



# GIVE TREES, SAVE TAXES

## LEAVING MATURE TIMBERLAND TO THE NEXT GENERATION CAN MAKE SENSE WHEN IT COMES TO AVOIDING CAPITAL GAINS TAXES NOW - AND AFTER YOU'RE GONE

BY PATRICK HIESL AND ALEX TURNER

**A**ny forest landowner considering the sale of timber should be aware of how the proceeds from the sale will be taxed. The decision whether or not to harvest timber is particularly important for older landowners interested in maximizing the assets passed on to their heirs and minimizing the tax consequences of that transfer. The purpose of this article is to introduce forest landowners to key concepts related to taxes on the sale of timber as they relate to inheritance.

### ESTATE PLANNING

Estate planning is the process of deciding and documenting what you would like to have done with your estate when you die. In this process, you are deciding who will get what and when. Everything you own is part of your estate: your car, home, and also your timberland. This means that estate planning entails the details of who will inherit the forested property that you have been managing passionately. However, deciding who will get the property, and possibly passing on your wishes for the property, might not be all that you should be considering.

Let's envision a mature southern yellow pine stand that you have cared for many years that has reached the end of its rotation time. There is nothing greater than to reap the fruits of your labor and to see the final harvest of your trees progress. But how will this final harvest impact the capital gains taxes and timber basis for the next generation of forest owners that will likely inherit your property?

### CAPITAL GAINS TAX

Trees grow as they increase in value. Once cut, the government expects its own cut in the form of taxes. If you have owned the timber you are cutting for more than one year (or have inherited the property), and your property is classified as an investment property with the goal of making a profit, you will have to pay long-term capital gain taxes. Typically, long-term capital gains tax rates are lower than regular income tax rates, so that is a benefit for





Any delay in the final harvest should be undertaken in a manner which does not compromise the vitality of the timber.

forest owners that have an economic objective for their forestland. The capital gains tax is calculated as a percentage of the forest owner's gain on the sale of timber. The gain is the amount resulting from the sale of the timber less the forest owner's basis in the timber.

### TIMBER BASIS AND TAXES

The timber basis is the fair market value of your timber at the time you purchased or inherited the timber. It is important to note that if you received the timber as a gift, your basis is the fair market value of the timber at the time the person who gifted it to you acquired it. As a result, forest owners who have owned timberland for a number of years should approach gifting timber to the next generation with a degree of caution. The timber basis is important for the calculation of the capital gains tax, as all or a portion of the timber basis can be depleted with a timber harvest, meaning that the actual long-term capital gains income that needs to be taxed can be reduced. In general, the higher the timber basis for a given amount of timber, the lower the taxable income will be. Timber taxes and timber basis are topics that a forest owner and their accountant need to know about. More detailed information can be found on the National Timber Tax Website ([timbertax.org](http://timbertax.org)). Also be on the lookout for the annual Tax Tips for Forest Landowners by Dr. Linda Wang, National Timber Tax Specialist with the USDA Forest Service.

### STEPPED-UP TIMBER BASIS

Back to our question on how all this can impact the next generation of forest owners. Generally, when someone inherits a forested property, the heirs will benefit from a stepped-up timber basis. This means that the timber basis for the new owners will be the fair market value of the timber at the time of death of the previous owner, and thus most likely much higher than the timber basis for the previous owner. For example, at the end of a rotation of southern yellow pine, the timber basis is most likely depleted and there is no timber basis left. When this property passes on to the heirs, their timber basis will now be the fair market value of the timber at the time of death of the prior owner. In this example, the value could be around \$2,400 per acre. Depending on the timber quality, management history, and the proximity of the property to timber markets, this value could be higher or lower. Given this stepped-up timber basis, the new owners can now deplete this value over their ownership tenure to reduce their taxable income from forest management activities on that property.

But what if the current owner harvests the mature trees at the end of the rotation and then passes on the property to the next generation? Since a freshly cut stand has no merchantable timber on it, the new timber basis will be zero or very low in value. The new timber basis will be a bit higher if seedlings have been planted and/or site preparation activities were conducted,



however, the stepped-up basis will not reach the same amount as for a mature stand.

### A SIMPLE TAX EXAMPLE

Let's assume that timber volumes on a mature southern yellow pine stand in the Piedmont of South Carolina (Site Index 75) at age 38 are 54 tons of pulpwood, 30 tons of chip-n-saw, and 53 tons of sawlogs per acre. Average stumpage prices in South Carolina based on TimberMart-South in the second quarter of 2019 were \$11.11/ton for pulpwood, \$18.07/ton for chip-n-saw,

and \$24.22/ton for saw logs. The value of these trees when harvested is thus \$2,425/acre. With a timber basis of zero dollars the taxable capital gains income is \$2,425/acre. The current federal capital gains tax rate for taxpayers with a taxable income of \$78,750 or more ([irs.gov/taxtopics/tc409](https://www.irs.gov/taxtopics/tc409)) is 15 percent, plus an additional 3.8 percent net investment income tax for individuals with a household income over \$200,000 for single or \$250,000 for married filing jointly.

