Forestry Tax Update

Robert A. Tufts
Ph.D, J.D., LLM(tax)

School of Forestry and Wildlife Sciences
Auburn University
(334) 844-1011
tuftsra@auburn.edu

1099 Reporting Required for All Timber Sales

- Lump-sum timber sales have been exempt from reporting requirements under Sec. 6050N
  - Pay-as-cut sales have been reportable since 1990
- The new Regulation 1.6045-4(b)(2)(i) has been amended so the definition of reportable real estate includes the new category, "(E) Any non-contingent interest in standing timber."
  - Ownership interest includes any contractual interest in a sale or exchange of standing timber for a lump-sum payment that is fixed and not contingent
  - Effective for transactions completed after May 28, 2009

Reporting Person

- The reporting person is the person responsible for closing the transaction
  - If there is no person responsible for closing then, in order:
    - The mortgage lender,
    - The transferor's broker
    - The transferee's broker, or
    - The transferee.
  - The report is filed on Form 1099-S
    - Due February 15th (previously January 31st)

No New Forestry-Specific Tax Issues

- Timber Tax and Return Preparation Workshops in October and November
- Would you like a workshop in your area?

Potential Fix for the Budget Deficit

- Raise new taxes by eliminating tax deductions
  - Exclusion for employer-provided health care
  - Mortgage interest deduction
  - Tax breaks for retirement plans
  - Lower tax rates on dividends and long-term capital gains
  - Earned income credit
  - Medicare benefits
  - Charitable contributions
  - State and local income taxes

Recent Tax Legislation

- Economic Growth and Tax Relief Reconciliation Act of 2001;
- Jobs and Growth Tax Relief Reconciliation Act of 2003;
- Tax Increase Prevention and Reconciliation Act of 2005;
- Pension Protection Act of 2006; and finally
- Tax Relief, Unemployment Insurance reauthorization, and Job Creation Act of 2010

Estate Taxes

- The sunset of EGTRRA, which was scheduled to occur after 12/31/2010, has been extended through 12/31/2012
- Federal estate and generation skipping transfer taxes will apply to the estates of decedents dying after 12/31/2009, and before 1/1/2013, but with the higher estate tax applicable exclusion amount of $5 million and lower tax rates (35% maximum)
  - For estate of decedents dying in 2010, executors may elect to have the EGTRRA rules (no estate tax, but modified carryover basis) apply

Result of the increased exclusion amount

- As estimated by the Tax Policy Center and reported by the Congressional Research Service, if the Applicable Exclusion Amount was:
  - $5 million, then only 3,600 estates or 0.14% of deaths would be subject to the federal estate tax in 2011
  - $3.5 million, then only 6,160 estates or 0.24% of deaths would be subject to estate taxes
  - $1 million, then only 46,000 or 1.76% of deaths would be subject to estate taxes

Gift Taxes

- The gift tax rate for lifetime transfers remains at 35%
- The gift tax applicable exclusion amount for 2010 was $1 million and it was increased to $5 million for 2011 and 2012
- What happens in 2013 if you made a $5 million gift in 2011?
  - Discuss EGTRRA
  - Clawback

Estate Planning

- Start a gifting program to reduce the value of your taxable estate
- It is better to gift during life than waiting until death
  - The effective tax rate is lower because the base is different
    - $1 million estate generates $350,000 in estate taxes and $650,000 to the beneficiary
    - $1 million to gift and pay tax generates $259,259 gift tax and a $740,740 gift
  - You remove all income and appreciation from the estate without paying tax
  - You have to consider basis - donee takes donors basis, whereas you get a step-up in basis when taking from a decedent

Estate Planning

- Gifting program
  - Tax-free gifts for medical expenses and tuition
  - Annual exclusion gifting - $13,000 per person per year
  - Transfer some or all of the applicable exclusion amount
    - $1 million or up to $5 million
- Using the applicable exclusion amount
  - Remove life insurance first - in the estate at face amount or gift at cash value
  - Use split-interest techniques (GRAT's, QPRT's) or discounted gifting of minority interests in a business

