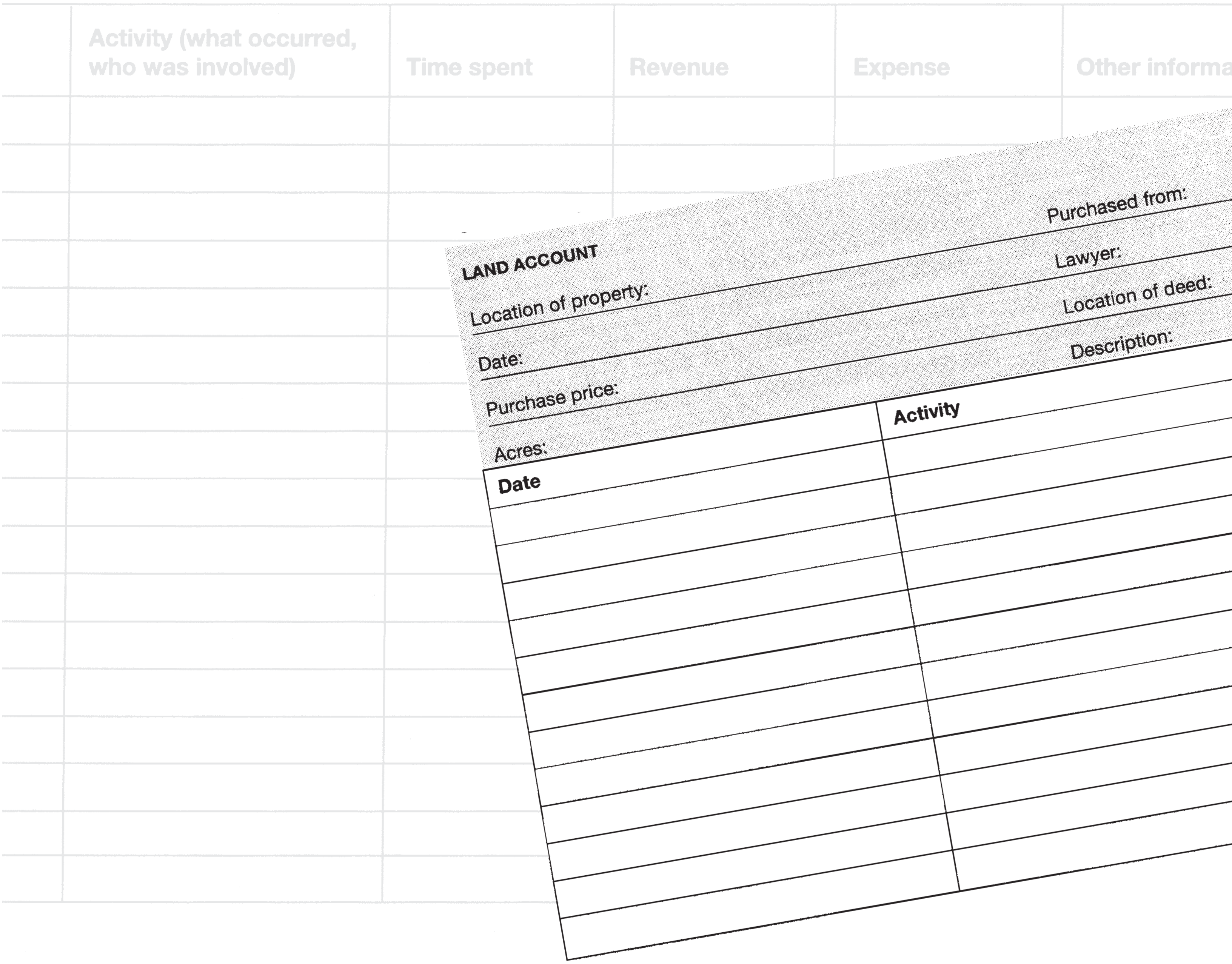
Forest Finance

Keeping Records of Forest Management Activities



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Why record?

