



Tax Tips for Forest Landowners: 2024 Tax Year

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As a private forest landowner, you might only consider timber-related Federal income taxes when you have a timber sale. However, each forestry activity you conduct can have tax implications. Generally, all income received is taxable unless explicitly excluded by tax law, and nothing is deductible unless a provision allows it. Understanding the forest-related provisions and integrating tax planning into your forest management can help lower your tax.

This publication is intended to be an informational and educational resource for you and your tax advisor. It is not intended as financial, tax, or legal advice. Please consult with your tax advisor concerning your tax situation. The information is current as of December 15, 2024.

Know the Tax Classification of Your Forest Ownership

The classification of your forest ownership affects applicable tax rates, availability of deductions, and filing requirements. Your forest property generally falls into one of the following three broad categories:

- (1) **Personal use or hobby.** Your primary purpose for owning the property is for personal use, enjoyment, or hobby, rather than earning money. Tax deductions are limited under this category.
- (2) **Investment.** You intend to make a profit from the property (profit motive); however, your activities and involvement do not rise to the level of a trade or business (see below). Tax deductions are relatively limited.
- (3) **Trade or business.** You have a profit motive, and your forestry activities are conducted in a business-like manner. Your involvement in the business may be material participation or passive (determined annually). Material participation implies regular, continuous, and substantial activity and results in greater tax deductions and faster cost recovery. Losses from passive activities can only offset passive income.

Some farmers may own forests as a small part of their farming business and receive periodic income from timber sales. Tax rules for timber sales generally apply in these cases. In general, income tax provisions do not treat forestry as part of the farming business, though there are a few exceptions.

The Internal Revenue Service (IRS) determines whether an activity has a for-profit motive or meets the material participation test based on many factors. Objective facts carry more weight than a taxpayer's statement. Record keeping is crucial to substantiate your profit motive and level of involvement. See IRS Publication 925 and FS-2007-18 for details.

Example 1. You own a 40-acre forest property primarily for timber sale income. You occasionally visit it to stay connected with nature. A forester has developed a forest management plan with timber production as one of the management objectives. You implement the plan's recommendation and update it as conditions necessitate. Given these factors, you may classify the timber as an investment for Federal income tax purposes.

Understand Timber Sale Income and Recovery of Timber Basis

Your taxes on timber sales depend on many factors, including your forest ownership classification, holding period, and the method of selling timber. You pay taxes on the net income from timber sales, rather than the gross proceeds. To find your taxable net income, subtract the following from your gross proceeds:

- Selling expenses (e.g., forester fees, appraisal, attorney fees).
- State/local severance, harvest, or yield taxes.
- Timber depletion allowance (or allowable timber basis).

Sale of Standing Timber

Usually, income from the sale of standing timber held for more than 1 year qualifies for the lower long-term capital gains tax rate (0, 15, or 20 percent—depending on your taxable income). If you inherited timber, you are considered to have held the property longer than 1 year, regardless of how long you actually held it.

Example 2. In 2024, you sold standing timber for \$20,000 in a lump-sum sale. The timber was purchased 5 years ago and held as an investment with a cost basis of \$6,000. You can subtract the timber basis, selling expenses (\$2,500), and the yield tax (\$1,000) from the sale proceeds to get the net income of \$10,500 (= \$20,000 – \$6,000 – \$2,500 – \$1,000). The income qualifies as a long-term capital gain.

Personal-use and investment owners use Form 8949 and Schedule D (Form 1040) to report a lump-sum timber sale. Use Form 4797 (Part I) and Schedule D (Form 1040) to report the sale if sold under a pay-as-cut contract.

Under section 631(b), income from the sale of standing timber in a trade or business (for sale or for use) and held for more than 1 year may be treated as long-term capital gains (section 1231 gain). Both lump-sum and pay-as-cut timber sales qualify. The major tax treatment includes: (1) the gain is taxed at the lower capital gains tax rate rather than the ordinary income tax rate; (2) the gain is not subject to self-employment tax; and (3) it can offset ordinary income when you have a net section 1231 loss. Use Form 4797 (Part I) and Schedule D (Form 1040) to report the sale. See below for filing requirement of Form T (Timber), “Forest Activities Schedule.”

Example 3. In 2024, you had a lump-sum sale of the standing timber held in your business. Because you held the timber for over 1 year, the income is a section 1231 gain and qualifies for long-term capital gains tax treatment under section 631(b).

Sale of Cut or Processed Timber

You may cut (or have someone cut) your timber (or timber held under a contractual right to cut) and sell the processed timber or use it in your trade or business. The income would be taxed as ordinary income unless it has been held for more than 1 year and a special “election” is in effect. You may make a section 631(a) election by indicating on Part II of Form T and performing the proper tax computation under section 631(a) and section 1231. Once the election is made, it is not necessary to do it again in future years unless you revoke it with consent from the IRS.

