

## Drought Sales of Timber

During periods of drought some farmers view timber sales as a way to improve their cash flow. Selling timber during periods of economic distress is a good way to generate income, but it is important to realize that such sales may also result in a tax liability. The amount of liability depends on the sales volume, the basis or cost of the timber sold, and the seller's other taxable income as a farmer.

Most farmers hold timber as an investment property. Therefore, income from the sale of standing timber can qualify as a long-term capital gain for federal income tax purposes, depending on how long the timber was held. Timber must be held for more than one year before being cut to qualify for long-term capital gains. To determine the holding period, begin counting from the day of purchase or acquisition (i.e., inheritance date). Normally the purchase date is the day the title was transferred.

For most farmers, standing timber qualifies as a capital asset. Therefore, any gain from the sale of standing timber held for the required period results in a long-term capital gain. There are two reasons why timber sales qualifying for long-term capital gain result in less tax. The maximum federal capital-gain income tax rate is 15 percent for taxpayers falling in the 25 percent or higher income tax bracket. For taxpayers falling in the 10 or 15 percent income tax bracket the capital gain income tax rate is 5 percent. Additionally if the timber qualifies for capital gain treatment (either long- or short-term), the income is not subject to self-employment tax.

Most farmers sell standing timber for a lump-sum payment. In a lump-sum sale, the owner sells standing timber for a fixed price agreed upon in advance. Typically, the value is determined by estimating the volume of usable wood products (boards, poles, etc.) from standing timber. The sale may cover a given acreage, certain species, or certain diameter classes.

Because this method of selling timber is relatively simple, it is the one farmers use most often. For landowners who hold timber only as an investment and make infrequent sales, any gains from such a lump-sum sale of timber should qualify as capital gains income. Recent changes in the Internal Revenue Code (IRC) allow for timber held in the course of trade or business to also qualify for capital gain treatment; see IRC Section 631 for more detail.

Example of sale: A taxpayer made a lump-sum sale of timber for \$75,000. Sales costs were \$5,000. The timber was located on a tract of land purchased 15 years ago for \$50,000. At the time of purchase, \$35,000 was allocated to the cost of the land and \$15,000 was the cost (basis) of the timber stand. Gain or loss is calculated below:

Sales receipts	\$75,000
Less cost of sale	5,000
Less cost of timber (basis)	15,000
Gain	\$55,000

Because the timber was held for the appropriate time, the gain of \$55,000 is long-term capital gains. Sales receipts, cost-of-sale expenses and gain are reported on Schedule D, Form 1040 for federal income tax purposes. The federal income tax liability for this sale, assuming the taxpayer is in the 25 percent income tax bracket, is \$8,250 (\$55,000 \* .15).

Timber sales do not qualify for income averaging for farmers under IRC Section 1301.

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