



BIG SKY NIPF-ty NOTES



*Supporting non-industrial private forest owners (family forests)
in their rightful and responsible use, management and
enjoyment of their forested lands*

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2019 Legislative session

The 2019 legislative session will commence on January 7 and end May 1, after 90 legislative days. For more information go to the legislative site at <https://leg.mt.gov>. The MFOA takes an active role with the legislature, supporting positions which protect and enhance the property rights of the members. Some of the bills we expect to see will involve:

- Maintaining and increasing rights to access public properties
- Reducing or eliminating liability for prescribed burning
- Assessing fees to landowners for fire preparedness costs
- Transferring liability for Streamside Management Zone (SMZ) compliance from the landowner to the logger

If you wish to help watch for bills impacting forest owners, or to testify in Helena on behalf of the MFOA, please contact us.

Tax Cuts and Jobs Act of 2017

It has been nearly a year since the Tax Cuts and Jobs Act of 2017 became law on December 22, 2017. Many of us will first realize the impact of the law when we file our 2018 income tax returns. The new law may adversely impact forested land owners who hold timber as an investment, rather than holding the timber as a business with “material participation” by the owner. This NIPF-ty Notes includes Tax Tips for Forest Landowners for the 2018 Tax Year prepared by Dr. Linda Wang, National Timber Tax Specialist, USDA Forest Service. The tax tips cover

- Timber Property Types
- Deductions of Timber Expenses and Taxes
- Timber Sales and Reporting
- Timber Basis and Depletion Deduction
- Timber and Landscape Tree Casualty Loss
- Installment Sales
- Reforestation Costs
- Depreciation, Sec. 179 Expensing and Bonus Depreciation
- Net Investment Income Tax

- Cost-Share Payments
- Filing Form T (Timber)
- Conservation Easement
- Lake-Kind Exchanges

Neither this NIPF-ty Notes nor the enclosed Tax Tips should be relied upon for tax or legal advice. You may wish to consult your tax advisor before December 31, 2018, to determine whether you should take steps before year’s end.

Dates to calendar

- March 23, 2019 - the Forestry Mini-College at the University of Montana in Missoula. This is a one-day educational event for family forest landowners, professionals, and everyone interested in forestry. Classes begin at 9:00 a.m. and continue through 5:00 p.m. with a one hour lunch break. The fee is \$30 per person and it covers a catered lunch, refreshments between classes and handout materials. Each attendee may register for a maximum of four classes (out of 12 offered) at 90 minutes each. While you are there, stop and say hello at the MFOA booth and get some chain saw raffle tickets. The class listing has not been posted, but keep an eye out at <http://forestry.msuextension.org/fmc.html>.
- April 12, 2019 - the Forest Landowner Conference at the Copper King Hotel and Convention Center in BUTTE. While you are there, stop and say hello at the MFOA table and get some chain saw raffle tickets. This will be MFOA’s fourth year to raffle a Stihl MS271 chain saw.
- Forest Stewardship Workshops (bring your friend or neighbor). These workshops have become well-known as a “must do” for private forest owners who seek important forestry knowledge from experts. The workshops are well worth your time (according to over 90% of past attendees). The 2019 workshop locations and dates are listed below. For more information go to <http://forestry.msuextension.org/mfsp.html>.

<u>Location</u>	<u>2019 Workshop dates</u>	<u>Register by</u>
Libby	April 25, 26 and May 3	April 12
Trout Creek	May 16, 17 and 24	May 3
Corvallis	June 6, 7 and 14	May 24
Kalispell	July 11, 12 and 19	June 28
Lewistown	August 8, 9 and 16	July 26

Forestland fire preparedness assessments

Montana’s Environmental Quality Council (EQC) requested the drafting of proposed bill LC0427 (an update from the EQC’s LCFPA4) to revise fire assessment fees. This bill proposes to expand the assessments for fire preparedness across the entire state. The assessments would apply on a per-parcel basis; however, municipal, tribal and state parcels would be excluded. The bill proposes that one-third of the DNRC’s fire preparedness budget or \$6M, whichever is less, plus \$1M for aviation equipment replacement, be funded yearly through assessing parcel owners. That total for the current year, for example, would be \$3.8M plus \$1M = \$4.8M. It would be raised by assessing every parcel, forested parcel, and dwelling approximately \$6.38. Each parcel would be assessed \$6.38. If the parcel were designated at class 10 forestland, it would be assessed an additional \$6.38. If the parcel had a dwelling, it would be assessed an additional \$6.38. Until this scheme, using the current total to be raised, the maximum a single parcel could be assessed would be \$19.14. This draft bill is particularly advantageous to forested parcel owners in the west who have been paying “fire protection” fees for years for the benefit of the entire state, but results in those in the east paying assessments for the first time. Representative Willis Curdy of Missoula will be carrying this bill.