Under section 631(a), your net income from the sale of cut timber or further processed timber products includes two portions:

- (1) Income from holding standing timber is treated as a long-term capital gain. It is the difference between the adjusted basis of the standing timber and its fair market value (FMV) on the first day of the tax year in which it is cut. It is treated as if you have sold the standing timber to yourself when it is cut.
- (2) Income from selling the cut timber or further processed timber products is ordinary income. Gain (loss) is determined by subtracting the FMV of the standing timber in (1), harvesting and processing costs, and selling expenses from the sale proceeds.

Example 4. You hired a logger to cut your timber (owned more than 1 year) and sell the logs to a mill you specified for \$20,000. You paid the logger \$4,000. The FMV of the standing timber on January 1, 2024, was \$15,000, and your timber depletion (see below) was \$2,000. If you made a section 631(a) election, you would treat \$13,000 (= \$15,000 – \$2,000) as a long-term capital gain, and \$1,000 (= \$20,000 – \$15,000 – \$4,000) as ordinary income.

Timber Basis and Depletion Allowance

To figure net gain or loss on a timber sale or exchange (or casualty or theft loss, or gifting), you need to determine your adjusted basis in the timber. Timber basis is generally the amount of capital investment in your timber for tax purposes. It starts from the original basis, increases as you make capital improvements or capitalize expenditures, or decreases as you make a sale, exchange, or other disposition of timber. The

adjusted basis is the remaining costs after those adjustments. Timber basis does not include the cost of your land.

Original basis depends on how you acquired the property. If you purchased it, the original timber basis is the amount of your total acquisition costs allocated to the timber. If you inherited it, timber basis generally is its FMV on the deceased person’s date of death. If you received it as a gift and it appreciated in value, the basis generally is the donor’s basis plus part of the gift tax paid by the donor.

Example 5. You bought a pine tract for \$33,000, including purchase price and expenses. The total costs were allocated proportionally among the land and the timber based on their FMVs (assuming \$10,000 and \$20,000 for the land and timber, respectively). Therefore, the original basis for timber was \$22,000 [= \$33,000 × (\$20,000 ÷ \$30,000)]. The basis for the land was \$11,000.

“Timber depletion allowance” and “allowable timber basis” refer to deduction of a portion of timber basis from the net proceeds of a timber sale. The allowed deduction is based on the portion of the timber that was sold. It is used to recover your investment in timber when you sell or otherwise dispose of the standing timber. Timber depletion is not allowed for timber cut for your personal uses, such as firewood for your home.

Example 6. You sold 500 tons of sawtimber and 3,000 tons of pulpwood on a tract held as an investment. Your timber account contained 1,000 tons of sawtimber (\$10,000 basis) and 6,000 tons of pulpwood (\$6,000 basis) before the sale. The depletion unit was \$10/ton (\$10,000 ÷ 1,000 tons) for the sawtimber and \$1/ton (\$6,000 ÷ 6,000 tons) for the pulpwood. Your allowable basis for the timber sale was \$8,000 (= 500 tons × \$10/ton + 3,000 tons × \$1/ton).

Other Tax Issues Related to Timber Sales

Net investment income tax (NIIT). If you hold standing timber as an investment or a passive business activity, you may owe an additional 3.8-percent tax on the timber sale income. NIIT applies if modified adjusted gross income (MAGI) is over a stated threshold (\$200,000 for single taxpayer and \$250,000 for married couples filing jointly). Material participants in timber businesses are not subject to this tax.

Form T. You need to file Form T if you do any of the following:

- Claim a timber depletion deduction.
- Sell cut products in a business [under section 631(a)].
- Sell standing timber held in a trade or business in a lump sum sale [under section 631(b)].

However, Form T is not required if you only have occasional timber sales (one or two sales every 3 or 4 years). Even if you don’t file Form T, it is good practice to keep it for your records.

Installment sale. In some cases, it may result in a lower overall tax liability to receive payments from a timber sale over 2 or more tax years. An installment sale (under a lump-sum contract) makes this possible. Income from the sale is prorated and recognized as payments are received. You should treat part of each payment as interest and report as ordinary income. You cannot use the installment method if the sales agreement (or a

later agreement) calls for the buyer to establish an irrevocable escrow account to pay the remaining installments and interests in full.

Consider the Reforestation Tax Incentives

You may deduct, in the year incurred, up to \$10,000 of qualifying reforestation expenditures (\$5,000 for married couples filing separately) per year for each qualified timber property (QTP) [section 194(b)]. You can deduct (amortize) the remaining amount over 84 months [section 194(a)]. Both owned and leased lands qualify as long as they are used for commercial timber production. Trusts are eligible for the amortization deduction only. A recapture provision applies if you sell the property within 10 years at a gain.

