Mike Jacobson

PAFS Training

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TAXES FOR FOREST LANDOWNERS

Penn State Extension

Types of Forest Taxes

- Types of forest taxes
  - Income taxes
  - Estate taxes
  - Property taxes
    - Clean and Green
- Gas taxes

This talk touches on some key tax opportunities, tips, and resources every landowner should

Forests and Taxes

- Truisms:
  - You have to pay taxes
  - Your land is an investment (business)
  - You can reduce tax payments legally
  - There are tax incentives
  - Its complicated stuff
- This information and discussion should be treated as EDUCATIONAL, not legal advice.
- Discuss with professional tax team

What Makes Forest Investments Unique?

Key Income Tax Opportunities

1. Establish a basis
2. Take deductions for forest-related expenses
3. Report timber income as capital gains
4. Use reforestation tax incentives
5. Exclude cost share program income
6. Know about casualty loss rules
7. Think about conservation easement tax incentives (also estate taxes)

1. Establishing Basis

- All investments in ‘capital assets’ have a tax basis
- What is basis?
- Why bother establish basis?
  - So you can deduct the basis from the income you receive when you dispose/sell/depreciate the asset

Original Basis

- **Purchase**—Total cost to acquire the property, 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

- **Gift**—Lower of donor's basis (carry-over basis) or property's fair market value

Establishing Basis

- Do it ASAP
- Allocate original basis proportionately among your capital accounts – for example, Land, Timber, Buildings, Equipment
- Use Form T

Form **T (Timber)** (Rev. December 2005) Department of the Treasury Internal Revenue Service

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: Your Name

Identifying number: SSN

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	
3a	Name and address of seller or person from whom property was acquired: Sellers Name and Address	b Date acquired: MM/DD/YYYY
4	Amount paid: a In cash	$50,000
	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.	
6	Legal expenses	$300
7	Cruising, surveying, and other acquisition expenses	$1,600
8	Total cost or other basis of property. Add lines 4a through 7	$51,900

2. Deducting Operating Expenses or Carrying Costs

- Why capitalize when you can deduct in year they occur?
- Depends of type of investment
  - Personal use (hobby)
    - No profit motive, not deductions allowed
  - Investment (Not major source of income)
    - Expense needs to be more then 2% of AGI
  - Trade and business (regular income)
    - Active – 'materially participate'
    - Passive do not 'materially participate'
- The more active, the more you can deduct!

3. Reporting Capital Gains Income

- How much should you pay?

  Price – Expenses – Timber Basis

- Can I report it as capital gain?
  - How long you have held it (how acquired)
  - How you dispose of it (3 methods)
    - Lump-sum sale or exchange
    - A Section 631(b) disposal, pay-as-cut contract
    - A Section 631(a) transaction, by cutting the timber yourself, converting it to products for sale, and making an election on your original tax return
- 1099 required for all sales

Why Capital Gains?

- Long-term capital gains rates
    - 5% (if in 25% or higher tax bracket)
    - 0% (if in 10 or 15% tax bracket)
  - Highest ordinary income rates – 35%
    - So there is a 5% to 20% tax rate differential
- Ordinary income you earn from timber is subject to self-employment taxes, at rates up to 15.3%
- If you have large capital losses, apply them 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 cut

4. Reforestation Incentives

- The American Jobs Creation Act of 2004 changed the nature of the incentives
- Two tax incentives reduce or eliminate the need to hold reforestation expenses in a capital account until you sell timber or timber products:
  - You can deduct reforestation expenses – up to $10,000 per year of qualifying reforestation
  - And for those expenses over $10,000 you can amortize – write off over an 8 year period

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
- Remember recapture provisions

5.Cost-share Payments

- Generally, you are required to report government cost-share payments as part of your gross income (1099G).
- However, under Section 126 of the IRS Code, all, or part of, certain government cost-share programs **MAY** be excluded from gross income.
  - ‘Substantial’ increase in annual income
- Nevertheless, even if you choose to exclude an approved government cost-share payment, YOU MUST REPORT IT!

