

Forestry Income Tax Series: Setting up the Books Using a Tree Farm Journal

Few small-acreage landowners keep adequate records on their timberland. Keeping records for your forestland doesn't have to be formal or complicated, as you will see.

In this publication, we discuss setting up a tree farm journal to record expenses, income, and activities. This is the first step in keeping good records.

Why Keep Records?

As a forest landowner, you need to keep records so you can deduct legitimate expenses, reduce taxes on timber sales income, and recover reforestation costs. The IRS expects you to have reasonable records and may penalize you if you don't. Keeping good records lets you determine your return on your investment. It also provides needed information for your heirs if the forestland is a family asset. This information will help them make better decisions and provide the necessary information for them to be able to take full advantage of the special timber tax provisions.

What Records MUST You Keep?

The official answer is "sufficient records so that you can prepare a complete, accurate, and auditable income tax return." In other words, you need to keep enough records to satisfy the tax man—bills, proof of payment, and receipts to back up your deductions. If these assorted records are going to be useful, you should keep them in a format that will let you easily file taxes, respond to an IRS audit, and figure taxable gain or loss when you sell any timber. You can keep these records in a formal set of books or in a more informal way, such as in a tree farm journal.

How Long Should You Keep Records?

For yearly operating expenses deducted annually, you can generally throw out receipts and proofs-of-payment after 3 years (or 6 years in case of audit). Even if you choose to throw out old receipts, you should still have these amounts recorded in your tree farm journal and/or in specific accounts. This will help you figure your return on your investment, track costs, and show the IRS you own timber as an investment or a business, not as a hobby.

Capital expenses are different. Capital expenses are investments in long-term assets, such as land or timber. For example, the cost of establishing a new forest is a capital expense. For these expenses, you'll need to keep records as long as you own the asset, plus 6 years in case of an IRS audit. If you use the special tax provisions to recover reforestation and site preparation costs, keep the receipts for at least as long as you are recovering costs plus 6 years—8 years of amortization plus 6 years.

Capital expense records help determine your basis or investment value. This basis is deducted from the sale of these assets to determine net taxable gain. If you don't have these records, you'll find yourself needlessly paying more in taxes when you sell timber or sell land.

IRS Categories and Record Keeping

The IRS categorizes owners of timberland as hobby owners (personal use), business owners, or investors. Each category has its own characteristics and rules for treatment of timber income and expenses. Your category will help determine what records you need to keep for your forestland.

If you are a business owner, you must keep records of the amount of time you spend on forest management, as well as financial records. Investors and hobby owners do not need to keep time information for tax purposes, but they do need to keep financial records. For more information on IRS categories, consult Agricultural Handbook 731 Forest Landowner's Guide to the Federal Income Tax, available from the U.S. Government Printing Office or www.timbertax.org.

Where to Start

Keeping good records for your forestland does not have to be complicated. You can start with a tree farm journal—a simple, chronological list of expenses, income, and activities. If you are a landowner with a limited amount of timberland and few yearly expenses, a tree farm journal, along with land and timber accounts, will be sufficient.

How to Set Up Your Tree Farm Journal

The first step in setting up your tree farm journal is to buy a ledger—a spiral-bound notebook will be fine. Tape a large envelope on the back cover to hold receipts and bills until you can record them in your journal. Then you can move them to a more permanent storage spot in case of an IRS audit. A good permanent place to keep them would be in a shoe box or an accordion check file, sorted by category.

You'll record the amounts of these bills or receipts in your journal, along with other chronological entries about your activities on your forestland. You will be writing down the date, activity, purpose, and amount of money involved. Remember, if you are a business owner, you'll need to keep a time record, so the tree farm journal is a good place to jot down the hours you spend on your forest business. Keep the journal handy, where it will be easy to jot down notes and where you'll see it every day.

Example of a Tree Farm Journal for Hilltop Woods

Let's look at a comprehensive example of record keeping. Serotina Pine has decided to purchase 320 acres once owned by her grandfather. She plans to treat the property as a timber business, so she knows she will need to keep records of the time she spends on her timber business. Ms. Pine has two daughters, Blanche and Virginia, and she plans to leave the forestland to them. Therefore, she wants to make sure the records she keeps will help them assume management of the property and understand the financial value of their forestland.

