
Chapter 15. Forest Records

Systematic and timely recording of transactions by type, purpose, and amount is vital for proper management of long-term forest investments and tax compliance. In addition, accurate records, coupled with knowledge of the Federal income tax rules, allow you to ensure fair tax treatment of the income and expenses associated with your forest ownership as intended by Congress. Tax items discussed previously include (1) qualifying timber revenue as a long-term capital gain; (2) recovering invested capital through current deductions, depletion, depreciation, and amortization; and (3) deducting management and qualified reforestation expenses while complying with the passive activity loss rules for businesses. Provisions concerning cost-sharing payments, involuntary conversions, installment sales, and like-kind exchanges also may be important to you.

You should keep accurate and complete documentation of your forest activities to verify all entries made on tax returns. Examples of documents to keep include invoices, contracts, receipts, canceled checks, and maps that validate forest land holdings and forest operations. See Internal Revenue Service (IRS) Form T (Timber) in appendix B for examples of entries that may be required. You should retain documents related to currently deductible expenses on your forest land for a minimum of 3 years from the date the tax return reflecting them is filed. This is the ordinary limit for audit by the IRS, although in some cases, this limit can reach up to 6 years after the return is filed. If a return is false or fraudulent, however, or if no return is filed, an action by the IRS generally can be brought at any time. Documents relating to acquisition of land, timber, and other capital items (discussed in chapter 4) should be held for the entire period of ownership, plus a minimum of 3 years after the disposition.

Taxpayers should keep books and records adequate for audit—this means that the books and records exist, are in proper form, and are readily accessible. An IRS auditor could compel you to produce the records needed to audit your return. IRS Publication 556, *Examination of Returns, Appeal Rights, and Claims for Refund* provides additional information on audit procedures. If you are unsure about the appropriate records to keep after reading this chapter, you should consult with a qualified tax accountant, as discussed in chapter 2. The income tax accounts needed for recording forest expenditures and timber sale revenue are discussed in this chapter. IRS Publication 538, *Accounting Periods and Methods*, can be consulted for additional details.

Management Information

Good records are essential for a successful forest management program as well as for tax purposes. They show the status of the timber inventory, timber growth rates, current cost and revenue information, and projected cash flows for your forest activity. This information can be used to analyze the efficiency of proposed management options, enabling you to make informed choices in a timely manner. They also should show the relationship between your management decisions and the profit potential of your forest land. Adequate records also serve as historical documents that can help you avoid repeating mistakes.

Accounting Methods

You may adopt an accounting method that provides the most favorable tax treatment for your forest activities as long as it clearly reflects revenues and expenses. It may be the same as one you use in other businesses or investment activities, or it may be different as dictated by the nature and scope of your forest program. The two accounting methods in general use are cash and accrual.

Cash Accounting

With cash accounting revenue is reported when actually or constructively received, and expenses are deducted when actually paid. Most small service firms and farms (including forest ownerships) have adopted cash accounting methods that are simple, flexible, and effective.

Accrual Accounting

With accrual accounting revenue is recorded when it is earned, whether or not received at that time. Expenses are deducted when they are incurred rather than when actually paid. An accrual accounting method is preferred by accountants and is used by many incorporated timber businesses. It has the advantage of evenly matching income and expenses so that revenues and costs are recorded closer to the time they actually occur. Thus, the accrual method more nearly reflects economic activity, which may or may not be matched by a concurrent cash flow. One disadvantage of the accrual method is that it does not postpone the payment of tax until revenue actually is received.

Taxpayers may use combinations of the cash and accrual methods as long as the procedure adequately reflects income and is followed consistently. The installment method of reporting revenues (see chapter 9) is an example of a hybrid accounting method. IRS approval by filing IRS Form 3115: Application for Change in Accounting Method is generally necessary before an accounting method can be changed.

