



# Timber and Taxes

## Estate Tax Basics

by Dr. Linda Wang

When it comes to woodland property inheritance and estate planning, many private woodland owners place a high value on leaving a family legacy from the land they own for future generations. They want their children to enjoy the land, saving it from being sold to pay taxes and debts. They want the inheritance of the land to happen with the least amount of expenses, taxes and problems. Learning and understanding the tax laws helps minimize the estate taxes and the income taxes of woodland property upon the death of the landowner.

### Federal Estate Taxes

The amount of an estate that can be exempt from estate tax is \$5.43 million for 2015. This means one may leave up to \$5.43 million without paying federal estate taxes in 2015. Thus, the great majority of the estates are not subject to federal estate tax because the total estate value falls below the threshold amount of tax exemption. An estate is not required to file a federal estate tax return when its value is less than the exemption threshold amount.



Careful estate and tax planning can help avoid this.

**Example 1:** Single taxpayer John Jones owned 180 acres of woodland for 30 years near his home. When he died in 2015, his total estate asset was appraised to be \$200,000. Because his estate asset is below \$5.43 million, the amount that can be exempt from estate tax in 2015, there's no federal estate tax due. The person responsible for the estate affairs does not need to file federal estate tax return for the estate. If John's total estate asset was over \$5.43 million, the estate is subject to the federal estate tax (basically only the excess amount over the exemption threshold is taxed). The federal estate tax return must be filed. Generally, the return due date is within nine months after death of the owner. But the IRS may grant an extension of time. The federal estate tax form is Form 706.

For married couples, the amount of estate that can be exempt from the federal gift and estate tax doubles: married couples can save a total of \$10.86 million from gift and estate tax in 2015. Each year the amount of estate that is exempt from the estate tax is indexed for inflation.

Also, if the deceased spouse did not use all of his or her exclusion amount, the unused portion can be carried over to the surviving spouse. This is called "portability."

**Example 2:** Steven's total estate value was \$430,000 when he died in January 2015. Since the total amount of estate that can be exempt from the federal estate tax is \$5.43 million in 2015, he had \$5 million exclusion left unused upon his death. Mary, his surviving spouse, gets to use the \$5 million unused by Steven plus her own exclusion amount, which would total more than \$10 million.

To qualify for the portability, when the first spouse dies, the federal estate tax return must be filed on time (even if no taxes were due). On the estate tax return, an election to use the "deceased spouse's unused election amount" must be made.

### State Inheritance and Estate Tax

Some states impose inheritance or estate tax separately from the federal estate tax. For example, Maryland, New Jersey and Pennsylvania have state inheritance taxes. There may be situations where a federal estate tax return is not required because the estate falls under the federal filing threshold, but a state inheritance or estate tax return may be required due to the different filing threshold and requirement.

## Federal Gift Tax

The current federal law exempts from gift tax is the first \$14,000 you give to any person in one year.

**Example 3:** If Sanderson gave \$5,000 to her nephew in 2015, it is gift tax free. But if she gave him \$15,000 in the year, \$1,000 is subject to gift tax. But she may or may not owe gift tax, depending on whether she has used up her federal gift tax credit.

**Example 4:** Mary and Billy sold \$120,000 worth of timber in 2015. Billy would not owe gift tax if he gave \$14,000 to each of his three children in 2015, a total of \$52,000 gift without gift tax consequence. His wife, Mary, can do the same, which would bring a total gift of \$104,000 from Billy and Mary in one year gift tax free.

Currently in 2015, you are required to file federal gift tax return when you give a gift worth more than \$14,000 per recipient per year. The person who gives the gift is responsible for paying the gift tax; the recipient is not subject to either gift tax or income tax on the gift.

The gift tax is tied to the estate tax. Taxable gifts will be added back to the estate tax calculation (credits are given for any gift taxes paid), which reduces the tax exclusion amount available for estate tax.

If you make a gift to pay for tuition and medical expenses, such gifts are not taxable even if it's over \$14,000 as long as the gift is made directly to the provider.

**Example 5:** In 2015, after he had a timber sale, Jimmy made a \$20,000 gift out of the money received from the sale to pay for his daughter's college tuition. He paid directly to the college. Even if the gift is more than the \$14,000 gift tax exclusion amount, the \$20,000 is not subject to gift tax because the gift is made for tuition expense.

## Generation-Skipping Tax

The generation-skipping tax is levied when the asset is given to a person two or more generations below the donor. For example, the generation-skipping tax issue may arise when a grandparent transfer asset directly to a grandchild which "skips" over the grandchild's parent generation. This is a separate tax that may apply where a taxpayer would have avoided a level of estate tax by "skipping" over a generation and making a direct gift to a grandchild.

## Tax Returns for the Deceased

Other than the federal and state estate or gift tax returns, the person handling the estate may be required to file the final federal and state income tax returns for the deceased person. If the estate or trust receives income over the filing cutoff amount, the estate or trust may be required to file federal and state income return for the estate or trust. Each kind of tax return has its own due date.

## Appraisal

Even if you are not subject to estate or gift tax due to the large tax exclusion amount, it may be still a good idea to have the woodland professionally appraised by a consulting forester. This is because it may help avoid the income tax when the timber is sold later.

**Example 6:** Bill and Kelly own 422 acres of woodland. They



It pays to know the tax laws when harvesting timber, especially if the land was inherited.

paid \$100,000 for it in 1980. After Bill and Kelly died, their son Tom inherited the land. The total estate is less than the federal estate tax exclusion amount and thus was not subject to the federal estate tax. He hired a professional forester to appraise the timber value and volume on the date of death, which became his basis ("cost") for the timber under the tax law. The timber was appraised at \$250,000. Three years after Tom inherited the land, he decided to sell timber to pay for a house down payment. The timber was sold for \$270,000. Because the timber basis was \$250,000, and the sale price was \$270,000, Tom only has a long term capital gain (assuming the sale qualified for capital gains) of only \$20,000. The increase in value from \$100,000 to \$250,000 escapes taxation.

If you have not established the timber basis when you inherited the property, you may establish it retroactively. Keep the professional appraisal as part of your important tax records.



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