



Timber Taxes Part III

In the third and final article about tax considerations for timber owners we will continue to provide information that can assist them minimize their federal tax liabilities. Some items we have included are not widely known by private landowners, many of whom are probably not taking advantage of tax regulations favorable to them.

Standing timber is considered to be part of the real estate and, thus, a capital asset. It is to your advantage to structure your timber sale so that only capital assets are sold. This is most easily accomplished through a written contract specifying a *lump sum payment* for specified trees or board foot volume. Full payment is received prior to harvesting and you qualify for capital gains treatment on the entire amount received. From a landowner perspective, lump sum contracts are usually the most desirable for many reasons.

Another popular method for selling timber is “Shares” type timber sales where the landowner agrees (usually with only a verbal contract) to accept payment of a specified percentage of the price received when the cut logs are sold to a mill or other processor. In this situation, the landowner is receiving part of the total payment for standing timber and part for cut logs, which are *ordinary assets* by definition. Thus, only the portion of the sale proceeds allocated to standing timber qualify for capital gains treatment. The remainder of the sale proceeds is taxed as ordinary income and may also be subject to self employment tax. In addition, the landowner assumes some risk because he still owns at least part of the trees during the cutting, skidding, loading, and hauling phases of the harvest. Bottom line: Shares contracts will increase your income tax liability. For that and many other reasons shares type contracts are usually less desirable for landowners.

If you find it expedient to sell your timber on a “shares” basis there are a couple of things you can do to improve your position.

- ❖ Know what you are selling! “All merchantable timber” and “All trees more than xx inches in diameter” are

phrases in a contract which are difficult to quantify if/when disagreements arise, especially in the case of a verbal contract. Avoid general or vague descriptions of what is being sold.

- ❖ In all cases having a written contract is more desirable than a verbal contract or having no contract. Use the sample contracts available to compile your own or seek advice from your local forester.
- ❖ If you own high quality timber, it is rarely to your advantage to sell it on a “shares” basis.

From experience it is clear that many landowners don’t realize that proceeds from a timber sale must be reported as income, so they do little, if any, advance planning to minimize tax liabilities. Hopefully, this series of articles has focused your attention on the advantages of preparation for future tax possibilities, tips for implementing tax saving measures and sources of timber tax information when you need it.

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