  
The *reimbursement* – for example, one-third of triple damages – which you subtract from the loss, and

27

## Theft Loss Deduction

- ✓ The *damage award* – for example, two-thirds of triple damages – which is ordinary income

28

## Condemnation

- ▶ Tax treatment is the same whether the property actually is condemned or you sell it to the government under threat of condemnation
- ▶ Condemnation for a right-of-way easement – where you keep title to the land but lose the right to grow timber on it – is treated the same as a sale

29

## Condemnation

- ▶ Condemnation differs in two ways from other forms of involuntary conversion:
  - ✓ It always involves your basis in the land  
*and*
  - ✓ It may not involve your basis in the timber

30

## Condemnation Deduction

- ▶ Deduct your basis in the land the year the condemnation occurs
- ▶ Also deduct the basis in timber you are not allowed to sell  
*but*
- ▶ Apply the basis in the timber you are allowed to sell against the sale returns – no basis from that timber will be left to deduct for the condemnation

31

**EXAMPLE:** Earlier this year you purchased a 50-acre timber tract for \$68,000, allocating \$22,300 to the Land Account and \$45,700 to the Timber Account. Now 5 acres have been condemned for a utility right-of-way. You are allowed to sell the standing timber – 25 MBF out of 190 MBF total for the tract – but you will lose the right to grow timber there in the future. Calculate your loss deduction.

32

### Solution

- ▶ Deduct your basis in the land from the condemnation award:

$$(\$22,300 \div 50 \text{ acres}) \times 5 \text{ acres} = \$2,230$$

33

### Solution

- ▶ Apply your basis in the timber against the sale return:

$$(\$45,700 \div 190 \text{ MBF}) \times 25 \text{ MBF} = \$6,013$$

None will be left to deduct from the condemnation award

- ▶ No further deduction is allowed for the loss of future timber income

34

### Treatment of Expenses

- ▶ Deduct the costs of determining a casualty, noncasualty, or theft loss – appraisal, cruising, etc. – as expenses; do not add them to the loss
- ▶ Deduct costs incurred to receive a condemnation award from the amount of the award, and report the net award on your tax return

35

### Treatment of Gains

- ▶ If your salvage sale proceeds, reimbursement, award, or other compensation from an involuntary conversion is more than your adjusted basis in the affected timber, you will have a taxable gain
- ▶ A taxable gain is just about guaranteed in the event of a salvage sale, since – as noted earlier – the loss deduction and salvage sale are separate events

36

**EXAMPLE:** In the casualty loss example above, say the trees were salvageable rather than completely destroyed by the fire. You are able to locate a buyer who pays you \$3,000 for them. You have \$500 of deductible expenses from the sale. Remember your new adjusted basis in the block is \$952, the entire plantation contains 640 cords of pulpwood, and 272 cords were burned. What is your taxable gain?

37

## Solution

- ▶ Calculation your depletion allowance:

$$(Timber\ Basis \div Pre\text{-}harvest\ Volume) \times Units\ Sold \\ (\$952 \div 640) \times 272 = \$405$$

- ▶ Calculate your taxable gain:

$$Sale\ Proceeds - Expenses - Depletion\ Allowance \\ \$3,000 - \$500 - \$405 = \$2,095$$

38

## Treatment of Gains

- ▶ *But* you can defer recognition of – and income tax on – the gain by using it to purchase qualifying replacement property, within the allowable replacement period

39

## Qualifying Replacement Property

- ▶ Qualifying replacement property includes:
  - ✓ Replacement timber sites
  - ✓ Seeds and seedlings
  - ✓ Replanting costs on sites that you own, lease, or buy as a replacement

40



## **Qualifying Replacement Property**

- ✓ Restoration work to repair damage, clean and clear drainage systems, or replace culverts, fences, gates, and roads
- ✓ Stock to acquire or gain control of a corporation that owns timber, timberland, or both

41

## **Allowable Replacement Period**

- ▶ For a casualty, noncasualty, or theft loss, the allowable replacement period is 2 years after the close of the first tax year in which you realize any portion of the gain
- ▶ For a condemnation, the allowable replacement period is 2 years ... for personal property and 3 years ... for real property
- ▶ Timber generally is real property, but timber under contract for sale may be personal property

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## **To Postpone Recognition of Gains**