Recordkeeping Systems

Shoebox

You should develop a systematic recordkeeping approach for your forest activities records, even for small tracts held as an investment. The much joked-about shoebox system is better than nothing if organized and followed routinely. If you adopt this system, you can use business envelopes and label one for

each tax category that applies to your activity. You then file the documents for each activity by category as it occurs. The categories that are important are discussed in previous chapters and illustrated by the example later in this chapter. Unless you also write notes describing transactions and file them in the appropriate envelopes, your shoebox system may not be adequate. A journal is a much better alternative for recording transactions associated with documents.

A Forest Landowner's Journal

To improve on the shoebox system, you should maintain a journal to record forest management information and activities. A journal is a chronological business diary that contains the details of each business transaction—description, purpose, date, and dollar amounts involved. Evergreen Tree Farm: Journal (fig. 15.1) is an example. In addition to recording financial information, you should include the time you spent on the ac-

Figure 15.1.—*Evergreen Tree Farm: Journal.*

Date	Accounts and Explanation	Reference	Debits \$	Credits \$
06/01/06	Temporary capital account	1	2,500	
	Cash			2,500
	E.Z. Cruiser, Consultant for forest land appraisal report			
06/01/06	Temporary capital account	2	275,000	
	Cash			75,000
	Mortgage payable			200,000
	Purchase Evergreen Tree Farm			
06/15/06	Temporary capital account	3	4,000	
	Cash			4,000
	L. Lawyer, attorney for title search, filing, and closing			
06/21/06	Evergreen tract (fig. 15.2)	5	59,537	
	Merchantable sawtimber (figs. 15.3 and 15.6)	6a	161,834	
	Merchantable pulpwood (not shown)	7	24,407	
	Young growth (fig. 15.4)	8	22,323	
	Equipment-Bridge (fig. 15.5)	9	13,399	
	Temporary capital account	4		281,500
	Allocation of tree farm purchase to permanent capital accounts			
12/31/06	Depreciation expense	10	521	
	Accumulated depreciation			521
	First year depreciation of bridge			
12/31/06	Interest expense	11	9,285	
	Mortgage payable		2,425	
	Cash			11,710
	Interest expense and mortgage			
	Principal reduction for 2006 (see Interest Expense and Mortgage Payable Accounts, table 15.1)			
01/15/06	Operating expense	12	421	
	Cash			421
	Forest suppliers for purchase of axes, posted signs, flagging			
06/01/06	Bridge maintenance	13	582	
	Truck maintenance		217	
	Road maintenance		897	
	Cash			1,696
	Forest expenses for servicing truck, grading, pulling ditches, and repairing bridge			

Figure 15.1.—*Evergreen Tree Farm: Journal (continued)*.