At 18.8 percent, the federal capital gains taxes are \$456/acre. In South Carolina, the capital gains tax rate is 7 percent

Leaving mature forestland to the next generation can minimize capital gains taxes.





**"WHEN SOMEONE INHERITS A FORESTED PROPERTY, THE HEIRS WILL BENEFIT FROM A STEPPED-UP TIMBER BASIS. THIS MEANS THAT THE TIMBER BASIS FOR THE NEW OWNERS WILL BE THE FAIR MARKET VALUE OF THE TIMBER AT THE TIME OF DEATH OF THE PREVIOUS OWNER, AND THUS MOST LIKELY MUCH HIGHER THAN THE TIMBER BASIS FOR THE PREVIOUS OWNER."**

and based on South Carolina Code §12-6-1150 there is a 44 percent capital gains deduction on the net capital gains. Thus, the South Carolina capital gains taxes are \$95/acre. Total taxes for the harvested timber are \$551/acre.

Good forest management practice includes a plan for reforestation after a final harvest. We can assume that after the final harvest, the cut area received some site preparation and tree planting at a cost of \$300 per acre. If this property is passed on to the next generation shortly after the final harvest, the new timber basis for the heirs will be the \$300/acre site establishment costs plus possibly some increase in the value of the planted trees.

This timber basis will be in the unmerchantable timber category until the trees reach merchantable sizes. At age 13 this stand may have a total merchantable volume of 64 tons per acre, leading to a timber basis of \$4.68 per ton (\$300/acre timber basis divided by 64 tons/acre merchantable weight). Assuming that the first thinning will produce 17 tons of pulpwood and five tons of chip-n-saw saw per acre, the total revenue of the first thinning is about \$279/acre, and the timber basis that can be depleted is \$102.96/acre (22 tons of timber removed multiplied by \$4.68/ton timber basis). Using the same federal and South Carolina capital gains tax rates as before, the total tax burden on the first thinning is \$40.05/acre.

### WHAT-IF TAX EXAMPLE

Harvesting the mature timber at the end of a rotation is a common and natural act of a forest owner, but how does this impact the next generation of forest owners? We just illustrated a common scenario above on how the tax situation on a property might work out.

But what if the current owner decides to wait with the final harvest and to pass on a mature stand of timber to the next generation? Will there be a benefit for the next generation? Let's assume that the same property from above is passed on to the next generation as a mature stand. The value of all trees at the time of death of the previous owner is \$2,425/acre and thus the new stepped-up timber basis is the same amount. A final harvest within a year will likely result in revenue of \$2,425/acre, and with all the timber harvested, the entire timber basis amount can be depleted at once.

This means that there is no capital gains income from this final harvest and thus there are no taxes to be paid; in this example, this is the same as receiving approximately 30 percent more for the timber.

It is important to notice that approximately \$551/acre in long-term capital gains taxes were saved by passing on a mature stand of timber. It is also important to notice that the savings were passed on to the new generation of forest owners. These savings may help the new generation to continue to manage the forest land properly. They may help to defray reforestation costs, or they may just be a nice bonus to the inheritance.

The examples presented here are simplified but show what kind of savings may be possible when you refrain from a final harvest of mature timber and instead pass the mature timber stand on to the next generation of forest landowner. It is important to note that any delay in the final harvest should be undertaken in a manner which does not compromise the vitality of the timber and it may be beneficial to thin the timber in order to maintain the vigor of the stand. The decision as to whether or not to delay a final harvest should be done with consultation from a forestry professional. There are a lot of different scenarios that can apply to this example, but our goal here was to raise awareness of what savings are possible with proper planning.

We acknowledge that not everyone will be able to take advantage of these savings due to many reasons that are beyond our imagination. Gifting of highly appreciated timber should be approached with caution as this will eliminate the stepped-up basis. Forest landowners who are interested in maximizing the assets they leave to their heirs should seek advice from both forestry and tax consultants before selling highly appreciated timber. ■

---

*Patrick Hiesl, Ph.D., is an Assistant Professor of Forest Operations at Clemson University and engages regularly with family forest landowners. E. Alex Turner, III, J.D., is an Attorney at Law and a family forest landowner in South Carolina.*