6. Casualty Losses

- May have income tax deduction, if not reimbursed by income or otherwise
  - Casualty loss, non-casualty loss, theft loss, condemnation
    - Criteria for loss differs
- Caused by natural or outside forces
    - Sudden, Unexpected, Unusual
- How you keep records is important- is it by stand for the whole forest?

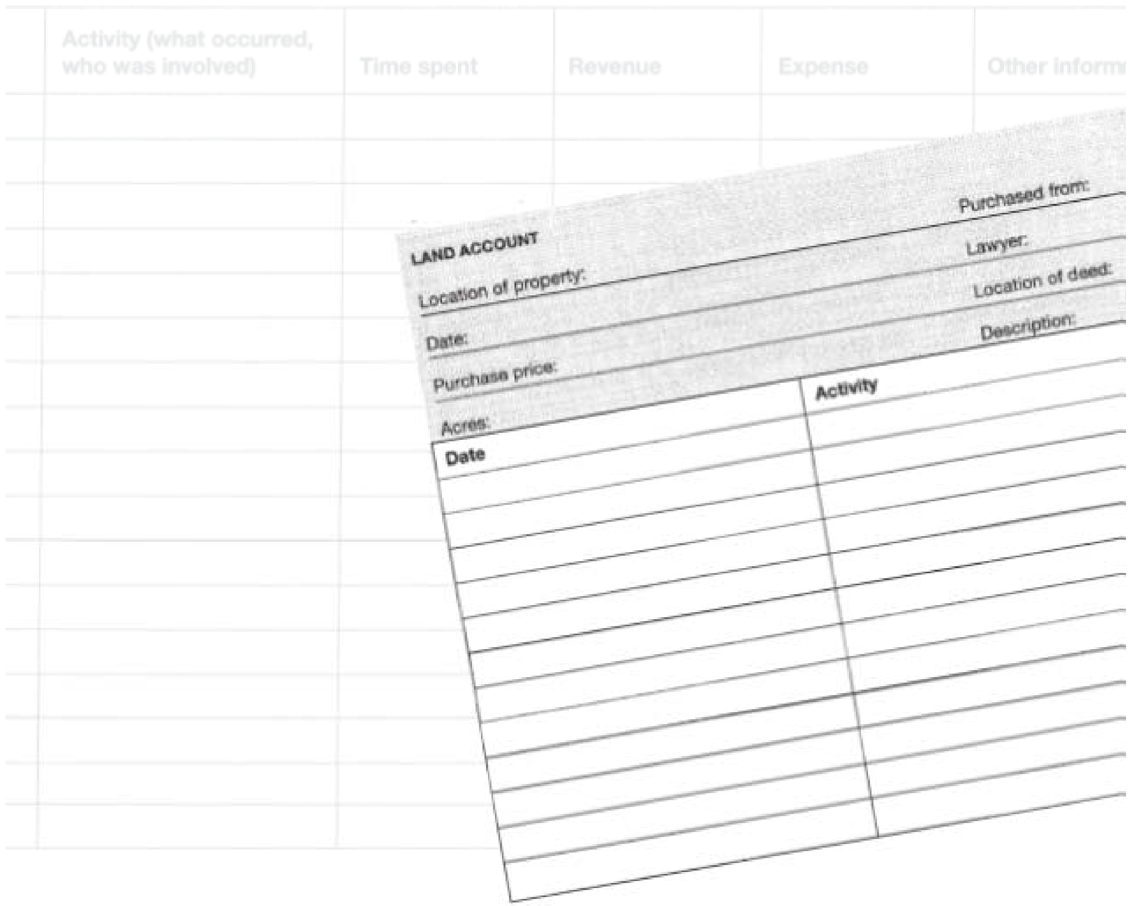
7: Donation of Conservation Easement (Section 170 IRC)

- Conservation purpose
- Donation vs sale vs bargain sale
- Charitable deduction is 50% of Adjusted Gross Income
- Excess deduction amounts is carried forward for 15 additional tax years
- Additional exclusion of up to $500,00 (IRC 2031c for estate planning

3

Forest Finance

Keeping Records of Forest Management Activities



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IRS Audits: Be Prepared

- Have management plan
- Keep good records (like what?)
- Get expert forestry advice
- Show how improvements/expenses contribute to profit motive
- Separate personal expenses from business expenses
- Separate work been done for income or pleasure
- How many deductions to make?
  - Subjectivity