Date	Accounts and Explanation	Reference	Debits \$	Credits \$
12/31/07	Property tax expense	14	820	
	Cash			820
	Treasurer, Local County			
02/15/08	Expenses of sale (table 15.1)	15	10,950	
	Cash			10,950
	E.Z. Cruiser, consultant for sale preparation (also see table 15.2)			
04/10/08	Cash	16	21,900	
	Timber sale revenue			21,900
	Deposit (10 percent) on timber sale from Sawyer Lumber Co.			
05/07/08	Cash	17	197,100	
	Timber sale revenue			197,900
	Balance of sale revenue from Sawyer Lumber Co. (also see table 15.1)			
12/31/08	Cost of timber sold*	18a	97,100	
	Merchantable sawtimber subaccount (value)			97,100
	Allowable as basis of sale			
	Merchantable sawtimber subaccount (also see chapter 5)			
06/15/08	Reforestation expense account (not shown)	19	12,500	
	Cash			12,500
	B. Dozer, contractor for site preparation on 60 acres of cutover land, QTP#1			
08/26/09	Bridge maintenance	20	352	
	Road maintenance		578	
	Cash			930
	M. Truck, contractor for road grading, bridge repair			
09/01/09	Cash	21	5,000	
	Reforestation account (not shown)			5,000
	Receipt of cost-sharing payments for site preparation (also see table 15.2)			
02/10/10	Reforestation expense account (not shown)	22	3,600	
	Cash			3,600
	E.Z. Cruiser, contractor for planting pine on QTP#1 (table 15.4)			
08/06/11	Timber stand improvement	23	1,800	
	Cash			1,800
	Tom Cleary, contractor for timber stand improvement in 60-acre natural pine stand			
09/01/11	Temporary capital account	24	384,900	
	Cash			384,900
	Mountain Realty Co., acquire Lonesome Pine—120 acres total			
09/02/11	Temporary capital account	25	6,400	
	Cash			6,400
	Mountain Realty Co., appraisal, title search, and legal fees to acquire Lonesome Pine tract			
09/15/11	Total cost of property (6,400 + 384,300)	26		391,300
	Land	27	60,998	
	Merchantable sawtimber (figs. 15.3 and 15.5)	28a	314,036	
	Young growth	29	16,256	
	Allocation of Lonesome Pine purchases to permanent capital accounts			
09/31/11	Pulpwood timber subaccount (not shown)	30	22,323	
	Young growth			22,323
	Young growth transferred to pulpwood timber subaccount (value not shown)			
11/01/11	Travel expense	31	276	
	Cash			276
	Routine inspection of boundaries, roads, and fire lines from travel diary (not shown)			
12/31/11	Property tax expense	32	1,280	
	Cash			1,280
	To Local County Treasurer for property tax expenses			
12/31/11	Interest expense	33	13,992	
	Mortgage payable		6,092	
	Cash			20,084
	Interest expense and mortgage principal reduction for 2006			

Figure 15.1.—*Evergreen Tree Farm: Journal (continued)*.

Date	Accounts and Explanation	Reference	Debits \$	Credits \$
12/31/11	Temporary capital account	34	15,548	
	Travel expense			276
	Property tax expense			1,280
	Interest expense			13,992
	Election to capitalize carrying charges for 2006			
12/31/11	Temporary capital account	35		15,548
	Merchantable sawtimber subaccount		14,041	
	Pulpwood subaccount (not shown)		905	
	Young growth subaccount		602	
	Allocation of carrying charges to timber accounts			
12/31/11	Cash	36	1,200	
	Hunting lease			1,200
	Receipt of hunting lease payment from Laid Back Hunt Club			

* Volume removed in sale of 438 thousand board feet (MBF) is adjusted in Merchantable Sawtimber Subaccount (fig. 15.3).

tivities associated with transactions. This information will help you justify your profit motive, and if you file as a business, it will help establish the extent of your participation for purposes of the passive loss rules, discussed in chapter 4. A journal and associated documents may provide a sufficient record of transactions for tax purposes, especially for landowners with limited management activities. All owners, however, should sort entries by tax categories: capital transactions, deductions from gross income, deductions from adjusted gross income, timber sale revenue, expenses of timber sale activities, and other transactions as appropriate.

A Forest Landowner's Journal With Accounts

As your forest operations increase in complexity, a journal serves as a diary of day-to-day activities that are systematically transferred (posted) to accounts. Ledger accounts may be needed for each separate business or activity associated with forest land, but under certain circumstances the transactions for multiple activities can be combined for tax purposes. Professional tax advice may be needed to deal with this issue, especially regarding the passive loss rules that apply to businesses.

The number and kind of ledger accounts will vary with the details of your forest business. Accounts that are typically used by forest landowners include those specifically related to timber operations, plus those needed for any business. Only the basic accounts necessary to illustrate the records needed for forest-related activities are introduced here. To save space, repetitive costs (for example, annual property taxes) are shown in the journal only once.

Ledger Accounts

Capital Accounts

Forest land assets generally include (1) land, (2) timber, and (3) improvements. Each item that adds significantly to the value of the property should be reflected in an account for that item of property. Subaccounts usually are needed to adequately record transactions for management and tax purposes.