Forest landowners should keep records of activities on their forestlands. Accurate, complete, and well-organized records are important for a number of reasons but especially for reporting forest management expenses and revenues for income tax purposes. This publication is primarily for landowners whose main source of income is not from the forested property. It introduces you to record-keeping, what to record, and simple recording systems. Landowners whose primary business is selling forest products may need more detailed records than those described in this publication. Furthermore, this information is not a substitute for legal advice and landowners should consult with accountants, estate planners, lawyers, or foresters familiar with the tax code.

The records you keep should reflect your forest management goals and objectives. Timber production involves long-time periods and keeping records in a systematic fashion will help you remember activities that happened years ago. Furthermore, maintaining a historical record of forest management activities will assist you in making better-informed decisions, and hopefully save you money in the long run. Keeping records is not only financially prudent, but results in more effective management.

Good record-keeping helps you to:

- Document your forest's history.
- Monitor and track management activities.
- Allocate funds, resources, and management activities.
- Provide information for tax purposes.

What to record?

In addition to the many nonproduction reasons to record activities, this publication focuses on record-keeping for timber production since the Internal Revenue Service (IRS) provides tax incentives for those activities. Similarly, records are also relevant for nontimber forest products such as ginseng or maple syrup, although tax-reporting requirements may differ.

Since tax filing is one of the main reasons for keeping good records, this bulletin references a number of timber tax situations. For example, good records help you determine production costs, establish a basis, and estimate taxable income or expenses due to timber sales, involuntary conversions, casualty losses, timber theft, and estate transfers. Many of these topics are complex and beyond the scope of this publication. Specific forest tax information is found in other reports such as "Timber Taxation: A General Guide for Forestland Owners" (Penn State Extension), which provides a simplified overview of forest taxation while "Forest Landowner's Guide to the Federal Income Tax" (USDA Forest Service) provides more detailed information. (See references on page 10.)

Record all forest management activities and their associated costs and revenues including:

- Acquisition and ownership
- Invoices
- Receipts
- Contracts
- Tax statements
- Paid labor
- Boundary maintenance
- Consultation with professionals or financial advisers
- Hours of work done by you and family (especially your spouse)
- Attendance (and hours) at forestry-related meetings
- Management plans – maps, inventories, etc.
- Use of property by outside groups
- Tours and workshops on your property
- Special recognitions (e.g., certification or awards)
- Important events
    - Fires
    - Storms
    - Pests

This list is not inclusive and shows that tax-filing requirements are not the only reason to keep records. Recording natural and climatic events, wildlife observations, and other occurrences such as school tours or hunting success may provide useful insight into future management decisions. For example, recording and making notes about inquiries from loggers may become useful in the future.

How to record?

Organizing your records requires time and investment. One approach is to record enough information to present to your accountant or tax preparer. The type of journal you use depends on your forest management activities. If you simply use your land for personal enjoyment, then a diary or written journal is sufficient. Landowners who manage their forestlands as an investment or business should consider a formal system of accounts, since these owners may deduct expenses and receive tax incentives. No matter which system you use, you should record events and activities, and describe the land, forest types, location, and sources of assistance (i.e., your forester, tax, accounting, and legal advisers).

Figure 1 depicts an example of a basic journal or diary. This journal is useful for limited forest activities, showing activities, revenues, and costs. A more detailed system of accounts is needed for landowners with a large number of tracts, many activities, or regular income from their land. They may find that the simple journal is inadequate for proper recording, especially for tax purposes. Today there are many computer programs to help perform these accounting tasks.