Fall/Winter Tasks

The NIPF-ty Notes often lists tasks that you might wish to consider taking. This edition covers a few tasks to prepare for your early 2019 work.

- Either run engines out of gas or add stabilizer to the gasoline and run the engines to get the stabilizer in the carburetor. A third alternative is to do nothing if you have been using a fuel-oil pre-mix such as Motomix by Stihl (assuming your engines require a 50:1 fuel:oil mixture). (Motomix is a 50:1 fuel mixture that combines non-ethanol, high-octane motor fuel and Stihl HP Ultra Oil.)
- Move batteries inside to avoid freezing.
- Store herbicides in safe containers, paying particular attention if they are stored in freezing conditions. Some herbicides may be stored in freezing conditions. Check the instructions for each herbicide.
- Verify that smaller trees have protection from rodents (particularly voles) girdling the trunks.
- View MSU Extension Forestry's five-part series titled "Northern Rockies Forest Ecology and Management." Go to <http://forestry.msuextension.org/videoresources.html>.
- View MSU Extension Forestry's two-part videos on "Chainsaw Safety Awareness." Do this before starting your saw. Go to <http://forestry.msuextension.org/videoresources.html>.
- View videos on Montana State University Extension Forestry's YouTube channel.
- Mistletoe – Don't forget to hang the mistletoe in just the right place. The word mistletoe conjures up good feelings from a kiss, or for the forest owner a reminder that the mistletoe is a parasite that extracts water and nutrients from the host plant. In contrast, a "witches broom" is not a parasite. It is a deformity of a tree, sometimes arising from the presence and growth of mistletoe.

Good Neighbor Authority

The 2014 Farm Bill authorized the USDA Forest Service to enter into Good Neighbor Authority (GNA) Agreements with Montana and other states for the purpose of increasing restoration of our National Forest Service lands. The GNA authorizes the Montana Department of Natural Resources and Conservation (DNRC) to assist the Forest Service in planning and implementing projects to improve forest health and increase the total National Forest acreage under management. Authorized forest, rangeland, and watershed restoration services include activities to treat insect and disease-infected trees, activities to reduce hazardous fuels, and other activities to restore or improve forest, rangeland, and watershed health, including fish and wildlife habitat.

Montana's State Forester Sonya Germann announced that the DNRC is trying to raise \$150,000 per year for the next three years from the conservation and business partners to sustain this effort. Thereafter the GNA funding for the DNRC shall be from the sale of timber products arising from forest management. This should be a win-win situation. If you wish more information on the GNA or wish to donate, you may contact Tim Love at tglove@charter.net or download the donation form from the MFOA website. Tim is donating substantial time and effort to this cause.

Holiday wish

We wish you and your forests all the best as year 2018 draws to a close.

Tax Tips for Forest Landowners for the 2018 Tax Year

by Dr. Linda Wang, National Timber Tax Specialist, USDA Forest Service

The Federal income tax provisions that apply to timber have changed for the 2018 tax year from the December 2017 new tax legislation. To help family timber owners, foresters, and their tax preparers in filing their 2018 tax returns, this bulletin provides income tax guidance that is current as of September 30, 2018.

Timber Property Types

It's important to recognize that the tax treatments vary significantly for different types of properties. You must make a determination on your property type each year. Your timber may be classified under one of the following three types: (1) *personal-use* property (mainly for personal enjoyment vs. for profit); (2) an *investment* property (mainly for generating profit from growing timber or asset appreciation); or (3) a *business* property (with regular, active, and continuous profit-making timber activities to qualify). Businesses are subject to passive loss rules (i.e., losses from a passive business cannot be used to offset nonpassive income such as wages). In other words, deductions from a passive business may be denied for the year (when there's no income of the passive source). A passive activity is one in which you do not materially participate, mainly based on the number of hours you participate in the business. Also, your timber may be considered a *hobby* if it is not engaged for profit. Losses from hobby activities are generally not deductible.