Land Account. The land account contains entries for the land and permanent land improvements (fig. 15.2). Permanent land improvements include things that have indefinite useful lives, such as roadbeds, land leveling, and impoundments. The basis for land and nondepreciable improvements should be maintained in separate subaccounts. The cost of these assets generally is not recovered until they are disposed of; they are nondepreciable. A casualty may occur, however, that results in the destruction of a roadbed or other permanent improvement. You would need to know the basis in the affected property—for example, the roadbed—to claim a loss from a casualty (see chapter 7).

Timber Accounts. Timber accounts include subaccounts for merchantable timber, young growth, and plantations.

Merchantable Timber Subaccount. One or more merchantable timber subaccounts may be kept, depending on your management goals, but a single account for average depletion is the simplest for small to medium-sized operations. The opening balance in the merchantable timber volume subaccount is the merchantable volume that could have been harvested at prevailing

utilization standards when the property was acquired (fig. 15.3). The opening balance in the associated merchantable timber basis account (dollar amount) is the portion of the original basis allocated to merchantable timber (see chapter 4).

Young-Growth Subaccount. When premerchantable timber is acquired, its allocable portion of the total acquisition cost or other basis on a per-acre basis is established in a young-growth subaccount (fig. 15.4). You are required to establish a young-growth subaccount if the premerchantable timber makes a substantial contribution to the total value of the forest property (see chapter 4). The young-growth timber basis is transferred to a merchantable timber subaccount when the young growth becomes merchantable. Merchantability standards vary with local market conditions as well as by agreement with the IRS. An estimate of the volume per acre being transferred also is required, because the unit for measuring timber changes from area to volume. The transfer is made by increasing the basis and

volume in the merchantable timber subaccount while reducing the basis in the young-growth subaccount by a corresponding amount. For example, in the case that follows, the basis of \$22,323 on 60 acres in the Evergreen Tree Farm: young-growth subaccount (see figs. 15.1 and 15.4, ref. 29) is estimated to represent a merchantable volume of 1,350 cords when transferred to a merchantable pulpwood subaccount (not shown).

Plantation (Deferred Reforestation) Subaccount. A plantation subaccount, also referred to as a deferred reforestation subaccount, is similar to the young-growth subaccount. It is created when a new timber stand is established by artificial regeneration (planting or seeding) following a harvest or on land converted to timber. Such an account would include reforestation expenses that are not deducted or amortized under the provisions of section 194 of the Internal Revenue Code (IRC), as discussed in the following paragraph and in chapter 4.

Figure 15.2.—*Evergreen Tree Farm: Land Account.*

Date	Accounts and Explanation	Reference	Debits \$	Credits \$
06/21/06	Allocation of Evergreen Tree Farm purchase cost to land: John Jones Tract (table 15.3)	5	59,537	
09/15/11	Allocation of Lonesome Pine purchase cost to land	27	60,998	
09/15/11	Adjusted balance (basis) carried forward		120,535	

Figure 15.3.—*Evergreen Tree Farm: Merchantable Sawtimber Subaccount: Volume Basis.**

Date	Accounts and Explanation	Reference	Debits \$	Credits \$
06/21/06	Estimated merchantable volume of pine and hardwood sawtimber at date of purchase (see Evergreen Tree Farm cruise in table 15.2)	6b	650	
01/02/08	Growth for 2006-08 (2 years: see cruise report, table 15.2)		80	
01/02/08	Adjusted volume carried forward		730	
12/31/08	Volume removed in sale	18b		438
12/31/08	Adjusted volume carried forward		292	
09/15/11	Estimated volume on Lonesome Pine tract when purchased (table 15.2)	28b	750	
09/31/11	Adjusted volume carried forward		1,042	

* See fig. 15.6 for corresponding value.