The remainder of this publication focuses on details for recording revenues and expenses for tax purposes. The IRS has strict rules for reporting revenues and expenses. The IRS recommends that you use federal tax form T (Timber), "The Forest Activities Schedule" to show and separate your capital assets (land, timber, buildings, equipment), and report timber sales, land improvements, and reforestation expenses. Form T has schedules showing where to record each activity. Information recorded on Form T transfers to your income tax schedules depending on your income classification (personal, corporate, or farmer). Form T and other tax forms and schedules are downloadable and available at **www.irs.com.**

There are three key situations when a forest landowner needs to keep accurate tax records:

1. To establish accounts and allocate costs for land and timber purchases.
2. To record expenses associated with forest management activities.
3. To record income from timber sales and adjust timber accounts.

Figure 1. Simple Forest Management Journal or Diary

Date	Activity (what occurred, who was involved)	Time spent	Revenue	Expense	Other information

The first step, establishing accounts, is done on Form T. This provides the framework for recording all other income and expenses associated with forest management activities. The following sections describe the process for setting up initial accounts and recording expenses and income. Remember, many of the specific tax-related details for filing taxes are covered in other publications.

1. Establishing Capital Accounts: Recording Land and Timber Purchases

When you purchase, inherit, or are gifted forestland, you are acquiring a capital asset. Record these capital assets on Schedule B of Form T. Differentiated from assets with a life of less than a year, capital assets are not deductible from income taxes in the year acquired. The costs associated with acquiring (or improving) capital assets are only deductible when disposed of through sale, depletion, or depreciation. The four main types of capital accounts for forest landowners are land, timber, durable equipment, and buildings.

Land account

The fair market value (FMV) is the bare land value. To derive the FMV you can use the sale price of recently cutover forestland in your area. Cost or income appraisal methods are used if sales of cutover land are difficult to find. It is important to use a realtor, certified appraiser, or forester to derive land value. In the land account keep track of land costs and improvements such as permanent roads and fire-breaks (Figure 2). These improvements and the land itself cannot be depreciated or depleted. Some improvements such as culverts, bridges, fences, or temporary roads are depreciable, and you may want to establish a separate sub-account for such assets. The basis in the land account is recovered when the land is sold or disposed of.

Figure 2. Example of a Land Account

LAND ACCOUNT

Location of property:	Purchased from:
Date:	Lawyer:
Purchase price:	Location of deed:
Acres:	Description:

Date	Activity	Cost/Revenue

Timber account

You can divide your timber account into two sub-accounts: merchantable timber and young growth (premerchantable timber) (Figure 3). The merchantable (marketable) timber is recorded in standard units—usually board feet, cords, or tons, depending on the intended product. Premerchantable timber is usually recorded in acres. As the timber matures, adjust the accounts accordingly. The IRS allows landowners to separate accounts for each timber stand (an individual management unit). The criteria for a stand include similar species type and age, a separate plan, and identifiable on a map.

The FMV recorded in the timber account is the total volume on the tract or stand multiplied by the price you would receive if you cut it on the date acquired. Factors involved in determining FMV for timber include species type, age, size, quality, and quantity per acre. Another way to estimate the basis for merchantable timber is to calculate the difference between the purchased price of the tract and the bare-land value.

Figure 3. Example of Recording Timber Basis and Timber Account

TIMBER—ORIGINAL (ACQUISITION) BASIS

Location of property:	Purchase date:
Acres:	Purchase price:
Who conducted inventory:	Date of inventory:

Merchantable Timber

Management unit:	Acres:
Age of stand:	Volume:
Value:	Description:

Premerchantable Timber

Management unit:	Acres:
Age of stand:	Volume:
Value:	Description:

Name of Timber Account (Merchantable or Premerchantable)

Date	Activity	Volume	Value

Equipment and Buildings accounts

These accounts include all nonland and timber assets, such as tractors, chainsaws, skidders, farm buildings, and residential rental properties (Figure 4). You can establish separate accounts for each type of equipment or buildings based on the FMV at time of acquisition or purchase price. As capital assets, these items should be depreciated. Major repairs that extend the life of equipment or buildings can be considered capital improvements and also should be depreciated. Normal operating expenses on equipment and buildings such as repair and maintenance (discussed below) are deductible in the year they occur.

