



## Tax Treatment of Timber Acquisition and Reforestation Costs

By Karen Potter-Witter  
Professor  
Department of Forestry

### Capital Costs and Income Tax

Timber is considered a capital investment. The costs that a landowner incurs to acquire or establish his or her timber stand are, thus, **capital costs**. These capital costs include the value of the standing timber at time of purchase, and reforestation costs such as the cost of purchased seed, planting stock, paid labor, and paid site preparation.

The distinction between capital costs and other expenses is important since they are treated differently for income tax purposes. The methods of recovering capital costs are through a **depletion allowance** taken when timber is sold, or through a schedule of income tax deductions for reforestation called **amortization**.

### Depletion Allowance

The **depletion allowance** is the amount the IRS will allow to be deducted from gross income when timber is sold. It is calculated from the **timber basis** and the amount of timber sold.

The capital costs discussed above determine a landowner's timber basis. A landowner's basis represents to the IRS the amount of his or her investment in timber – in other words what was paid to establish or acquire the timber plus any improvements. It is this amount that the IRS will allow to be deducted from timber income and be excluded from taxation. The value of the timber basis must be separated from the value of the land on which the trees stand. The landowner should establish the value of the timber at the time of purchase. Landowners may need the assistance of a professional forester to determine fair market values for timber if not established at time of purchase.

#### Example:

An individual bought 90 acres of pine plantation in 1999 and paid \$36,000. The value of the timber at this time was \$13,500. This is their capital cost or **timber basis**. There were 1,350 cords of merchantable timber at the time. In 2005 they sold all the timber, now grown to 1,800 cords, for \$29,000.

$$\text{Taxable income from the sale} = \underset{\substack{\uparrow \\ \text{sale price}}}{\$29,000} - \underset{\substack{\uparrow \\ \text{basis}}}{\$13,500} = \$15,500$$

When landowners only sell a portion of their trees in a single sale, a portion of the basis may be applied to the trees sold. To do this, a depletion unit and a depletion allowance are calculated using the following formulas.

**Depletion unit** = basis ÷ total timber volume in current inventory

**Depletion allowance** = depletion unit x volume of timber sold

If, in the above example, 1,000 cords were sold for \$16,000 the depletion allowance would be calculated as follows.

$$\text{Depletion unit} = \$13,500 \div 1,800 \text{ cords} = \$7.50/\text{cord}$$

$$\text{Depletion allowance} = \$7.50/\text{cord} \times 1,000 \text{ cords} = \$7,500$$

$$\text{Taxable income from sale} = \$16,000 - \$7,500 = \$8,500$$

$$\text{New basis} = \$6,000$$

### **Reforestation Amortization**

The income tax code allows a deduction from taxable income of up to of \$10,000 of a landowner's reforestation expenses in the year in which they occur. Any reforestation expenses above \$10,000 may then be amortized and deducted from income over eight years. The schedule is such that 1/14 of the expenses are deducted from income in the first year (since planting does not take place at the beginning of the year), 1/7 of them are deducted from income in each of the next six years, and the final 1/14 is deducted in the eighth year.

#### **Example:**

One hundred acres were planted in 2005 at a cost of \$200 per acre for a total cost of \$20,000.

Year	Item	Deduction Amount
2005	Expensing of first \$10,000	\$10,000
Amortization of remaining cost		
2005	Deductions from income	\$ 714 (1/14 x \$10,000)
2006 – 2011	Deductions from income	\$ 1,429 per year (1/7 x \$10,000)
2012	Deduction from income	\$ 714 (1/14 x \$10,000)

Amortizing reforestation expenses reduces the dollar investment a landowner had in his or her timber. The IRS, therefore, requires that the landowner's timber basis be reduced by the amount of the amortization. In the example above, if timber is sold from the plantation the basis will be \$0 since all \$20,000 of the timber investment was expensed in the first 8 years.

### **Where to Go For Help**

Bulletins and advice on timber taxes are available from local MSU Extension offices. MSU Extension also periodically offers programs on timber taxes for landowners. Private consulting foresters can help in determining the timber basis and depletion allowance. Some tax preparers and accountants have participated in special timber tax training programs sponsored by the Michigan Forest Association and the MSU Extension. For detailed information on timber depletion see Potter-Witter, K. and C.W. Ramm. 1999. Depletion Accounts for Landowners and Consulting Foresters. North Central Regional Extension Bulletin. NCR 609. East Lansing, MI: Michigan State University. On-line resources include IRS publications on the basis of assets and on depreciation at [www.irs.gov/formspubs/index.html](http://www.irs.gov/formspubs/index.html) and the National Timber Tax website at [www.timbertax.org](http://www.timbertax.org).