Figure 15.4.—*Evergreen Tree Farm: Young-Growth Subaccount.*

Date	Accounts and Explanation	Reference	Debits \$	Credits \$
06/21/06	Allocation of Evergreen Tree Farm purchase cost to young growth (60 acres of pine, see table 15.3)	8	22,323	
09/15/11	Allocation of Lonesome Pine purchase cost to young growth (40 acres, see table 15.3)	29	16,256	
09/31/11	Transfer young growth to Merchantable Pulpwood Subaccount (value); volume estimated (cruised) to be 1,350 cords by E.Z. Cruiser	30		22,323
09/31/11	Adjusted balance carried forward		16,256	
12/31/11	Election to capitalize carrying costs, proportional allocation	35	602	
12/31/11	Adjusted balance carried forward		16,858	

Reforestation Account. This account is for tracking the cost basis of each qualified timber property (QTP) for which you are deducting or have deducted qualified reforestation costs under the provisions of IRC section 194. It reflects all qualified reforestation expenditures made on the QTP, the amount and nature (that is, by outright deduction or amortization) of all deductions taken, and the basis remaining in the QTP. Note that you must maintain the account until the timber on the QTP is harvested, even if there is no basis remaining. You are required to establish a separate reforestation account for each QTP for which you deduct outright up to \$10,000 of qualified reforestation costs in a given year. Most forest owners, however, only need one reforestation account, which coincides with their entire forest ownership. Only owners who have divided their forest holdings into two or more *blocks* (see chapter 7) or who wish to deduct outright more than \$10,000 of qualified reforestation expenses in a single year need more than one reforestation account. For additional information, see chapter 4, “Reforestation Tax Incentives” and IRS Notice 2006-20, part C2.

Depreciation Accounts. Depreciation accounts are established for equipment and other depreciable assets that are used in your forest activity (see fig. 15.5 and table 15.1, ref. 10). The cost of equipment is established in subaccounts according to the procedures discussed in chapter 4. Bridges, culverts, improved road surfaces, and fences are examples of depreciable land improvements for which subaccounts also may be established. They are depreciable because they wear out and have a determinable useful life. The cost of such items must be depreciated rather than deducted currently because their determinable useful life is greater than 1 year.

Expense Accounts

The number of expense accounts that is needed depends on the nature of your operations. Property taxes, travel expenses, and expenditures for various timber stand maintenance operations are typical of costs that you may incur (for example, see

table 15.1). Maintenance operations include such activities as precommercial thinning, prescribed burning for hazard reduction, the purchase of small tools and supplies, and equipment maintenance. See chapter 4 for a discussion of expenses and their tax treatment, including the effect of the passive loss rules.

Capital Income Accounts

Timber normally generates capital gains or losses upon disposal (see the discussion on capital gains in chapter 5). Accounts associated with timber dispositions include: Timber Sale Revenue, Basis of Timber Sold, and Expenses of Sale (see table 15.1 and Accounts 14, 15, and 16, respectively).

Ordinary Income Accounts

Ordinary income may be generated in many ways from forest land. In fact, most income other than that from the sale of timber or land will be ordinary income. Examples are hunting lease payments, selling firewood from logging residue, sale of wild nuts and herbs, and sale of pine straw (chapter 11). Because ordinary income may be important for offsetting management expenses, appropriate accounts should be established to record it. A Hunting Lease Account illustrates this point (table 15.1, ref. 36).

General Business Accounts

You also need to establish accounts that are basic to any business. A Cash Account is used to handle revenues, pay bills, and make allocations to other business accounts. Categories of accounts for accumulating cash flows for business or tax decisions include: Interest Expense, Travel Expense, Vehicle Maintenance, Depreciation Expense, Accumulated Depreciation, Mortgage Payable, and Miscellaneous. These categories are shown in table 15.1 in abbreviated form to provide continuity with the forest accounts (figs. 15.2 through 15.6) in the comprehensive example.