Example 1: Mr. Henderson owns a 57-acre tree farm where he manages timber primarily for profit. He reports his timber as an investment.

Deductions of Timber Expenses and Taxes

For timber owned as a business, if you are "materially participating" in the business, the timber expenses are fully deductible on Schedule C of Form 1040. These expenses may include fees paid for forester, attorney, or accountant, precommercial thinning, firebreak maintenance, overnight travel, vegetation-competition control, insects, disease, and fire control, and depreciation from equipment used. For timber held as an investment, timber expenses (along with certain other "miscellaneous itemized deductions") are no longer deductible, starting in 2018 through 2025 (Public Law 115-97).

Example 2: Ms. Smith owns a 50-acre property as an investment. Her 2018 timber expenses of \$1,000 is not deductible.

State and local property taxes on timber investment property are deductible on Schedule A. Alternatively, you may elect to treat these taxes as part of the timber costs (i.e., as "carrying charges") and deduct them upon timber sales. Property taxes paid in a trade or business are deductible on Schedule C. Severance and yield

taxes paid are deductible from the timber harvests.

Timber Sales and Reporting

To be eligible for the beneficial long-term capital gains, you must own the standing timber held as an investment for more than 1 year before the sale (inherited timber is automatically considered long-term). Timber sale expenses are deductible from the sale proceeds. Report the sale of standing investment timber on Form 8949 and Schedule D.

Example 3: Ms. Johnson sold hardwood standing timber she inherited 10 years ago for \$12,000. The timber is an investment for her. Assuming the selling expense was \$500 and the timber depletion (see topic below) was \$4,000, she will report \$7,500 (\$12,000 - \$4,000 - \$500) as a long-term capital gain on Form 8949 and Schedule D.

Example 4: Assuming the same facts as above in Example 3, except that the taxpayer is classified as timber business. In this case, the gain of \$7,500 would qualify as a capital gain.

However, if the business taxpayer cut his timber (or had "a contract right to cut" the timber) to sell or to use in his trade or business, different rules apply. Under this sales method, capital gain treatments (Sec. 1231 gain) are available when the taxpayer has owned such timber for more than 1 year and elects to treat the cutting as a sale. The election is made on Form T, Part II.

Example 5: Mr. Jones is a logger and manages his Douglas fir timber as a business. He cut his timber himself and delivered and sold the logs to a mill for \$20,000. Assuming the fair market value (FMV) of the standing timber on January 1, 2018, was \$15,000, and his timber depletion (see below) was \$2,000, under Sec. 631(a) election, gains of \$13,000 (\$15,000 - \$2,000) from standing timber are capital gains, and the \$1,000 (\$20,000 - \$15,000 - \$4,000 cut-n-haul cost) from the sale of felled timber is ordinary income.

Timber Basis and Depletion Deduction

Generally your timber basis is the amount you paid for it (if you purchased the property). For inherited property, it is the timber's fair market value on the decedent's date of death.

Example 6 (a): Six years ago, Mr. Forrest inherited a tract of timberland. A professional appraisal had retroactively established the timber basis as of the date of death, which consisted of \$16,000 for 80 thousand board feet (MBF) of pine sawtimber and \$5,000 for 250 cords of pine pulpwood.

Timber depletion is a deduction against the timber basis upon timber sale.



Example 6(b): Mr. Forrest sold 50 MBF of sawtimber. His depletion was \$10,000 ($\$16,000$ of total timber basis \div 80 MBF of total volume \times 50 MBF of timber sold).

Timber and Landscape Tree Casualty Loss

Depending on the type of properties affected, loss of timber and landscape trees due to a casualty event such as hurricane, fire, earthquake, tornado, or hail or ice storms may be tax deductible. For timber held as an investment or a business, the loss deduction is the smaller of the adjusted basis of timber and the difference of the FMV of the timber immediately before and after the casualty in the block. Report salvage sale of timber separately. A taxable gain may result if the salvage sale exceeds the adjusted basis of the timber and related selling expenses.

Example 7: Mr. Brown owned a woodland as an investment. A professional appraisal documented a \$5,000 timber loss from hurricane damage. Assuming his timber basis was \$1,000, the amount of casualty loss deduction would be limited to \$1,000.

