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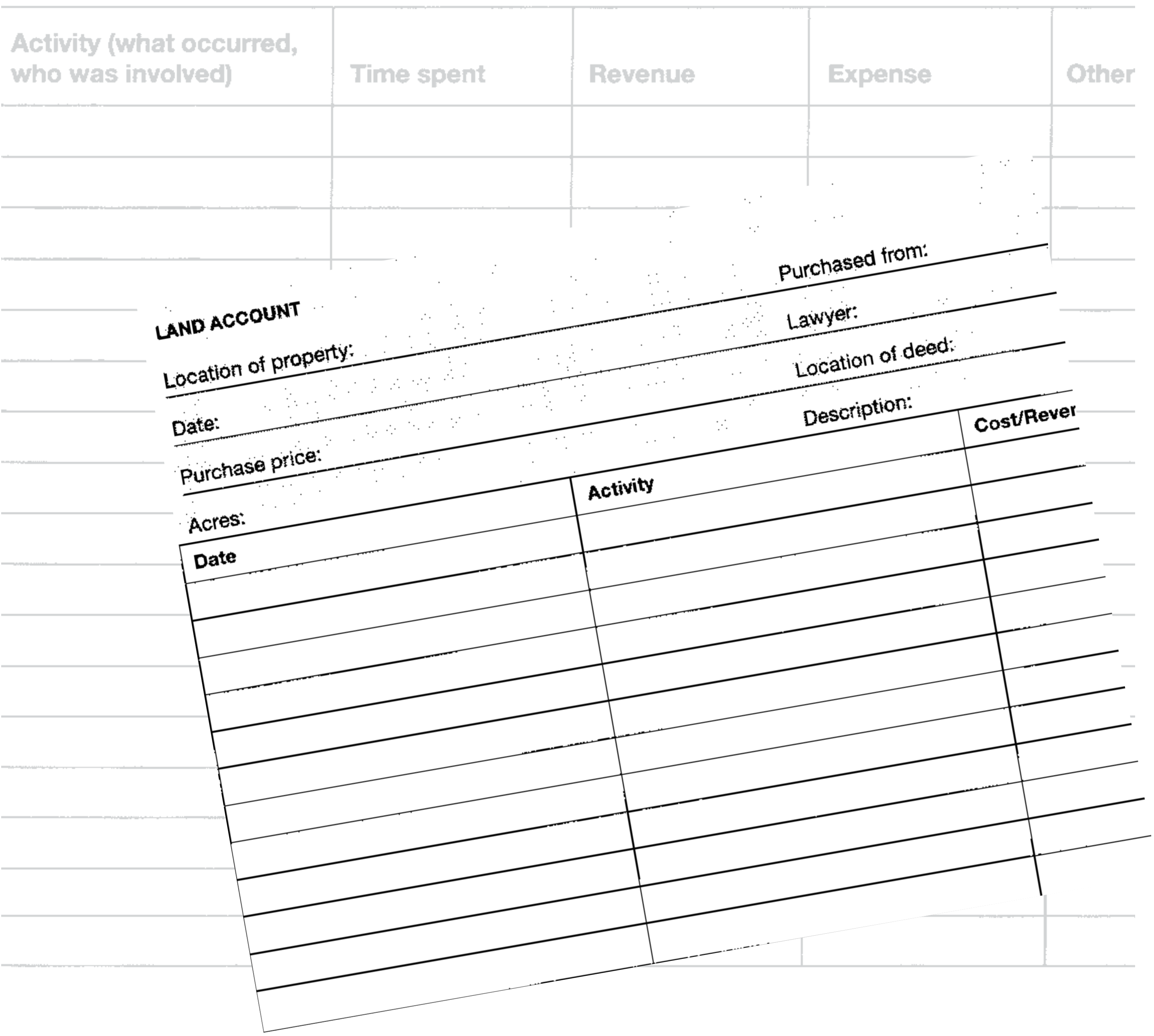
Penn State Extension

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:

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

What to Record?

Although there are many reasons to keep forestry activity records, 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 referenced on the last page of this publication.