Generation-Skipping Transfer Tax

- The generation-skipping transfer tax was restored for 2010 but with a 0% applicable rate in 2010.
- The rate for 2011 and 2012 is 35% but the GST exemption amount is $5 million

Reinstate Section 1014

- Code Section 1014 is reinstated and property acquired from a decedent generally is stepped up (or stepped down) to equal its value as of the date of the decedent's death
  - For decedents dying in 2010 the executor may elect the modified carryover basis rules of EGTRRA

Estate Taxes - Portability

- The new Act provides an election to allow the unused portion of the applicable exclusion amount of a predeceased spouse to be available to the estate of his or her surviving spouse

Tax Rates

- Lower income tax rates are extended to apply to tax years beginning in 2011 and 2012
  - The 10% rate continues to apply for lower income individuals
  - The 15, 25, 28, 33 and 35 percent rates for individuals, estates and trusts continue to apply
    - Note the 10% rate does not apply to estates or trusts

Rate	Single	Married	Trusts
10%	8,500	17,000	
15%	34,500	69,000	2,300
25%	83,600	139,350	5,450
28%	174,400	212,300	8,300
33%	379,150	379,150	11,350

Extension of marriage penalty relief

Planning note: may want to accelerate withdrawals from tax-deferred plans

Payroll and Self-employment Taxes

- For 2011, the rate of the old age, survivors, and disability insurance (OASDI) tax on self-employment income is reduced by 2% to 10.4 %
- The rate of the employee's OASDI portion of payroll tax is also reduced by 2% to 4.2%
  - The employer's share remains at 6.2%
  - The Medicare tax at 1.45% and 2.9% remains unchanged
- The rate reduction is not taken into account in determining self-employment income deduction
  - For 2011 the deduction remains at 7.65% of self-employment income

Standard Deduction

- The standard deduction for joint filers remains twice the inflation-adjusted amount of the standard deduction applicable to single taxpayers for tax years 2011 and 2012

Itemized Deduction

- Itemized deductions for higher-income filers will not be reduced for the next two years
  - After 12/31/2012 the amount of otherwise allowable itemized deductions will be reduced for higher-income taxpayers whose AGI exceeds the threshold amount ($100,000 for most taxpayers and is adjusted annually for inflation)
    - The amount of the reduction will be the lesser of
      - 3% of the amount of the taxpayer's AGI in excess of $100,000 or
      - 80% of the itemized deductions

Phase-out of Personal Exemptions

- If the taxpayer's AGI exceeds the threshold amount, the exemption amount will be reduced by *2%* for each \$2,500 or fraction thereof by which the AGI exceeds the threshold amount
  - The original threshold amounts in 1991 were \$150,000 for married filing jointly and \$100,000 for single taxpayers
- The repeal of the personal exemption phaseout will continue to apply to tax years beginning in 2011 and 2012

Deduction of Sales Taxes

- The election to deduct State and local general sales taxes as an itemized deduction in lieu of State and local income taxes is extended for 2 years

Capital Gains

- The reduced capital gains rate of 15% on adjusted net capital gain of noncorporate taxpayers (0% for taxpayers in the 10% and 15% tax bracket) has been extended for 2 years
  - The special tax break for assets held for more than five years will not be reinstated for 2 years
    - Assets have to have been acquired after 12/31/2000

Qualified Dividends

- Qualified dividends will continue to be taxed at capital gains rates for the next 2 years for individuals, trusts and estates
  - Dividends will continue to be included in the computation of the adjusted net capital gain
- Under the sunset provisions, qualified dividends will be taxed at the applicable ordinary income tax rates in tax years beginning after 12/31/2012
  - Beginning in 2013 high-income individuals may have to pay an additional Medicare tax of 3.8% on the lesser of their net investment income or modified AGI in excess of $250,000 ($200,00 for singles)

