

PRIVATE & FAMILY FORESTLAND 2006 TAX NEWS

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Changes in tax law have become commonplace. This year is no exception. You'll want to know about the changes and important issues in Federal and Oregon forest tax that we cover here.

FEDERAL INCOME TAX ISSUES & CHANGES

❖ **Reforestation Tax Incentives** – Beginning on Oct. 24, 2004 the Internal Revenue Service (IRS) allows a deduction of up to the first \$10,000 of qualifying reforestation expenses incurred and amortization over 84 months of all amounts exceeding \$10,000. "Qualifying expenses" are those for plantation establishment and for practices to encourage natural regeneration. If any expense is reimbursed through an approved cost-share program, to use the reforestation deduction and amortization provisions, the payment must be included in gross income. Reforested properties must be at least 1 acre and held to produce commercial timber products. Individual taxpayers, estates, partnerships and corporations are eligible for both the deduction and amortization; trusts are not eligible for the deduction, but may amortize their qualifying expenses in full.

❖ **Timber Sales** –

- ◆ **Capital gain treatment** – Beginning on Jan. 1, 2005 tax law *guarantees* long-term capital gain treatment for income from lump-sum timber sales. Therefore, owners making lump-sum sales in 2006 are guaranteed long-term capital gain treatment for the timber sale income. The "12-months and one day" holding period requirement remains in force.
- ◆ **Form 1099-S: Filing Requirements for Timber Buyers** – *Note: Lots of "fine print" here—talk with your tax advisor if you buy timber. We're including several law and IRS citations to help in doing your own research if desired.*

Form 1099-S filing requirements were complicated by changes to Public Law (P.L.) 108-357. Income from sales of timber held primarily for sale in the ordinary course of business are allowed long-term capital gain treatment if the timber [1] constitutes Internal Revenue Code (IRC) Section 1231 property *or* [2] is sold under a lump-sum or pay-as-cut contract ("12 months and one day" holding period applies).

Timber buyers must file Form 1099-S when payments to the seller constitute royalty payments under IRC Section 6050N. Royalties are defined as payments tied to resource extraction, which in "timber terms" means pay-as-cut contracts (IRS Announcement 90-129, Internal Revenue Bulletin 1990-48-10). Thus, regardless of whether the timber is property under IRC Sections 1221 or 1231, buyers are ***not*** required to file Form 1099-S for lump-sum contracts. Filing ***is*** required ***only*** for pay-as-cut contracts. For background

discussion and explanation of lump-sum and pay-as-cut contract sales, see Ag. Handbook 718, the National Timber Tax Website (both highlighted below), and IRS Letter Rulings 9104012 (Oct. 26, 1990), 9544005 (July 14, 1995), and 9643004 (July 12, 1996).

- ❖ **Annual Gift Tax Exclusion** – For 2006 (and 2007), to preclude having to file a gift tax return, the maximum amount one may give to any number of other persons is \$12,000 per individual per year. The joint gift maximum from a husband and wife is \$24,000. When cumulative taxable gifts reach more than \$1 million, a gift tax will be due.
- ❖ **Special Use Valuation for Estate Tax Purposes** – Special use valuation of qualified real property (IRC Section 2032A) may decrease the value of the estate of someone who died in 2006 a maximum of \$900,000. For someone dying in 2007 the amount increases to \$940,000.
- ❖ **New Rules for Contributions of Qualified Conservation Easements** – *"Fine print" here also—talk with your tax advisor if you donated a Conservation Easement (CE) in 2006 or are planning to do so in 2007.*

The Pension Protection Act of 2006 enacted new rules for contributions of qualified CE's for individual taxpayers generally, and qualified individual and corporate farmers and ranchers. These provisions apply only to qualified contributions in tax years beginning after Dec. 31, 2005 and before Jan. 1, 2008—meaning that they apply to contributions in 2006 and 2007. Some background helps in interpreting the new rules. We merely cite the basic changes below and refer you to the National Timber Tax Website and your tax advisor for more complete information and discussion.