When establishing an account for land, timber, equipment, or buildings, determine each asset's original cost basis. This is important as you can report less taxable income when filing because the basis is deductible from the asset's sale proceeds. The basis requires an estimate of the fair market value (FMV) on the date of purchase or acquisition. It is best to establish the basis when the property is acquired; however, it is possible to establish the basis later. To establish original basis you allocate the acquisition costs proportionally to each account relative to the FMV of each account. If the property is acquired by purchase or inheritance, the original basis is based on the FMV of the date of acquisition. If the acquisition is a gift, then the original basis is the donor's adjusted basis. The original basis is adjusted with acquisition or depletions of the capital assets. For more details on allocating and depleting basis, see the tax publications referenced at the end.

Figure 4. Example of Equipment and Buildings Account

EQUIPMENT/BUILDINGS ACCOUNT

Date of Purchase	Type of Equipment or Building	Expected life	Purchase price	Depreciation amount

2. Recording Management and Operating Expenses

Landowners should distinguish between capital expenses and normal operating expenses. Capital expenses include those that improve a capital asset that has a life generally of a year or more. Capital expenses are depreciable over the life of the asset. However, some expenses such as land and improvements to land (i.e., permanent roads) can only be recovered when the property is sold.

A special exception for reforestation expenses, which are considered capital expenses, should be included in the premerchantable account. However, the IRS allows up to $10,000 of those expenses deducted in the year they are incurred through a special reforestation tax credit and amortization option. See references for details. Expenses incurred during the life of the rotation such as timber stand improvement costs (thinnings, herbicide, or fertilizer applications) should be carried as a capital expense, or in some cases can be amortized over a five-year period or deducted as an expense.

Operating expenses are considered ordinary and necessary to manage, maintain, and improve the profitability of your forestland. Types of expenses include consulting fees, property taxes, insurance premiums, equipment repairs, and travel and meeting costs for forestry-related events. Expenses incurred for using your land for tours, demonstrations, and other events may also be tax deductible. Landowners may wish to lump expenses or divide them into separate categories such as fixed expenses and variable expenses. Expenses for personal use such as recreation are not tax deductible. Reporting expenses and the type and amount of an expense the IRS allows you to deduct depends on how you own your forest: as a business, for investment, or for personal enjoyment. Details on IRS criteria for which category you fit into can be found in "For More Information."

3. Recording Income from Timber Sales

Income is received when timber is sold (Figure 5). Landowners can deduct expenses associated with the sale of timber from the sale proceeds. These may include lawyer's or consulting fees, surveys, maps, advertising, and state and local taxes. In addition to these expenses you may also deduct the basis of the timber sold. Details on adjusting basis from timber sale are shown in the tax references. You can receive capital gains treatment depending on the method of timber sale, (lump-sum vs. pay as cut), the length of ownership, and ownership classification (investor or trade and business) All other income such as cost-share payments, hunting leases, maple syrup, and firewood permits are considered ordinary income. Some cost-share payments may be excluded from income taxes. Use Schedule C on Form T to record profit or loss for timber sales and to make adjustments to your timber accounts. It allows you to adjust your basis as timber is depleted.

Figure 5. Example of Recording Timber Harvests

TIMBER HARVEST RECORD

Management unit:	Date:
Acres involved:	Total revenues:
Total expenses:	Work done by:

Products removed and value:

Amount	Species	Price
Sawtimber	board feet of	at
Sawtimber	board feet of	at
Sawtimber	board feet of	at
Pulpwood	cords of	at
Pulpwood	cords of	at
Firewood	cords of	at

Sale expense:	**Amount**

Summary

All forest landowners should keep some type of journal or diary of the activities on their land. Whether you hold the land for enjoyment or income, the detail you put into the journal depends on your needs. If you report forest income and expenses, a more detailed journal is probably wise. The IRS has special forms for forest landowners reporting income and expenses that require detailed records. The federal government provides tax incentives to encourage timber production, and many local and state governments provide preferential property tax for forested properties.