Ms. Pine makes sure to identify the experts she consults about her property in her entries. In case she is unexpectedly unable to manage her property, Blanche and Virginia will know whom to contact for help. When she sets up her journal, she decides which expenses will need to be totaled each year. Her only recurring expense will be for travel, so she includes a column for mileage. She also includes a column to total her hours each year. Let's look at her journal entries as she purchases her property, named Hilltop Woods.

Example of Hilltop Woods Tree Farm Journal – Acquisition Costs

Date	Activity (what, when, why, how long, where, who was involved)	Hours ¹	Miles ²	Expense	Revenue
4/15/15	James Barrow offered to sell Grandfather Frank R. Bowen's land in Martin County to me for \$438,000. One hour spent discussing the sale with James.	1			
4/25/15	Hired forestry consultant Mark M. Good to cruise the timber on the property. Met him on the place to show him the corners and lines.	4	48	\$1,500	
5/15/15	Hired Frank Bucket of Rural Realty Inc. to do a land appraisal. Bucket recommended by Dewey Howe, attorney. Met him on the property to discuss the work.	4	48	\$1,500	
5/18/15	Hired Dewey Howe to perform title search and prepare deed.	2	37		
6/4/15	Met with Barrow and offered \$425,000 for property. After negotiation, he agreed to sell property for \$432,000 if deal can be closed by July 31.	4	48		
6/14/15	Hired Line M. Up Surveyors to survey property and mark land lines. Surveyor Bill Brantley, recommended by Uncle John Barnes.	1		\$1,250	
7/17/15	Purchased Hilltop Woods for \$432,000. Deed signed and recorded in Martin County Courthouse.	6	48	\$432,000	
7/30/15	Paid Howe for title search, title insurance, and deed work associated with purchase of Hilltop Woods. Set up land & timber accounts as per Ag. Handbook 731, using Form T Forest Activities Part I.	2		\$5,000	

¹Only business owners need to record hours to prove material participation.

²(Total miles) x (federal rate) = deductible mileage expense.

Keeping Up the Tree Farm Journal

Ms. Pine continues to keep her journal after purchase because she wants to have records of her operating expenses. She also continues to keep track of the time she spends on her property, since she is a business owner and she wants to document material participation. She keeps her receipts in the envelope she has taped on the back of the notebook until she files them in her file box. Here are a few examples of her recorded expenses:

Conclusion

Keeping records for tax and management purposes doesn't have to be complicated. The first step is a tree farm journal to detail your expenses and activities as they occur. Consistent record keeping makes it easier to take advantage of all your income tax breaks. These records are also helpful to your heirs if the property is a family asset. Start your own tree farm journal to make sure you and your heirs are able to deduct expenses and report income correctly and confidently.

Example of Hilltop Woods Tree Farm Journal – Management Costs

Date	Activity (what, when, why, how long, where, who was involved)	Hours ¹	Miles ²	Expense	Revenue
8/1/15	Paid subscription to Mississippi Forestry Association, Forest Landowner Association.	1		\$135	
8/14–15/15	Virginia, Blanche, and I brushed out and marked landlines with orange paint. Put up posted signs – \$215. Paint, brushes, drawing knife, machetes, and brush hook – \$415. Paid daughters \$130 each for 16 hours of work.	19	68	\$890	
9/1/15	Reading MFA's Tree Talk magazine.	2			
11/14/15	Forestry Commission prescribe-burned 50 acres. I showed the lines, watched the burn, and walked lines afterward.	10	48	\$1,900	
1/27/16	Worked on tree farm journal and records.	3			
2/2/16	Reading Forest Landowner magazine.	3			
2/12/16	Attended Woodlands Management Short Course, MSU Extension county office, Brandon, MS.	11	71	\$25	

¹Only business owners need to record hours to prove material participation.

²(Total miles) x (federal rate) = deductible mileage expense.

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