- ▶ Attach a statement to your tax return (Form 3-P)
  - ✓ State you elect to postpone recognition of the gain
  - ✓ Describe conversion, replacement property
- ▶ The amount deferred cannot exceed the fair market value of the converted assets
- ▶ Your basis in the replacement property is its cost, minus the deferred gain

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**Tax Forms: Form 4684, Section B (Back)  
Form 4797, Part I**

44

# **Tax Forms and Examples**



## **Involuntary Conversion**

|   |                    |
|---|--------------------|
| Name(s) shown on tax return. Do not enter name and identifying number if shown on other side. | Identifying number |
|---|--------------------|

**SECTION B—Business and Income-Producing Property**

**Part I Casualty or Theft Gain or Loss (Use a separate Part I for each casualty or theft.)**

- 19 Description of properties (show type, location, and date acquired for each property). Use a separate line for each property lost or damaged from the same casualty or theft.
- Property A \_\_\_\_\_
- Property B \_\_\_\_\_
- Property C \_\_\_\_\_
- Property D \_\_\_\_\_

|    |  | Properties |   |    |   |
|----|--|------------|---|----|---|
|    |  | A          | B | C  | D |
| 20 | Cost or adjusted basis of each property . . . . .  | 20         |   |    |   |
| 21 | Insurance or other reimbursement (whether or not you filed a claim). See the instructions for line 3 . . . . .<br><i>Note: If line 20 is more than line 21, skip line 22.</i>  | 21         |   |    |   |
| 22 | Gain from casualty or theft. If line 21 is more than line 20, enter the difference here and on line 29 or line 34, column (c), except as provided in the instructions for line 33. Also, skip lines 23 through 27 for that column. See the instructions for line 4. If line 21 includes insurance or other reimbursement you did not claim, or you received payment for your loss in a later tax year. | 22         |   |    |   |
| 23 | Fair market value before casualty or theft . . . . .   | 23         |   |    |   |
| 24 | Fair market value after casualty or theft . . . . .  | 24         |   |    |   |
| 25 | Subtract line 24 from line 23 . . . . .  | 25         |   |    |   |
| 26 | Enter the smaller of line 20 or line 25.<br><i>Note: If the property was totally destroyed by casualty or lost from theft, enter on line 26 the amount from line 20.</i>   | 26         |   |    |   |
| 27 | Subtract line 21 from line 26. If zero or less, enter -0-  | 27         |   |    |   |
| 28 | Casualty or theft loss. Add the amounts on line 27. Enter the total here and on line 29 or line 34 (see instructions).   |            |   | 28 |   |

**Part II Summary of Gains and Losses (from separate Parts I)**

|                                | (b) Losses from casualties or thefts            |   | (c) Gains from casualties or thefts includable in income |
|--------------------------------|---|---|--|
| (a) Identify casualty or theft | (i) Trade, business, rental or royalty property | (ii) Income-producing and emp byee property |  |

| Casualty or Theft of Property Held One Year or Less |  |     |     |
|---|--|-----|-----|
| 29  |  | ( ) | ( ) |
| 30  | Totals. Add the amounts on line 29 . . . . .   | 30  | ( ) |
| 31  | Combine line 30, columns (b)(i) and (c). Enter the net gain or (loss) here and on Form 4797, line 14. If Form 4797 is not otherwise required, see instructions . . . . .   |     | 31  |
| 32  | Enter the amount from line 30, column (b)(ii) here. Individuals, enter the amount from income-producing property on Schedule A (Form 1040), line 28, or Schedule A (Form 1040NR), line 18, and enter the amount from property used as an employee on Schedule A (Form 1040), line 23, or Schedule A (Form 1040NR), line 11. Estates and trusts, partnerships, and S corporations, see instructions . . . . . |     | 32  |

