
Forestry as Business or Investment: What does it matter?

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Tax and Financial Education Project



- USDA-FSA Funded Project
- Tax related educational materials:
 - Beginning Farmers/Ranchers
 - Commercial Farmers/Ranchers
 - Socially Disadvantaged Farmers/Ranchers
 - Landowners
 - Others

RURAL TAX EDUCATION

RuralTax.org

RuralTax.org



- Website hosted by Utah State University
- Material developed, managed, and owned by the **National Farm Income Tax Committee**
- Informational Material on Ag, Timber, and Rural tax topics include but not limited to:
 - Disaster/Weather Losses
 - Treatment of Government Payments
 - Farm Losses and Hobby Rules
 - Self-Employment Taxes
 - Estate and Gift Taxes
 - Like Kind Exchanges
 - Depreciation
 - Etc...





Think about your goals....

- Now describe it
 - Revenue?
 - Habitat?
 - Recreation?

Classification of Activity

Business

Investment

Personal

Hobby

Personal Use

- Property owned primarily for recreation or personal residence
- No/minimal profit motivation (just covering the bills)





Investment

- Motivated by profit
- Lacking frequent income production

Business

- Profit motivation
- Regular & continuous activity
- Indicators:
 - Carried on for livelihood or profit
 - Regular transactions
 - Time spent working

Business or Investment?



NO HARD AND
FAST RULES



PROFIT NOW VS
LATER



OTHER INCOME?
YOU WORK OR
MONEY WORKS?



FACTS &
CIRCUMSTANCES



HOBBY

Not engaged in for profit

Presumption of Profit Motive

- Profit in three out of five tax years
- Do not need to make a profit to be operating a trade or business
 - Do need to show profit motive
 - Management plan!
- Failure allows IRS to question

Hobby Test

- Conducted in businesslike manner
- Expertise of taxpayer or advisor
- Time & effort expended
- Expectation of appreciation in value
- Success in other activities
- History of income & losses
- Amount of occasional profits earned
- Financial status
- Elements of personal pleasure

Facts &
Circumstances!

The factors

- Businesslike manner

- Profit
- Separate checking accounts
- Records
- Business plan
- Legal entity?

- Expertise of taxpayer or advisor

- Take classes
- Seek professional assistance (and do it)

The factors

- Time & effort expended

- Document
- Appropriate for profit

- Expectation of appreciation in value

- Value of land?
- Growth in timber
 - Quantity
 - Quality

The factors

- Success in other activities

- Have you done this before?
- Done anything similar?
- Dissimilar?

- History of income & loss

- Losses at beginning?
- Production timeline for income
- Losses beyond control (fire, ice?)
- Records

The factors

- Amount of occasional profits

- Large gains?
- Small recurring losses?
- Reasonable expectation of large future gain?

- Financial status

- Other sources of personal income?
- Smell test – losses to offset income
- Your why

The factors

- Elements of personal pleasure

- Would you keep doing this even if you never make money?
- Fun outweighing the effort and gain?
- This test is tough for forestry

- Facts & Circumstances

- Not any one factor decides
- Preponderance of evidence
- How does this compare to normal?

Why does it matter?



Ability to deduct expenses



Treatment of Income



Handling of losses

Passive vs Active Business

- A business is considered “passive activity” if taxpayer doesn’t materially participate
 - See Pub 925
 - More than 500 hours during tax year
 - Substantially all the participation during year
 - More than 100 hours and as least as much as anyone else
 - Significant participation (total of multiple activities)
 - Facts & circumstances

Passive vs Active Business

- Income:
 - Passive: subject to NIIT
 - Active: not subject to NIIT
- Net losses:
 - Passive: carried forward (must offset with passive income)
 - Active: fully deductible in year incurred

Deducting Expenses



Businesses deduct all “ordinary and necessary” expenses incurred for production or collection of income



Investors deduct expenses associated with production of income

Currently: suspension of miscellaneous itemized restricts deductions. Can still deduct property tax, will capitalize other expenses as carrying expenses



Personal Use: no deduction for expenses



Hobby: no deduction for expenses

Treatment of Income

- Income from timber sales sold “on the stump” qualify for capital gains
 - Businesses:
 - §631(b) sale on Form 4797
 - Personal use, investment, hobby:
 - lump sum sale § 1221, on Schedule D
 - Pay-as-cut sale §1231 under 631(b), Form 4797

Treatment of Income

- Income from sale of logs is ordinary unless elect § 631(a)
 - Businesses:
 - Gain from growing timber: Form 4797
 - Gain from selling logs: Schedule C
 - Personal:
 - Ordinary income, non-self-employment

Handling of Losses

Operating Losses

- Investment: allowed
- Personal: not deductible
- Hobby: not deductible

Casualty Losses

- Investment: treated as business-use
- Personal: limited to federal disaster areas with reduction of \$100 per and 10% of AGI

Handling of Losses

Operating Losses

- Business Active: allowed
- Passive: carried forward

Casualty Losses

- Business: deductible

Legal Structure

- Defines who owns the land
- Has tax implications
- Determines liability
- No one right answer!
- Get professional advice



Burden of
proof on
YOU!

Documentation!

Often not black
and white

Does it pass the smell test

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