For 2018 landscape tree loss at a private residence, the deductible casualty loss would be limited to federally declared disasters.

Installment Sales

Using Form 6252, a taxpayer may defer taxes by spreading the gain from the property sale over 2 or more years.

Example 8: Mr. Davis sold \$10,000 of timber (\$7,500 after deducting timber depletion and sale expenses). His *gross profit percentage* was 75 percent ($\$7,500 \div \$10,000$). The buyer paid him \$6,000 in 2018, and he took a note payable in 2019. Report a \$4,500 gain ($\$6,000 \times 75\%$) for 2018. Interest charged on deferred payments is ordinary income.

Reforestation Costs

Reforestation costs are tax deductible. Taxpayers may deduct up to \$10,000 (\$5,000 for married couples filing separately) per year per qualified timber property (QTP). Any amount over \$10,000 per year per QTP may be deducted over 84 months (*amortized*). Trusts are eligible for amortization only.

Example 9: Mr. and Mrs. Lee incurred \$17,000 to replant their property in 2018. They deduct \$10,000, plus 1/14th (\$500) of the remaining \$7,000 in 2018 for a total deduction of \$10,500. For 2019–2024, they will deduct 1/7th (or \$1,000) of the \$7,000. In 2025, they will deduct the last 1/14th (or \$500). Report the deduction as an adjustment to gross income on the front of Form 1040 for investment, or Schedule C for business. Elect to amortize on Form 4562. Also, attach a statement to the return showing the date, location, and amount of the expenditure.

Depreciation, Sec. 179 Expensing and Bonus Depreciation

For timber held as an investment or a business, you may take depreciation on the assets used (for example, tractor, logging equipment, bridge, culvert, fence, or temporary road). Land is not depreciable. Also, business taxpayers may elect to deduct up to \$1,000,000 for qualifying property in 2018, subject to

\$2,500,000 annual phase-out and business taxable income limitations (Sec. 179 expensing). Also, eligible taxpayers may take a bonus depreciation equal to 100 percent of the cost of qualifying property.

Net Investment Income Tax

Timber sales from an investment or passive business may be subject to a 3.8-percent net investment income tax for single taxpayers with adjusted gross income (AGI) over \$200,000 (or \$250,000 for couples).

Example 10: Mr. and Mrs. McDonald sold investment timber at a \$40,000 gain. Assuming their AGI was \$270,000, the lesser of the timber gain or \$20,000 ($\$270,000 - \$250,000$ threshold) are subject to the 3.8-percent tax (\$760 tax).

Cost-Share Payments

You may exclude part or all of a qualified cost-share payment you received from your income if it was used for capital expenditure. Otherwise, report it as ordinary income. Qualified Federal programs for income exclusion include the Forest Health Protection Program, Conservation Reserve Program (CRP), Conservation Security Program, and Environmental Quality Incentives Program. Several State programs also qualify for exclusion. The excludable amount is the *present value* of the greater of \$2.50 per acre or 10 percent of the average annual income from the affected acres over the last 3 years.

Example 11: Mr. Hill received \$6,000 from CRP cost share for qualified capital expenditure in his timberland. If he had no income from the property in the last 3 years, he could exclude up to \$4,912 ($(\$2.50 \times 100 \text{ acres}) \div 5.09\%$) from his income. The interest rate is from the Farm Credit System Bank. If he had \$9,600 of income from the property in the last 3 years, he could exclude up to \$6,287 ($(10\% \times (\$9,600 \div 3)) \div 5.09\%$). Attach a statement to the tax return describing the cost-share program and the exclusion calculations.

Filing Form T (Timber)

Form T (Timber), Forest Activities Schedule, is required if you claim a timber-depletion deduction, sell cut products in a business (under Sec. 631(a)), or sell outright business timber. However, you are not required to file if you only have occasional timber sales (one or two sales every 3 or 4 years).

Conservation Easement

Donation of a qualified conservation easement are tax deductible. The deduction is up to 50 percent (or 100 percent for qualified farmers and ranchers, including forest landowners) of the taxpayer's AGI in a year. Any excess amount of donation over the 50- or 100-percent limit may be carried forward for 15 years.

Like-Kind Exchanges

The tax deferral rules for like-kind exchanges after December 31, 2017, apply only to exchanges of real property not held primarily for sale. It no longer applies to personal property.