Estate planning: The Cost of Dying Unprepared

- Unexpected heirs
- Unexpected values
- Transfer costs
- Loss of business leadership and income
- Estate shrinkage due to liquidation
- Long Term Care Planning - Living Within Your Money

Everyone has a plan

- Either you decide or the government does

It’s not just about taxes

Its about your land

Questions to consider

- Do you have management plan?
- What happens if you or, your spouse of both of you were to die today, what would happen to the forest land?
- Does the plan address continuity and minimize disruption?
- Will forest investment retain value after death?
- Have you taken steps to minimize transfer fees and death taxes?

Consider a “readiness questionnaire”

Three common phrases

- “we don’t need a will’
- ‘we have a will – we’re all set”
- “we want to treat our children fairly, so we will divide everything equally among them”

Communication is the key:

- Dying is as much as part of living. To die well is to do so in consideration of the people you leave behind.”
- Its not just about the taxes

Federal Estate Tax Applicable Exclusion

Year of Death	*Applicable Exclusion*
2004-2005	$1,500,000
2006-2008	$2,000,000
2009	$3,500,000
2010	tax repealed but no stepped up basis
2011-2012	$5,000,000
2013	**$1,000,000**

Rates also came down from 55% in 2001 to 35% in 2012

Pennsylvania Inheritance Tax Rates

Note: Now exemption for forest landowners

Rates:

0%: Spouses, charities;

4.5%: Lineal descendants;

12%: Siblings;

15%: All others

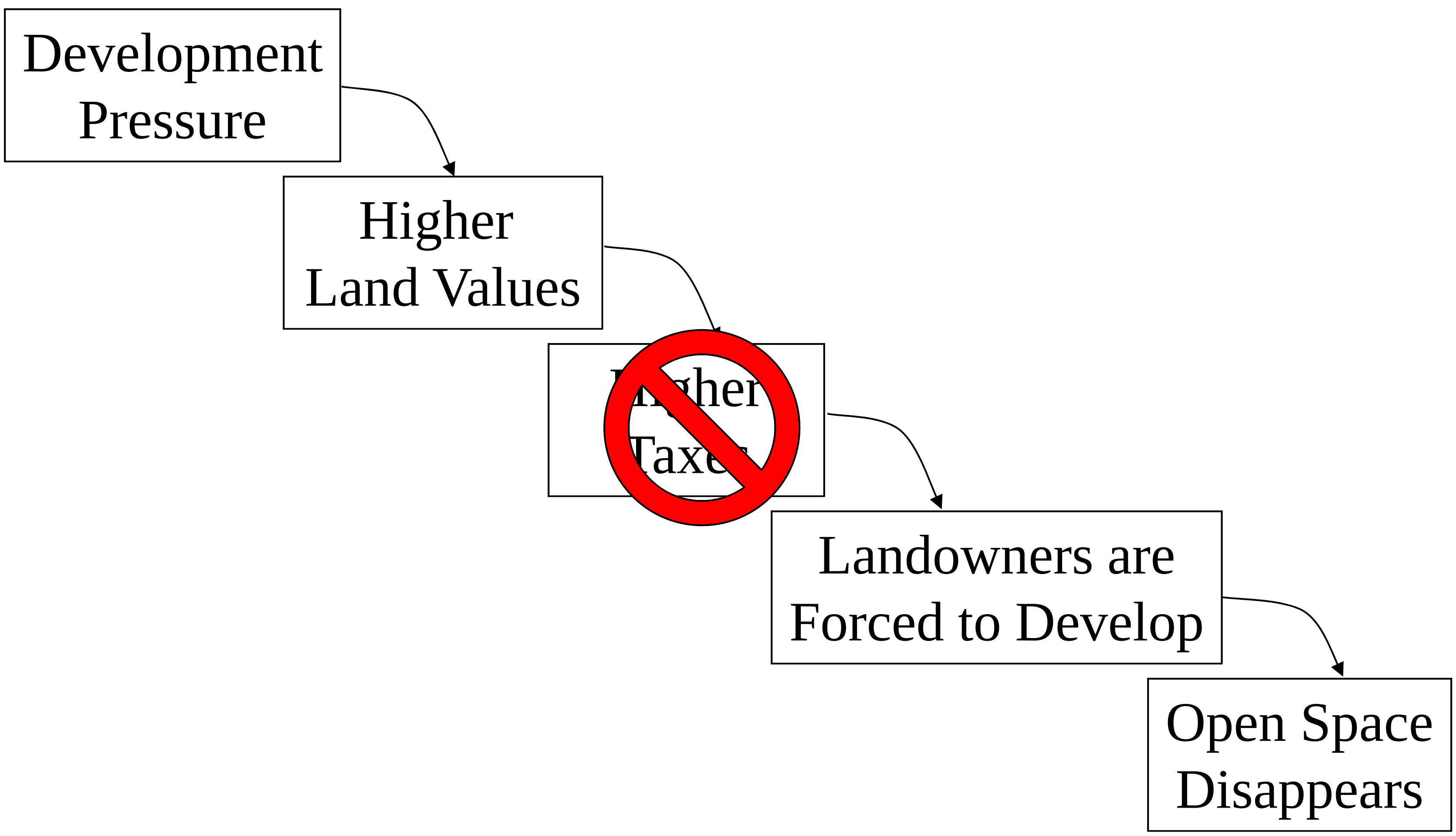
Where to Start?