- ◆ **Individual Taxpayers** – The maximum charitable contribution deduction of an individual donating a qualified CE is now 50% of their contribution base.
- ◆ **Qualified Individual Farmers & Ranchers** – The charitable deduction of real property used in agriculture or livestock production is limited to 100% of the contribution base. A qualified farmer or rancher is an individual whose gross income from the farm business exceeds 50% of the taxpayer's gross income for the tax year. The term "farming" includes raising agricultural or horticultural commodities and preparing them for market; and planting, tending, cutting down, and preparing trees for market. Therefore, timber and Christmas tree growers and processors qualify as farmers.
- ◆ **Qualified Corporate Farmers & Ranchers** – A corporation that during the year of the contribution qualifies as a farmer or rancher may deduct up to 100% of the excess of the corporation's taxable income over the amount of all other allowable charitable deductions. The contribution must be made to a maximum deduction charitable organization, i.e. an IRC Section 501(c)(3) organization. To qualify, a corporation must meet the rules applicable to individual farmers & ranchers (noted above). Other "fine print" requirements also apply.

The amount of other charitable contributions is taken first, and the CE deduction applies to the remaining amount, if any. In addition, the CE amount not deductible in the year of the contribution can be carried over to the following 15 years, instead of only 5 years.

❖ **Forest Activities Schedule (Form T)** – Most forest owners with active operations and tax professionals handling forestry accounts already know about Form T. The most current version is Dec. 2005. The Form and its Instructions are separate 4-page documents that may be downloaded from the IRS website at www.irs.gov/formspubs/index.html. Follow links to "Forms and Publications - Form & Instruction Number - 1205 Form T (Timber) Forest Activities Schedule." At the same "Form & Instruction Number" location, for the instructions, follow links to "... - 1205 Form T (Timber) Forest Activities Instructions." If you need more detailed discussion of Form T beyond these instructions, see Agriculture Handbook 718 mentioned below.

❖ **Helpful Resources –**

◆ **Agriculture Handbook 718: The Forest Owners Guide to the Federal Income Tax** – Long acknowledged by forest owners as the small woodland tax "bible," this very valuable reference is now, unfortunately, out of print while being revised. Not all is lost, however. The most current version (March 2001) is available on the National Timber Tax Website where you can use it on-line and/or download and print all or part of it.

◆ **National Timber Tax Website**

A tremendous resource for both lay and professional use. This well-maintained and heavily documented site gives detailed, yet practical explanation including links to other valuable sites. Find it at:

www.timbertax.org

◆ **National Woodlands Magazine Articles**

Both recent articles by William C. Siegel, J.D. and Tax Counsel for the National Woodlands Association (NWOA) can be found on the NWOA website www.woodlandowners.org.

- *Recovering Management Costs on Your 2006 Tax Return* (Autumn 2006 edition). Follow website link to "Magazine (Autumn)." When you access the site, if the article has been moved to the archives, then follow link to "Publication Archives (Autumn 2006)." The article conveys an in-depth discussion of how to recover operating costs and carrying charges incurred in managing a private and family forest operation.
- *Postponing the Tax on Timber Salvage Income* (Summer 2006 edition). Follow link to "Publication Archives (Summer 2006)." The article examines timber casualty loss and the treatment of timber salvage sale income.

OREGON FORESTLAND AND TIMBER TAX ISSUES & CHANGES

- ❖ **Severance Tax Rates** - The Department of Revenue sets and announces these rates each June 1 for the next calendar year. Rates for 2006 tax filings are:
 - ◆ Western Oregon - \$4.11/MBF
 - ◆ Eastern Oregon - \$3.21/MBF

- ❖ **Forest Products Harvest Tax (FPHT) Rate** - The statewide rate is set by the Oregon legislature and Oregon Forest Resources Institute Board of Directors on a calendar year basis.
 - ◆ Rate for 2006 tax filings is \$2.61/MBF
 - ◆ A reminder: the first 25 MBF harvested by an owner each year is exempt from the FPHT