| Casualty or Theft of Property Held More Than One Year  |   |     |     |
|--|---|-----|-----|
| 33   | Casualty or theft gains from Form 4797, line 32 . . . . .   |     | 33  |
| 34   |   | ( ) | ( ) |
| 35   | Total losses. Add amounts on line 34, columns (b)(i) and (b)(ii) . . . . .  | 35  | ( ) |
| 36   | Total gains. Add lines 33 and 34, column (c) . . . . .  |     | 36  |
| 37   | Add amounts on line 35, columns (b)(i) and (b)(ii) . . . . .  |     | 37  |
| 38   | If the loss on line 37 is more than the gain on line 36:  |     |     |
| a  | Combine line 35, column (b)(i) and line 36, and enter the net gain or (loss) here. Partnerships (except electing large partnerships) and S corporations, see the note below. All others, enter this amount on Form 4797, line 14. If Form 4797 is not otherwise required, see instructions . . . . .  |     | 38a |
| b  | Enter the amount from line 35, column (b)(ii) here. Individuals, enter the amount from income-producing property on Schedule A (Form 1040), line 28, or Schedule A (Form 1040NR), line 18, and enter the amount from property used as an employee on Schedule A (Form 1040), line 23 or Schedule A (Form 1040NR), line 11. Estates and trusts, enter on the "Other deductions" line of your tax return. Partnerships (except electing large partnerships) and S corporations, see the note below. Electing large partnerships, enter on Form 1065-B, Part II, line 11 . . . . . |     | 38b |
| 39   | If the loss on line 37 is less than or equal to the gain on line 36, combine lines 36 and 37 and enter here. Partnerships (except electing large partnerships), see the note below. All others, enter this amount on Form 4797, line 3 . . . . .  |     | 39  |
| <p><i>Note: Partnerships, enter the amount from line 38a, 38b, or line 39 on Form 1065, Schedule K, line 11.</i></p> <p><i>S corporations, enter the amount from line 38a or 38b on Form 1120S, Schedule K, line 10.</i></p> |   |     |     |

**Sales of Business Property**

(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

▶ Attach to your tax return. ▶ See separate instructions.

|                         |                    |
|-------------------------|--------------------|
| Name(s) shown on return | Identifying number |
|-------------------------|--------------------|

|  |   |
|--|---|
| 1 Enter the gross proceeds from sales or exchanges reported to you for 2008 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20 (see instructions) . . . . . | 1 |
|--|---|

**Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year** (see instructions)

| 2 | (a) Description of property | (b) Date acquired (mo., day, yr.) | (c) Date sold (mo., day, yr.) | (d) Gross sales price | (e) Depreciation allowed or allowable since acquisition | (f) Cost or other basis, plus improvements and expense of sale | (g) Gain or (loss) Subtract (f) from the sum of (d) and (e) |
|---|-----------------------------|-----------------------------------|-------------------------------|-----------------------|---|--|---|
|   |                             |                                   |                               |                       |   |  |   |
|   |                             |                                   |                               |                       |   |  |   |
|   |                             |                                   |                               |                       |   |  |   |
|   |                             |                                   |                               |                       |   |  |   |

|   |   |
|---|---|
| 3 Gain, if any, from Form 4684, line 45 . . . . .   | 3 |
| 4 Section 1231 gain from installment sales from Form 6252, line 26 or 37 . . . . .  | 4 |
| 5 Section 1231 gain or (loss) from like-kind exchanges from Form 8824 . . . . .   | 5 |
| 6 Gain, if any, from line 32, from other than casualty or theft . . . . .   | 6 |
| 7 Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows: . . . . .  | 7 |
| Partnerships (except electing large partnerships) and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.  |   |
| Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below. |   |
| 8 Nonrecaptured net section 1231 losses from prior years (see instructions) . . . . .   | 8 |
| 9 Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return (see instructions) . . . . .  | 9 |

**Part II Ordinary Gains and Losses** (see instructions)

|  |  |
|--|--|
| 10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less): |  |
|  |  |
|  |  |
|  |  |
|  |  |

|  |        |
|--|--------|
| 11 Loss, if any, from line 7 . . . . .   | 11 ( ) |
| 12 Gain, if any, from line 7 or amount from line 8, if applicable . . . . .  | 12     |
| 13 Gain, if any, from line 31 . . . . .  | 13     |
| 14 Net gain or (loss) from Form 4684, lines 37 and 44a . . . . .   | 14     |
| 15 Ordinary gain from installment sales from Form 6252, line 25 or 36 . . . . .  | 15     |
| 16 Ordinary gain or (loss) from like-kind exchanges from Form 8824 . . . . .   | 16     |
| 17 Combine lines 10 through 16 . . . . .   | 17     |
| 18 For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below:   |        |
| a If the loss on line 11 includes a loss from Form 4684, line 41, column (b)(1), enter that part of the loss here. Enter the part of the loss from income-producing property on Schedule A (Form 1040), line 28, and the part of the loss from property used as an employee on Schedule A (Form 1040), line 23. Identify as from "Form 4797, line 18a." See instructions . . . . . | 18a    |
| b Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Form 1040, line 14 . . . . .  | 18b    |