The Department of

FORESTRY AND NATURAL RESOURCES

FNR-FAQ-3

Frequently Asked Question Series

How to Treat Timber Sale Income

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Reporting Timber Income on Federal Income Tax Return

Two basic determinations must be made to report the gain or loss from the sale of standing timber, called a stumpage sale. These are,

(1) the amount of the gain or loss, and
(2) the type of gain or loss.

Amount of Gain or Loss

The amount of gain or loss is determined by reducing the amount received for the timber (sale proceeds) by the allowable basis of the timber and any expenses incurred in making the sale.

Net gain (loss) = sale proceeds - allowable basis -- sale expenses.

Example 1 demonstrates this.

Example 1. The Barlows sell all the merchantable timber, 105 MBF, on their 35 acres of forest land, the same year they purchased it. The amount paid by the buyer is $20,000. The allowable basis is determined as explained in FAQ-1. The costs for the services of a consulting forester, having a lawyer check the contract, and other selling expenses totaled $2,200. The net gain from the sale is:

Sale proceeds	$20,000
Less: Allowable basis (cost basis)	(12,068)
Sales expenses	(2,200)
Net gain	$5,732

The Barlows would report $5,732 on their tax return.

Timber Depletion

The determination of the net gain in Example 1 was simplified by the assumption that all of the merchantable timber was sold in the same year the forest land was purchased. This made it possible to reduce the sale proceeds by the entire cost basis of the merchantable timber. If only a portion of the timber is sold, only a similar portion of the cost basis can be recovered. The portion of the cost basis written off against a particular sale, known as the allowable basis or depletion allowance is determined by multiplying the number of units (volume) sold by the depletion unit, Example 2.

The volume used to determine the depletion unit in the year timber is sold is the total volume of timber on your forest land in the year of sale, not the volume sold. Thus, it is necessary to estimate the total volume of timber as well as volume marked for sale.

If some time has passed since you acquired your forest land you may also need to adjust the basis of your timber for additional expenditures made to improve the timber or for previous losses.

Type of Gain or Loss

With rare exception the net gain from the sale of standing timber in the mid-west qualifies as a capital gain or loss. This is because most forest owners in this region sell timber only infrequently and don't depend on the timber as a primary source of income. In technical terms they "aren't holding the timber primarily for sale to customers in the ordinary course of a trade or business." If the forest land had not been owned for more than one year any net gain or loss would be a short-term gain or loss. If owned for more than one year it would be a long-term gain or loss.

Example 2. Assume the Barlows sell only 60 MBF, instead of the entire 105 MBF of merchantable timber as was assumed in Example 1. The depletion unit for the timber is $114.93 per MBF, obtained by dividing $12,068 by 105 MBF. The allowable basis is 60 MBF times $114.93 per MBF. Assume the selling expenses are $1,400 and they receive $12,000 for the 60 MBF of stumpage. The net gain is:

Sale proceeds . . . . (12,000.00)
Less: Allowable basis: 60 MBF x $114.93 per MBF (6,895.80)
Sales expenses: . . . . (1,400.00)
Net gain . . . . $ 3,704.20

The Barlows would report $3,704.20 on their tax return.

Qualifying and reporting gains from stumpage sales may be beneficial to you because capital gains are subject to a maximum 28% tax rate, and are not subject to the self-employment tax.

Stumpage sales are reported on Schedule D of Form 1040. If held for more than one year the sale is reported in Part II. The following information is reported in the columns: (a) "sale of standing timber," (b) date you acquired the forest land, (c) date you signed the timber sale contract, (d) amount received from buyer, (e) add together your allowable basis and any selling expenses and insert the total here, (f) usually blank, (g) column d less e. It's rare to have a loss from a timber sale, but if your allowable basis and selling expenses exceed the amount received the net loss is reported in column(f). After reporting any other gains and losses follow the instructions on schedule D to determine the amount to carry over to the front of Form 1040.

You do not need to know the allowable basis of your timber to report a sale as a capital gain. If you haven't made the determination described in FNR-T-1 your allowable basis is zero and the only amount reported in column (e) would be any selling expenses.

Cautions
Profit from the sale of logs, lumber, or other products you produce from your timber, or pay someone else to produce for you does not qualify as capital gains. The revenues and expenses from such activities are reported on Schedule C or F as ordinary income.

Capital gains treatment may be in question if you agree to a so-called "shares contract" with a logger. The usual agreement is for the logger to cut your timber and sell the logs to a mill or other buyer. The log buyer then pays the logger his "share" and writes a separate check to you for your "share." The split is part of your agreement with the logger.

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For more details go to the National Timber Tax Website at:
http://www.fnr.purdue.edu/ttax/welcome.htm

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