- Inventory your estate assets. Determine what you own and what it is worth.
- Determine your personal estate planning objectives.
  - Each plan is personal to its preparer!
- Seek the help that you need.
  - Identify the issues you must confront
  - Explain options to deal with these issues.

Example Strategies In Planning Forestland Estates

- Donation of a conservation easement
  - Combine tax saving and conservation objectives
- Gifting: $13,000/person/year
- Property that involves a trade or business
  - Special use valuation of the timber related assets
  - Installment payment over 14 year, 9 month period
- Deferral and extension
- Marital deduction
- Trusts

Basic Concept of Clean and Green



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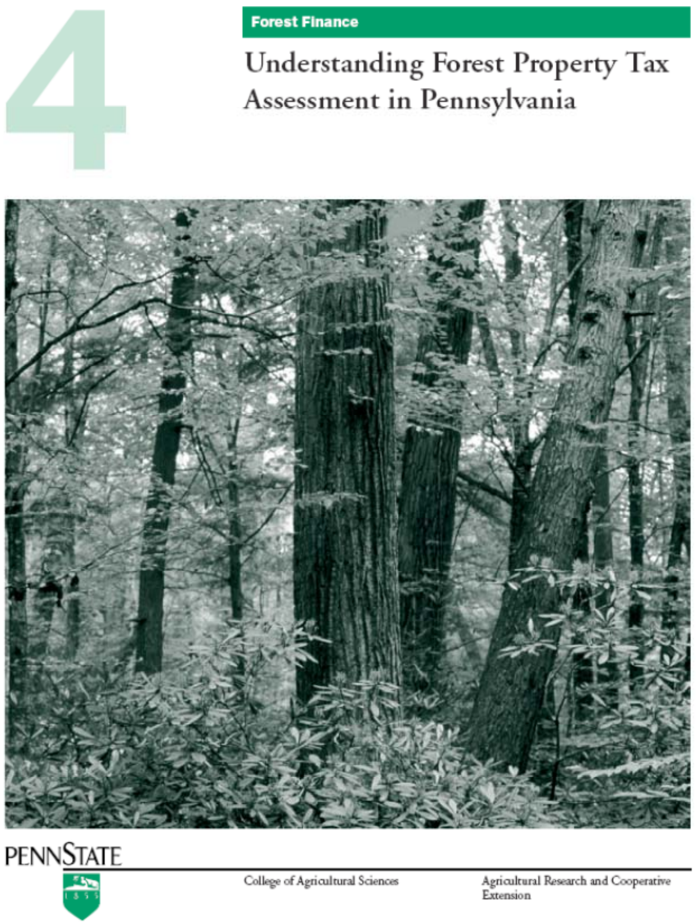
Issues with Clean and Green