Figure 15.5.—*Evergreen Tree Farm: Depreciable Land Improvement Account.*

Date	Accounts and Explanation	Reference	Debits \$	Credits \$
06/21/06	Allocation of Evergreen Tree Farm purchase cost to equipment, a 90-foot wooden bridge (table 15.3)	9	13,399	
12/31/06	Depreciation deduction for 2006 (Straight line: $(\$13,399 \div 15) \times 7 \div 12$ months)	10		521
12/31/06	Adjusted balance carried forward (Subsequent depreciation entries are not shown)		12,878	

Table 15.1.—Evergreen Tree Farm accounts.

Reference	Debits \$	Credits \$
1. Cash account		
1		2,500
2		75,000
3		4,000
11		11,710
12		421
13		1,696
14		820
15		10,950
16	21,900	
17	197,100	
19		12,500
20		930
21	5,000	
22		3,600
23		1,800
24		384,900
25		6,400
31		276
32		1,280
33		20,084
36	1,200	
2. Temporary capital account		
1	2,500	
2	275,000	
3	4,000	
4		281,500
24	384,900	
25	6,400	
26		391,300
34	15,584	
37		15,584
3. Mortgage payable		
2		200,000
11	2,425	
	Bal Fwd	197,575

	Bal Fwd	177,531
33	6,092	*
4. Depreciation expense		
10	521	
5. Accumulated depreciation		
10		521
6. Interest expenses		
11	9,285	*
33	13,992	
34		13,992
7. Travel expenses		
31	276	
34		276
8. Operating expenses		
12	421	
9. Truck maintenance		
13	217	

Table 15.1.—Evergreen Tree Farm accounts (continued).

Reference	Debits \$	Credits \$
10. Bridge maintenance		
13	582	
20	352	
11. Road maintenance		
13	897	
20	578	
12. Property tax expense		
14	820	
32	1,280	
34		1,280
13. Timber stand improvement		
23	1,800	
14. Timber sale revenue		
16		21,900
17		197,100
	Bal Fwd	219,000
15. Cost of timber sold (basis)		
18	97,100	
16. Expenses of sale		
15	10,950	
17. Hunting Lease		
36	1,200	

* Repetitious data are omitted.

***** missing entry.

A Comprehensive Example of Forest Land Purchases and Management

Records for Forest Land Purchases

John Jones purchased Evergreen Tree Farm from Bob Smith on June 1, 2006, for \$275,000. Jones structures his timber management activities on the properties as a business in which he materially participates. The journal entries to record the acquisition of these properties, the allocation of acquisition cost to the respective capital accounts, the payment of annual operating expenses, the selling of timber, and the reforestation of harvested stands are shown in the Evergreen Tree Farm Journal (fig. 15.1). They are then transferred (posted) to their respective capital accounts (figs. 15.2 through 15.6) and to the general business accounts that are shown in abbreviated form in table 15.1.

An example of each type of transaction is briefly explained to illustrate the process of handling various cash flows and to indicate the tax treatment each should receive. E.Z. Cruiser, the consulting forester, prepared an appraisal of the Evergreen Tree Farm forest land property's estimated value, table 15.2. His appraisal fee of \$2,500 (fig. 15.1, ref. 1) and related legal fees of

\$4,000 (fig. 15.1, ref. 3) are acquisition costs included in the total basis. They are added to the \$275,000 purchase price (ref. 2) that was allocated to the capital accounts. The initial bookkeeping is handled with a temporary capital account that reflects the \$281,500 total cost of the acquisition (ref. 4).

Allocation of the acquisition cost to the capital accounts is shown in table 15.3. Note that the appraised values are somewhat higher than the actual purchase price. Nevertheless, they provide the proportion that each account bears to the total value of the property. The basis in land is recorded in the Land Ac-

count (fig. 15.2, ref. 5). Similarly, the basis in merchantable timber is recorded in the Merchantable Sawtimber Subaccount (fig. 15.6, ref. 6a) and to the Merchantable Pulpwood Subaccount (ref. 7, not shown). A corresponding estimate of the merchantable volume of 650 MBF is reported in the Merchantable Sawtimber Subaccount (fig. 15.3, ref. 6b). Young growth is recorded in the Young-growth Subaccount (fig. 15.4, ref. 8). The basis of the bridge is posted to the Depreciable Land Improvement Account (fig. 15.5, ref. 9). It is depreciated using the straight line method with a 15-year recovery period and an

Table 15.2—Summary of cruise (appraisal) reports for Evergreen Tree Farm and Lonesome Pine forest land purchases.