Bonus Depreciation

- The additional depreciation allowance is extended for 2 years for qualifying property placed in service before 1/1/2013
  - The depreciation allowance is increased from 50% to 100% for qualified property acquired after 9/8/2010 and before 1/1/2012
    - Qualifying property is new property depreciable under MACRS and has a recovery period of 20 years or less
      - Property that must be depreciated under the alternative depreciation system does not qualify (passenger automobile used less than 50% for business

Section 179 Expensing

- The dollar limitation for tax years beginning in 2012 is $125,000 and the investment limitation is $500,000
  - After 2012 the dollar limit is $25,000 and the investment limit is $200,000
- Section 179 property is generally defined as new or used depreciable tangible section 1245 property that is purchased for use in the active conduct of a trade or business
- For 2011 the dollar limit is $500,000 and the investment limitation is $2 million

Mortgage Insurance Premiums

- The treatment of qualified mortgage insurance premiums as deductible qualified residence interest is extended for amounts paid or accrued in 2011
  - Not for premiums paid or accrued after 12/31/2011
  - The requirement that the premiums be paid pursuant to a contract issued on or after 1/1/2007 remain unchanged

Qualified Charitable Distributions from IRAs

- The exclusion from gross income for qualified charitable distributions of up to $100,000 received from traditional or Roth IRAs is extended to apply to distributions made in tax years 2010 and 2011

Qualified Conservation Contribution

- A contribution of qualified real property interest to a qualified organization exclusively for conservation purposes
- The limitation on the deduction is generally 20% or 30% of AGI depending on the type of charitable organization
  - The Pension Protection Act increased the deduction limitation to 50%
- If the individual is a qualified farmer or rancher the contribution base is raised from 50% to 100% for 2011
  - A qualified farmer or rancher is an individual whose gross income from the trade or business of farming is greater than 50% of the taxpayer's gross income

Qualified Conservation Easements

- For decedents dying before 1/1/2013 an executor may elect to exclude from the decedent's gross estate up to 40% of the value of the land subject to the qualified conservation easement
  - The value of the land is reduced by the amount of any charitable deduction allowed
  - If the value of the easement is less than 30% of the overall value of the land the applicable percentage is reduced by 2 percentage points for each percentage point that the value of the easement falls below the 30% threshold
  - The maximum exclusion is $500,000

Child Tax Credit

- The $1,000 per qualifying child tax credit amount is extended for two years
  - After 12/31/2012 taxpayers who have dependent children under age 17 at the close of a calendar year will only be eligible for a $500 child tax credit

Residential Energy Property Credit

- Effective for property placed in service during 2011, an individual is entitled to a credit against tax in an amount equal to:
  - 10% of the amount paid or incurred for qualified energy efficiency improvement (building envelope components) installed during the year, and
  - the amount of residential energy property (heat pumps, furnaces, central air conditioners and water heaters) expenditures paid or incurred during the tax year
- The maximum credit allowable is $500 over the lifetime of the taxpayer

Alternative Minimum Tax

- The alternative minimum tax exemption amounts have been increased for tax years beginning in 2010 and 2011
  - In 2010: $47,450 for unmarried and $72,450 for married
  - In 2011: $48,450 for unmarried and $74,450 for married
- The exemption amount is reduced by 25% for each $1 of AMTI in excess of: $112,500 for unmarried individuals and $150,000 for married individuals filing jointly

Incentives for Biodiesel, Renewable Diesel and Alternative Fuels

- The per-gallon incentives for biodiesel, agri-biodiesel, and renewable diesel have been retroactively extended for two additional years, through December 31, 2011
  - $1.01 per gallon cellulosic biofuel producer credit under Code Section 40
  - The definition of liquid fuel derived from biomass has been amended to exclude “black liquor”