Reforestation expenses are direct costs incurred for reforestation by planting or natural regeneration. They include costs for site preparation, seeds or seedlings, labor, tools, depreciation on equipment used in planting, and replanting. Your personal labor cannot be included.

If you hold timber as an investment, make an election to deduct the reforestation expenses on Part II of Schedule 1, line 24d (Form 1040), “reforestation amortization and expenses.” Sole proprietors use Form T and Schedule C (Form 1040), Part V or Schedule F (Form 1040), Part II, as appropriate. If Form T is not required, use Form 4562 to make the election to amortize and attach a statement about the date, location, and amount of the eligible reforestation expenditures to be amortized or deducted.

Most taxpayers may want to elect to deduct and amortize the expenses early in the timber cycle, unless you plan to sell the property within 10 years. You need to maintain a separate account for each QTP and cannot combine them with other timber accounts until the timber is disposed of. The QTP account should show a zero balance once the expensing and amortization are completed.

Deduct Operating Expenses and Carrying Charges

If you materially participate in your forestry business, you generally can deduct ordinary and necessary expenses in full. Use Schedule C (Form 1040) or Schedule F (Form 1040), as applicable. Such “operating expenses” may include equipment depreciations, expenditures for insect and disease control, prescribed burning, firebreak maintenance, overnight travel, precommercial thinning, timber insurance, and vegetation competition control, and fees for professional services, such as foresters, attorneys, or accountants.

Under section 212, investors can deduct the ordinary and necessary expenses associated with management, maintenance, and conservation of the forest property. However, “miscellaneous itemized deductions” are suspended for individual taxpayers through 2025. This is the category of deductions that investors would use to recover operating expenses. You may still fully deduct State and local property taxes on your forest property if you itemize deductions as they are not subject to the \$10,000 State and local tax deduction limit. You may deduct interest expense to the extent of your net investment income and carry over the excess (if any) to the next year. You may want to itemize only if your itemized deduction exceeds the standard deduction. Under section 266, you may elect (on a year-by-year basis) to add carrying charges

(e.g., property taxes, insurances, and interest expenses) to the corresponding property basis (capitalize) in tax years when no income is produced from the property. This will result in a smaller capital gain and lower taxes when you sell timber later. You may also elect to capitalize necessary development-related expenses (e.g., costs for silvicultural practices, timber stand improvement). Once you make the election to capitalize development costs, you must continue capitalizing these types of costs until the property is disposed of.

Under current law, you are generally not allowed to deduct the operating expenses if your forest land is held for personal use or as a hobby.

Recover Other Major Capital Costs

Depreciation is a deduction for the cost (or basis) of long-lasting equipment or property (e.g., logging equipment, tractor). It is available to investors or business owners. Land is not depreciable. You can recover your costs in land only when you dispose of the land. However, you can depreciate land improvements such as bridges, culverts, fences, temporary roads, and surfaces of permanent roads.

Bonus depreciation allows taxpayers to deduct 60 percent of the acquisition cost if placed in service in 2024 and 40 percent if placed in 2025. The remaining cost is subject to standard depreciation over time. The amount of allowable bonus depreciation will be phased down for property placed in service in the years 2023–2026, with no bonus depreciation allowed for property placed in service starting in 2027. Investors or businesses must take bonus depreciation for qualifying property unless they elect out of the provision for the entire property class.

Business taxpayers may immediately deduct up to \$1,220,000 for qualifying property in 2024, subject to phaseout and other limitations (section 179). Your section 179 deduction is limited to your business income for the year. You may also elect to apply the de minimis safe harbor to expense amounts paid for qualifying tangible properties costing less than \$2,500 per invoice or item rather than taking regular depreciation or the section 179 deduction.

Deduct Casualty and Theft Losses

Timber loss may be tax deductible as a casualty loss if it is caused by a sudden, unusual, and unexpected (casualty) event such as hurricane, fire, earthquake, tornado, hail, flood, or ice storm.

For investment and business owners, the deductible casualty loss is the lesser of the decrease in FMV due to the casualty or your basis in the timber block (the unit you use to keep track of the timber basis). If the adjusted basis is zero, you would not be able to deduct any casualty loss, regardless of your actual loss. For investors, use Section B of Form 4684 and Schedule A (Form 1040) to claim it under other itemized deductions (line 16). For timber in a trade or business, report the loss in Section B of Form 4684, then enter it on Form 4797, line 14, as net gain or loss from Form 4684. If it results in a loss after netting with other Section 1231 gains and losses, report it on Schedule 1 of Form 1040, line 4, as “Other gains or (losses).” To claim the casualty loss, investors need to itemize deductions. You may want to itemize only if the total of your casualty loss and other itemized deductions exceeds the standard deduction.