Description of assets	Value
Evergreen Tree Farm (01/15/06)	
1. 200 acres of average site land @ \$400/acre	\$80,000
2. Merchantable pine and mixed hardwood sawtimber on 100 acres*	217,500
Pine: 400 MBF @ \$450/MBF = \$180,000	
Hardwood: 250 MBF @ \$150/MBF = \$37,500	
3. Pulpwood-pine and mixed hardwood on 40 acres*	32,800
Pine: 880 cords @ \$30/cord = \$26,400	
Hardwood: 320 cords @ \$20/cord = \$6,400	
4. Young-growth pine averaging 8 years old on 60 acres @ \$500/acre	30,000
5. Used wooden bridge-90 feet (15-year recovery period with no salvage value)	18,000
Total estimated fair market value	\$378,300
Lonesome Pine Tract (08/01/11)	
1. 120 acres of fair quality land @ \$500/acre	\$60,000
2. Merchantable pine-hardwood sawtimber on 80 acres*	308,900
Pine: 470 MBF @ \$550/MBF = \$258,500	
Hardwood: 280 MBF @ \$180/MBF = \$50,400	
3. Young-growth pine averaging 5 years old on 40 acres @ \$400/acre	16,000
Total estimated fair market value	\$384,900

* Submitted by E.Z. Cruiser, Registered Forester No. 424. MBF = thousand board feet.

Table 15.3.—Allocation of Evergreen Tree Farm assets to capital accounts.

Account	Fair market value (FMV) (\$)	Percent of total FMV (%)	Allocation of acquisition cost (\$)	Allocation of purchase price to original cost basis (\$)
Land	80,000	21.15	1,375	58,162
Sawtimber	217,500	57.49	3,737	158,097
Pulpwood	32,800	8.67	564	23,843
Young growth	30,000	7.93	515	21,808
Bridge	18,000	4.76	309	13,090
Total	378,300	100.0	6,500	275,000

Figure 15.6.—Evergreen Tree Farm: Merchantable Sawtimber Subaccount: Cost Basis.

Date	Accounts and Explanation	Reference	Debits \$	Credits \$
06/21/06	Allocation of Evergreen Tree Farm purchase cost to merchantable timber	6a	161,834	
12/31/08	Allowable as basis for sale	18a		97,100
12/31/08	Adjusted basis carried forward		67,734	
09/15/08	Allocation of Lonesome Pine purchase to merchantable timber (table 15.1)	28a	314,036	
09/15/11	Adjusted basis carried forward		378,770	
12/31/11	Election to capitalize carrying charges	35	14,041	
12/31/11	Adjusted basis carried forward		392,811	

assumed salvage value of zero. The first year's depreciation deduction is shown in table 15.1 (Account No. 4, ref. 10) and accumulated depreciation is shown in table 15.1 (Account No. 5, ref. 10). The information in these accounts should be used to complete IRS Form T (Timber), Part I: Acquisitions, to be filed in Jones' permanent records.

The \$200,000 business loan on Evergreen Tree Farm is amortized at 8 percent over 20 years. The interest expense, which is deductible (fig. 15.1, ref. 11), and reduction of principal, which is not deductible (table 15.1, Account 3), are recorded in separate accounts.

Records for Forest Land Management

Various operating and maintenance expenses for the Evergreen Tree Farm also are shown in table 15.1. These expenses include supplies (Account 8, ref. 12), maintenance (Account 9, ref. 13), and property taxes (Account 12, ref. 14). See chapter 4 for a discussion of forest management and operating expenses, including treatment of the business interest discussed previously.