Record-keeping provides a way to assess the benefits of these incentive programs. Not only is record-keeping beneficial for tax filing or saving money, but it also provides information needed to make wise forest management decisions. Forest management for timber is a long-term investment that requires knowledge about the land that is built up over many years. Records are one of the keys to having a successful and sustainable forest to enjoy for many generations.

Key Terms (for others refer to publications listed on page 10)

Adjusted Basis
The original basis of a capital asset minus any reductions from sales, depletion, depreciation, amortization, or losses claimed.

Amortization
To recover or write off a qualifying capital cost over a specified period of time.

Basis
The money invested in a capital asset.

Capital Account
An account used to keep track of the basis and quantity of capital assets.

Capital Asset
An income-producing property used for investment or in a trade or business that is acquired through purchase, inheritance, or gift of an asset with a useful life of more than one year. Examples include land, timber, buildings, machinery, equipment, bridges, roads, and tree planting.

Capital Gain (or loss)
The net income realized from the sale or disposal of a capital asset. Capital gains (or losses) are treated differently for tax purposes from ordinary income.

Depreciation
The wearing out of an asset for which the IRS allows the cost recovered over a certain number of years, depending on the type of asset.

Depletion
The removal or using up of trees or other natural resources from property. The depletion allows recovery of the owner's basis. The depletion allowance is the portion of the adjusted basis and is based on the volume removed. Unexpected losses of timber from events such tornado or fire also result in depletion of basis. This is not to be confused with "depletion allowances" from mineral exploration.

Fair Market Value
The current price at which an asset would exchange hands in a transaction between both a willing and informed buyer and seller.

Operating Expense
An ordinary and necessary expense associated with carrying on a trade or business. Operating expenses may be deducted annually as they occur.

Ordinary Income
Reportable income other than a capital gain. Ordinary income is liable for self-employment taxes.

Original Cost Basis
The amount entered in a capital asset account (land, timber, or equipment) when it was acquired. If the asset is purchased, the original basis is the total cost of acquisition. If the asset is inherited, the original basis is the FMV on the date of the decedent's death (or alternate valuation date). If the asset is gifted, the original basis is the donor's adjusted basis.

For more information

Publications:

Jones, S. and M. Jacobson. 2000. *Timber Taxation: A General Guide for Forestland Owners.* Penn State Cooperative Extension.

Available at your local county extension office or on-line at **http://pubs.cas.psu.edu/FreePubs/uh131.html**

Haney, H. et al. 2001. *Forest Landowner's Guide to the Federal Income Tax.* USDA Forest Service Agriculture Handbook No. 718.

The guide is also on-line from the USDA Forest Service, State & Private Forestry Cooperative Forestry Web site at **www.fs.fed.us/spf/coop/** You can also purchase Ag Handbook 718 directly from the Government Printing Office for $20 by calling 202-512-1800, or by visiting their Web site at **http://bookstore.gpo.gov**

Web Sites:

National Timber Tax Web Site: **http://www.timbertax.org/**

Penn State School of Forest Resources Extension: **http://rnrext.cas.psu.edu/**

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Penn State College of Agricultural Sciences research, extension, and resident education programs are funded in part by Pennsylvania counties, the Commonwealth of Pennsylvania, and the U.S. Department of Agriculture.

This publication is available from the Publications Distribution Center, The Pennsylvania State University, 112 Agricultural Administration Building, University Park, PA 16802. For information telephone 814-865-6713.

Issued in furtherance of Cooperative Extension Work, Acts of Congress May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture and the Pennsylvania Legislature. T. R. Alter, Director of Cooperative Extension, The Pennsylvania State University.

This publication is available in alternative media on request.

Produced by Information and Communication Technologies in the College of Agricultural Sciences

CAT UH150 5M1/02ps4417C