- ❖ **Forestland Values** - The Department of Revenue has established new forestland values for the property tax year of July 1, 2006 to June 30, 2007. The values cover the usual 8 forestland classes (FX - FA) for Western Oregon and one class for all of Eastern Oregon. Rather than reproduce the entire table here, access it at:

www.oregon.gov/DOR/TIMBER/docs/06-07_forestland.pdf

- ❖ **Forestland Tax Program** - There were no changes to the program itself applicable to the July 1, 2006 - June 30, 2007 period. Reminders of key Program features include:
 - ◆ All landowners whose forestland ownership totals either less than 10 acres or more than 5,000 acres must be in the Forestland Program.
 - ◆ Property tax is based on 100% of the specially assessed land value for forestland use.
 - ◆ Forest Products Harvest Tax is levied on harvested timber.
 - ◆ No Severance Tax is levied on harvested timber.

- ❖ **Small Tract Forestland (STF) Tax Option** - There were no substantive changes to the option itself applicable to the July 1, 2006 - June 30, 2007 period. A minor, but important, change was made to the "notification surrounding disqualification" process. The new process is that upon learning of and verifying that the property has been sold, the county assessor provides written notification to the new landowner of options available (either continue in or leave the STF Option). The new owner must then notify the assessor with a decision within 30 days of the date of the assessor's letter. Reminders of key Option features include:
 - ◆ Applies to landowners whose forestland ownership totals from 10 to 4,999 acres.
 - ◆ Property tax is based on 20% of the specially assessed land value for forestland use.
 - ◆ Both Harvest and Severance Taxes are levied on the volume of timber harvested.
 - ◆ Apply to the County Assessor by Apr. 1 of the year you wish to enter the Option.
 - ◆ The current application version is dated 11-06 and available at the following web site:

www.oregon.gov/DOR/TIMBER/docs/390-001.pdf
 - ◆ Land not previously classed as forestland requires an additional application (current version 11-06) for "designated forestland" available at:

www.oregon.gov/DOR/TIMBER/docs/309-024.pdf

- ❖ **Revised Oregon Forest Tax Publication from OSU Extension Service** - "Taxes and Assessments on Oregon Forestland and Timber," previously revised and published in March 2006, has been revised and republished in Oct. 2006. To order, send the complete title and pub number (EC1151) along with payment (\$4.00/copy) to: Publication Orders, Extension and Experiment Station Communications, Oregon State University, 422 Kerr Administration, Corvallis OR 97331-2119. You may also call toll free 541-561-6719 or email to: puborders@oregonstate.edu
- ❖ **Oregon Department of Forestry Flyer Updated** - The Oregon Department of Forestry publishes a semi-annual summary of Oregon forest tax material, usually during the 1st and 3rd quarters. Link to "*Oregon Forestland Taxes, Assessments and Credits*" at the following web site:
http://egov.oregon.gov/ODF/PRIVATE_FORESTS/private_forests.shtml#Forest_Taxes
- ❖ **Department of Revenue Timber Tax Web Site** - An excellent, up-to-date source of information about tax programs, options, deciding which program to choose, and links to resource people and publications can be found at the following web site:
www.oregon.gov/DOR/TIMBER/index.shtml
- ❖ **Taxpayer Assistance from the Department of Revenue** - To get help with Oregon forest taxes, contact the Department of Revenue as follows:
 - ♂ **General tax information** - on the internet at: www.oregon.gov/DOR
 - Salem - 503-378-4988
 - Toll-free from Oregon prefix - 1-800-356-4222
 - ♂ **Asistencia en español**
 - Salem - 503-945-8618
 - Gratis de prefijo de Oregon - 1-800-356-4222

This update and summary is offered as educational information only, not legal advice. Remember that many of these provisions have "fine print" that may refer to rules not presented here. Read the fine print! Evaluate all of the options! If you have questions talk with your attorney, tax professional and forester to assess implications for your particular situation.

In the Federal section we have drawn heavily on and in several instances quoted directly from the National Timber Tax Website. To prevent unnecessarily complicating the text with quotes and other editorial marks, we gratefully acknowledge the excellent work of Dr. William Hoover and others in creating and maintaining the website. In the Oregon section, we have drawn from and acknowledge helpful contributions by Norman A. Miller, Oregon Revenue Dept., Manager, Timber Tax and Property Tax Deferral Programs.

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