When Jones decided to sell timber in 2008, he asked his consulting forester to prepare and market the sale for a fee of \$10,950, a 5-percent commission (fig. 15.1, ref. 15). To qualify the gain for treatment as a long-term capital gain, the timber is disposed of under IRC section 631(b). Either a sale-by-the-unit contract (also called a pay-as-cut contract) or a lump-sum contract qualifies. The sale revenue consisted of a bid deposit of \$21,900 (10 percent) and an advance payment of \$191,100. They are recorded in Account 14, Timber Sale Revenue (table 15.1, refs. 16 and 17, respectively). The cost of timber sold (allowable basis) is calculated on IRS Form T (Timber), Part II: Timber Depletion, using information from the Merchantable Sawtimber Subaccount (figs. 15.3 and 15.6). Cost of timber sold is subtracted from gross sale revenue in calculating net taxable gain or loss (chapter 5). This amount of \$97,100 (ref. 18a) is recorded in Account 15, Cost of Timber Sold (table 15.1). IRS Form T (Timber), Part III: Profit or Loss From Land and Timber Sales, is also completed but was not filed with the tax return because Jones makes only occasional timber sales for which the filing of Part III is not required.

The harvested 60 acres are site prepared at a cost of \$12,500 (fig. 15.1, 19). Jones receives a cost-sharing payment of \$5,000 (ref. 21), which he elects to exclude from his income under IRC section 126. He designates this project as QTP#1 and elects to deduct the remaining \$7,500 reforestation expense currently. IRS Form T (Timber), Part IV: Reforestation and Timber Stand Activities, is completed and placed in the

permanent files. QTP#1 was planted the following year for \$3,600, for which no cost-sharing payment was received (fig. 15.1, ref. 22). This expense is also deducted currently.

Jones spent \$1,800 on timber stand improvement (TSI) operations in natural stands to maintain the quality and growth of selected crop trees. This deductible expense is shown in table 15.1, Account 13, ref. 23.

On September 1, 2011, Jones purchased the adjoining tract known as "Lonesome Pine" for \$384,900. The purchase price and allocation of capital are similar to the establishment of the original accounts. These additions show the adjustments to basis in the Land Account (fig. 15.2, ref. 27), Merchantable Timber Subaccount (fig. 15.4, ref. 28b, and fig. 15.6, ref. 28a), and Young-growth Subaccount (fig. 15.4, ref. 29).

When the young growth in the original purchase reaches merchantability in 2011, it is transferred from the Young-growth Subaccount (fig. 15.4, ref. 30) to the Merchantable Pulpwood Subaccount (not shown). Note that this option is chosen by Jones based on his timber management goals. He is keeping the merchantable accounts separate by products (that is, sawtimber and pulpwood), although they could have been combined into a single merchantable timber subaccount.

In 2011, Jones' fortunes were not good, resulting in zero taxable income. To avoid the loss of deductible expenses, he elected to capitalize as carrying charges the costs for travel (fig. 15.1, ref. 31), property taxes (ref. 32), and business interest (ref. 33). The total of \$15,548 is proportionately allocated to the timber accounts (fig. 15.1, ref. 35).

The diversity of Evergreen Tree Farm, including mixtures of timber species, various age classes, and openings caused by harvesting, offers good hunting prospects. Jones leased the property for 5 years to the Laid Back Hunt Club for \$1,200 per year (\$4 per acre per year). Most members are neighbors, and the agreement includes clauses for insurance coverage, fire protection, and prevention of trespass. The first payment is received at the end of 2011 (table 15.1, Account 17, and fig. 15.1, ref. 36).

Blank ledger forms for beginning a forest land journal with accounts for merchantable timber, young growth, and reforestation can be found in most business supply offices. These forms are the minimum needed for efficiently recording information in forest land capital accounts. Other general business accounts, such as those suggested in table 15.1, should be added as needed to reflect the complexity of your forest land operations.