- Fairness/equity
- Deferred income/profitability
- Unintended beneficiaries

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Gas Finance and Taxation

- What “interest” do you own in the mineral rights?
- Types of income
  - Lease bonuses
  - Damage payments
  - Pipelines and easements
  - Royalty
    - Depletion
  - Shut-in royalty
  - Free natural gas
  - Sales of interests

MARCELLUS EDUCATION FACT SHEET

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Tax Treatment of Natural Gas

The Marcellus shale geological formation underlies almost two-thirds of Pennsylvania. It is believed to hold trillions of cubic feet of natural gas. Recent advances in drilling technology and rising natural gas prices have attracted new interest in this previously untapped formation. The Marcellus shale natural gas boom is creating unprecedented and extraordinary income for many rural landowners in Pennsylvania.

Dealing with this newfound wealth requires careful financial and tax planning. The tax law surrounding oil, gas, and mineral (OGM) leases and royalties is complex and ever-changing. The Internal Revenue Service (IRS) and the Pennsylvania Department of Revenue have specific tax rules for OGM revenue. By understanding these rules, you can avoid penalties and possibly save money by sidestepping unnecessary taxes.

This guide is written for the landowner leasing the OGM rights on the property (lessor), not the producer or lessee (usually a gas company). You as the landowner are potentially liable for income, property, and estate taxes from your land and the natural resources therein, primarily OGM, crops, livestock, and timber. Tax issues and responsibilities for producers or those with a “working interest” in the OGM are beyond the scope of this publication.

The “landowner” referred to in this publication is one who has fee interest in the mineral or subsurface rights to the property. In other words, he or she has a real property interest, also referred to as “mineral property” or “oil and gas property.” This distinction is important since the subsurface or mineral rights of some land in Pennsylvania are severed from surface rights. Owning the surface land does not automatically imply that you own the subsurface or mineral rights. Careful examination of the deed is important to verify ownership rights.

As a landowner you should be aware of the laws surrounding OGM production. Pennsylvania OGM exploration and production is closely supervised and regulated by various state agencies. There are a number of oil and gas regulations and laws such as the Oil and Gas Act, Coal and Gas Resource Coordination Act, and Oil and Gas Conservation Law. In addition, there are environmental laws that address OGM, including the Clean Streams Law, the Dam Safety and Encroachments Act, the Solid Waste Management Act, and the Water Resources Planning Act.

Before signing any documents, you should discuss the lease conditions with an attorney who is familiar with oil and gas law. Also examine the financial and tax options available to you as a result

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Summary

- Part of forest management
  - Timber is long term
- Be in the timber growing business
  - Capital gains
  - Expensing
  - Reforestation incentives
- Establish “profit motive”
- Recordkeeping
- Plan your estate now!

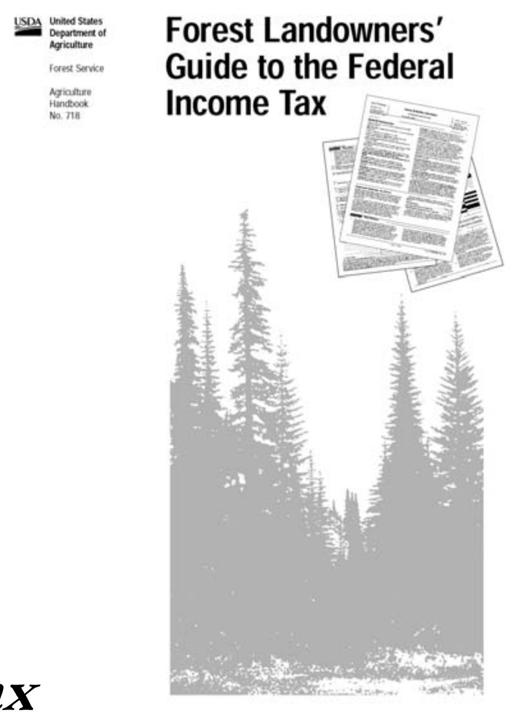
Tax Planning Resources

My Extension info:

http://extension.psu.edu/forest-finance

Mike Jacobson

mgj2@psu.edu or 814-865-3994



Timber Tax Website:

www.timbertax.org

Agriculture Handbook No. 718, ***The Forest Landowners' Guide to the Federal Income Tax***