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## Chapter 11. Taxation of Nontimber Forest Products

Most of the chapters in this guide focus on tax issues related to the production and sale of timber, but forest land generates many other types of products that also can be marketed. The sale of nontimber forest products can provide income to help offset the costs of owning and managing forest land or for other purposes. In nearly all cases, however, the income is not a capital gain, but ordinary income subject to higher Federal tax rates and Social Security self-employment tax. This chapter lists a broad sample of nontimber forest products and discusses their tax treatment.

### Products Taxed as Ordinary Income

#### Byproducts From Timber Harvests

Income from byproducts of a timber harvest sold separately from the harvest itself generally is ordinary income, even if the timber was harvested and converted into products for sale under the provisions of Internal Revenue Code (IRC) section 631(a) (chapter 5). This includes income from the sale of products from logging residues, such as pulpwood culled from downed tree tops and limbs, chips, mulching material, and firewood. It also includes income from the sale of tree stumps and roots left after a harvest, although income from the sale in one lot of stumps from land acquired in a cutover condition as a real estate investment does qualify as a capital gain (see the summary of Revenue Ruling 57-9, appendix A).

#### Fee Activities and Leases

Income from for-fee recreational activities and most forest-related leases is ordinary income. This includes income from fee camping and fishing, hunting leases, and long-term land leases. In contrast, income received under a long-term timber management contract which specifies that the payments are partial payments for the average annual increment of wood fiber the land is capable of producing is a capital gain. Such contracts were used by forest products firms in the South during the 1960s, and it is likely some are still in effect.<sup>6</sup>

#### Products From Trees

Income from products gathered or collected from trees—such as wild fruits or nuts, cuttings for seasonal decorations, pine straw, or maple syrup—is ordinary income.

#### Living Trees

Income from the sale or disposal of evergreen trees that are more than 6 years old when cut and sold for ornamental purposes (that is, Christmas trees) can qualify as a capital gain, as discussed in chapters 5 and 10. Trees sold live, however, as living Christmas trees or landscaping trees, are considered horticultural products. They are not eligible for the provisions of IRC section 631(a) or 631 (b), and income from their sale is ordinary income.

#### Products From Wild Forest Plants

Literally hundreds of species of forest plants are used for culinary, decorative, educational, medicinal, or research purposes. Income from products gathered or collected from forest plants—such as wildflowers for sale fresh or dried, vines, edible plants, herbs, medicinal plants, or botanical samples—is ordinary income.

#### Products From Cultivated Forest Plants

As gathering and collecting of forest plants has caused wild stocks to diminish, interest has grown in cultivating forest plants in shade beds or simulated wild conditions. Income derived from cultivated forest plants that are annuals or from the leaves, flowers, or bark of perennials is ordinary income. As discussed in the following section, however, income derived from the roots or main stems of cultivated forest plants that are perennials can qualify as a capital gain.

### Products Taxed as a Capital Gain

#### Qualifying Income From Tree Stumps and Long-Term Contracts

As noted previously, income from the sale in one lot of tree stumps from land acquired in cutover condition qualifies as a

<sup>6</sup> See W.C. Siegel. 1973. *Long-term Contracts for Forest Land and Timber in the South*. Research Paper SO-87. USDA Forest Service, Southern Forest Experiment Station, New Orleans, La. 14 p., and J.L. Greene. 1979. The increment contract. *Southern Journal of Applied Forestry*. 3(3): 82–85.

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capital gain, as does income under a long-term timber management contract which specifies that the payments are partial payments for the average annual increment of wood fiber the land is capable of producing.

## Qualifying Income From Cultivated Forest Perennials

Income from sale of the roots or main stems of cultivated forest plants that require more than 1 year to produce salable products also can qualify as a capital gain. The most commonly cultivated forest perennials include American ginseng (*Panax quinquefolius*), black cohosh (*Cimicifuga racemosa*), and goldenseal (*Hydrastis canadensis*).

Among traditional agricultural products, the cultivation of forest perennials is perhaps most similar to orchard trees or grapevines, but the tax situation is quite different. With orchard trees or grapevines, the plant is depreciable capital, the fruit is the product, and income from the sale of the fruit is ordinary income. With cultivated forest perennials—as with trees grown for timber—the plant itself is both capital and product, and income from the harvest of the plant can qualify as a capital gain.

Forest perennials can be grown from seed or from cuttings. Either approach is inherently a business operation. Both require careful selection and preparation of a site. Growing plants from seed requires collection and stratification of the seed, planting the prepared seed in seedbeds, and transplanting the seedlings into prepared *gardens*. Growing plants from cuttings involves fewer steps and provides a somewhat faster return, but still requires careful preparation of the *garden*, cultivation, and regulation of shade.<sup>7</sup>

Plants grown in simulated wild conditions command a higher price than those grown in shade beds, but entail considerably greater risk. American ginseng plants grown from seed require up to 10 years to produce a salable product, whereas plants grown from root cuttings require up to 8 years. Black cohosh

or goldenseal plants grown from seed require 6 to 7 years to produce a salable product, whereas plants grown from root cuttings require 3 to 5 years.<sup>8</sup>

## Reporting Expenses and Income From Nontimber Forest Products

Sale of nontimber forest products can help substantiate a profit motive, so forest owners should keep careful record of their expenses and income (chapter 15). Depending on the level of involvement, production of several types of nontimber forest products can qualify as a trade or business (see chapter 4, “The Passive Loss Rules”).

Expenses incurred to gather, grow, process, or market nontimber forest products are deductible expenses, subject to the same guidelines as operating expenses for timber production (see chapter 4, “Currently Deductible Costs: Operating Expenses and Carrying Charges”). Owners who qualify as investors should report deductible expenses as miscellaneous itemized deductions on Internal Revenue Service (IRS) Form 1040, Schedule A, where they will be subject to the 2 percent of adjusted gross income floor. Owners who qualify as material participants in a trade or business should report deductible expenses on IRS Form 1040, Schedule C or F, as appropriate. Expenses incurred to establish forest perennials are capital expenses (see chapter 4, “Capital Costs”). They should be posted to a capital account and deducted from the gross proceeds from the sale of the harvested plants, using IRS Form 4797: Sales of Business Property.

Owners who qualify as investors should report ordinary income from the sale of nontimber forest products as “Other income” on the front of IRS Form 1040, and capital gains on IRS Form 1040, Schedule D. Owners who qualify as material participants in a trade or business should report ordinary income from the sale of nontimber forest products on IRS Form 1040, Schedule C or F, as appropriate, and capital gains on IRS Form 4797.

<sup>7</sup> See Z. Gardner. 2002. Special Supplement on AgroForestry: Cultivation and marketing of woodland medicinal plants. *The Natural Farmer*. 2(53, Spring): 19–25, and R. Beyfus. 2002. Special Supplement on AgroForestry: Growing ginseng in your woodlot. *The Natural Farmer*. 2(53, Spring): 43–46.

<sup>8</sup> *Ibid.*