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 simple diary or written journal is sufficient. Figure 1 depicts an example of a basic journal or diary. This journal is useful for limited forest activities, showing activities, revenues, and costs. Landowners who manage their forestlands as an investment or business should consider a formal system of accounts. Examples include:

- Shoebox method: routinely and systematically file records in folders, envelopes, shoeboxes labeled for each necessary tax category
- Tree farm journals with accounts: business diary with dollar amounts posted to ledgers; uses double-entry bookkeeping

There are many computer programs to help perform these accounting tasks. No matter which system you use, you should record events and activities, and describe the land, forest types, location, and sources of assistance (e.g., your forester, tax, accounting, and legal advisers).

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 timber-related activities. Owners who only have an occasional timber sale are not required to file Form T, but it is recommended especially for those in the business and when a timber-related activity occurs. Form T is only required with activities such as depletion deductions or a specific type of timber sale (e.g., Section 631[a]). Form T has sections showing where to record activities. 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 at **www.irs.gov.**

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

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

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.

Establishing Capital Accounts

When you purchase, inherit, or are gifted forestland, you are acquiring a capital asset. Record these capital assets on Part I of Form T (Figure 2). 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.

Figure 1. Simple forest management journal or diary.

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

Depending on the size of your forest and the number of stands or parcels, you can can have multiple subaccounts for each class of timber. 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.

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. Anytime you adjust an account—be it from acquiring more timber or land for a timber sale or moving timber from one subaccount to another over time—use Part II of Form T. For more details on allocating and depleting basis, see the tax references at the end of this publication.

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 (e.g., permanent roads) can only be recovered when the property is sold.

A special exception is for reforestation expenses, which are considered capital expenses, should be included in the premerchantable account. However, the IRS allows $10,000 of those expenses deducted in the year they are incurred through a special reforestation tax deduction. Any amount above $10,000 is amortized. 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, equip-

Figure 2. Example of forest activities schedule.

Form **T (Timber)** (Rev. December 2005) Department of the Treasury Internal Revenue Service

Forest Activities Schedule

► **Attach to your tax return.** ► **See separate instructions.**

For tax year ending ...., 20 ....

OMB No. 1545-0007

Attachment Sequence No. **117**

Name(s) as shown on return | **Identifying number**

Part I Acquisitions

1 Name of block and title of account

2 Location of property (by legal subdivisions or map surveys)

3a Name and address of seller or person from whom property was acquired | b Date acquired

4 Amount paid: a In cash . . . .
b In interest-bearing notes . . . .
c In non-interest-bearing notes . . . .

5a Amount of other consideration . . . .
b Explain the nature of other consideration and how you determined the amount shown on line 5a.

6 Legal expenses . . . .

7 Cruising, surveying, and other acquisition expenses . . . .

8 Total cost or other basis of property. Add lines 4a through 7 . . . .

9 Allocation of total cost or other basis on books:	Unit	Number of units	Cost or other basis per unit	Total cost or other basis
a Forested land	Acre			
b Other unimproved land	Acre			
c Improved land (describe) ►	Acre			
d Merchantable timber. Estimate the quantity of merchantable timber present on the acquisition date (see Regulations section 1.611-3(e)). Details of the timber estimate, made for purposes of the acquisition, should be available if your return is examined.				
e Premerchantable timber. Make an allocation here only if it is a factor in the total cost or value of the land.				
f Improvements (list separately)				
g Mineral rights				
h Total cost or other basis (same amount as line 8). Add lines 9a through 9g				

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 16717G Form **T (Timber)** (Rev. 12-2005) ment 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."

Recording Income from Timber Sales

Income is received when timber is sold. 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. You can receive capital gains treatment depending on the method of timber sale. Details are in the tax references. 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.

Part III of Form T is where to report timber sales. Rules for reporting timber income as capital gains treatment are found in other publications.

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.

You should keep a copy of your tax returns indefinitely, and records that support current capital accounts and deductions should be kept for 6 years beyond the date the return was due.

- Adopt the accounting method that provides the most favorable tax treatment as long as it clearly reflects your income.
- Cash method: deduct expenses when paid, report income when received or constructively received; this is used by most farm and forest owners.
- Accrual method: deduct expenses when incurred, report income when earned; used by large firms, such as incorporated tree farms.

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 at right)

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.

Cord
A unit of wood cut for fuel equal to a stack 4 by 4 by 8 feet or 128 cubic feet.

Depletion
The removal or using up of trees or other natural resources from property.

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