Casualty loss deduction and salvage sales may be handled separately. You can claim a casualty loss deduction before the salvage sale. You may postpone taxes on the gain on salvage sales by claiming an involuntary conversion and electing to purchase qualifying replacement property.

Example 7. Your 200-acre forest land (\$6,000 in timber basis) is held as an investment. In 2024, the timber was damaged by a wildfire. A qualified professional assessed that the FMV of the timber block declined by \$18,000 from \$20,000 to \$2,000 due to the fire. Your casualty loss deduction is limited to the lesser of the basis or the FMV decrease, or \$6,000.

The casualty loss deduction for timber or trees held for personal use has been suspended through 2025, except for losses attributable to a federally declared disaster. It is subject to the \$100 per casualty and 10 percent of your adjusted gross income (AGI) reductions. Use Section A of Form 4684 and Schedule A (Form 1040) to claim the loss as casualty and theft loss (line 15).

A theft loss deduction is made in the year you discover the theft and is limited to the lesser of the decrease in FMV or your basis in the stolen timber.

Consider Excluding Qualified Cost-Sharing Payments

In general, payments received from government programs are taxable ordinary income. However, all or part of some conservation-oriented cost-sharing payments may qualify for income exclusion (section 126). To be eligible for the exclusion, the cost-sharing payment should be from a qualified program and be used for capital expenditure.

Currently, qualified programs for the income exclusion include but are not limited to: Forest Health Protection Program (FHPP), Conservation Reserve Program (CRP), Environmental Quality Incentives Program (EQIP), and certain preapproved State-administered programs.

If you choose to exclude the payment from your income, you cannot deduct or add the related expenses to your basis. A recapture provision applies if the affected timber is sold within 20 years.

Consider Conservation Easement Donation

A conservation easement is a voluntary legal agreement between a landowner and a government agency or land trust that restricts uses of the property for conservation purposes. Working forest conservation easements generally allow some form of timber harvesting. Under section 170(h), if you donate a qualified conservation easement to a qualified organization for qualified conservation purposes, you are eligible for a Federal charitable income tax deduction. You could use the charitable easement deduction to offset up to 50 percent (100 percent for some qualified forest landowners) of your AGI and could carry over any unused deductions for an additional 15 years.

In 2024, the IRS issued final regulations to implement a new law passed in 2022 that disallows deductions for certain conservation contributions by partnerships or S corporations. With a few exceptions, a qualified conservation contribution is generally disallowed if the amount exceeds 2.5 times the sum

of each partner's or S corporation shareholder's relevant basis. Additionally, final regulations were issued to identify certain syndicated conservation easement transactions and substantially similar ones as reportable listed transactions.

Defer Taxes With Like-Kind Exchanges

Like-kind exchanges apply only to real property held for productive use in a trade or business or for investment. Exchanges of personal property no longer qualify for the tax deferral. Like-kind refers to the nature or character of the property, rather than its grade or quality. Standing timber and timberland are like-kind real property. Speak with your tax advisor about the applicability of a 1031 exchange before making a transaction.

Qualified Business Income (QBI) Deduction

For tax years 2018 through 2025, noncorporate taxpayers can take the QBI deduction under section 199A for certain income earned through sole proprietorship or other pass-through entities, subject to limitations. However, net section 1231 gains (most timber sales, including Christmas trees) are treated as capital gains and are excluded from QBI for deduction purposes.

QBI includes the ordinary income from selling cut timber products, pine straw, living trees, and products gathered or collected (e.g., wildflowers, vines, edible or medicinal plants or fungi, or botanical samples). Use Form 8995 (or Form 8995-A if applicable) to figure the amount of the deduction and report it on Form 1040.

Other Forest-Related Tax Considerations

Flow-Through Entities

Forest landownership can be structured through various entities, such as C corporations, S corporations, partnerships, and limited liability companies (LLCs). S corporations and partnerships are considered "flow-through" entities because they are not taxed independently, but rather net income and other relevant tax information is passed through to the owners, who are individually taxed. Single-member LLCs are disregarded for tax purposes. If the owner is an individual, the activities of the LLC are reported on the individual's personal tax return. Multimember LLCs are generally considered partnerships for tax purposes, unless they elect to be treated as a corporation. Partnerships annually must file Form 1065, as well as Schedule K, reporting each owner's share of net ordinary income (or loss) and separately stated information. Each owner in turn will receive a Schedule K-1 from the partnership. Similarly, S corporations file Form 1120-S, Schedule K, and send Schedule K-1 to owners.

Forest Carbon

Income received from transactions related to forest carbon generally is taxable. This topic is not directly addressed in any existing statute or regulation, so there is uncertainty about the details. Tax treatment of the income and its associated expenses may vary based on factors such as the terms of the carbon programs, contract clauses and length, the purpose of forest holdings, holding period of carbon credits/offsets, and payment scheme.