Capital Expenditure Recovery

Chapter 3

Capital Expenditure Recovery

- Land account
- Depreciation – MACRS
- Section 179 deduction
- Timber (cost) depletion
- Reforestation amortization
- Investment tax credit (ITC) -- Repealed
- Fertilizer

Land Account

- Land account – assets include the land and non-depreciable improvements
- Basis in recovered only when land is sold or otherwise disposed of
- Cost of protecting title and combating adverse possession is capitalized into the land account
  - See Anderson Tully
  - And Wacker cases

Depreciation

- General rule – annual deductions may be taken for
  - "Property" used in a business or
  - Held for production of income (i.e., an investment)
- Property must have a limited and determinable useful life
- It must either wear out, decay, get used up, become obsolete or lose value from natural causes [IRC §167(a)]

Depreciation Methods

- MACRS – Modified accelerated cost recovery System
- Unit of production .. deductions taken proportionally over life of timber operations
  - e.g., temporary logging roads, culverts, etc.
- There are no timber related rules, except for depreciation on equipment for permanent roads and reforestation. Avoid by using vendors.

Timber Related Real Property

- IRC § 611 authorizes depreciation deductions for timber related improvements
- Generally, depreciation methods applicable to all taxpayers apply to timber-related real property improvements – IRC § 168
- E.g., temporary roads, bridges, fences and culverts may be depreciated over a MACRS 15-year recovery period

Section 179 Deduction

- 2002 -- $25,000 of qualifying property may be deducted if associated with an "active business"
- Estates and trusts are not eligible.
- 2008 -- Economic Stimulus Act -- deduction increased to $250,000
- 2010-11 – Limit increased to $500,000 by the Small Business Jobs Act of 2010
- 2012 Relief Act -- § 179 $ limitations for 2012 and 2013 is $500,M; investment limit is $2MM
- Deduction reverts to $25,000 after 2013, but is increased to $500,000 in 2015. See additional page

Timber Depletion

- Generally, taxpayers can recover their investment in property tax-free when sold
- The gross sale proceeds are reduced by the basis in the property sold
- Same principle applies to timber – if all timber is sold, entire basis is recovered
- If only part of timber is sold, basis is **"equitably apportioned"** to part sold (Part II of Form T)
  - See p 3.6

Depletion Rules

- Most timber dispositions involve non-fungible trees – e.g., mature trees are cut and less mature growth is retained
- IRC has special “depletion” rules that allocate the trees cut as a portion of those that remain
- Depletion is used in two ways
  - “Allowable as basis of sale” and
  - Depletion deemed to be the “basis allocable” to the timber cut – IRC § 631 (See p 3.7 & Form T Part II)

Recovery of Timber Basis

- Taxpayer needs to know:
  - **Adjusted basis** in timber account – original basis plus purchases, transfers and capitalized cost; and less sales, gifts and involuntary conversions
  - **Total volume** in timber account – original volume plus growth, purchases, and transfers; less sales gifts and involuntary conversions
- See Part II of Form T for method of calculation

Depletion Calculation

- The **depletion unit** equals
  - Adjusted basis divided by the total volume
  - It is the $ investment per unit of timber measure
- D**eductible basis** for timber sold or disposed of
  - The depletion unit times the number of units cut, sold, or otherwise disposed of
- Results are identical whether a lump sum sale or a disposal under IRC § 631(b) are used

Amortization Election

- Complete Depreciation and Amortization Form 4562, part VI and attach to return
- Or, attach similar information to inputs required on Form T, Part IV on a plain sheet of paper
- Election must be made on a timely filed, but cannot be made on an amended return
- Investors take deduction on front page of Form 1040, and businesses use Schedule C or F
  - See p 3.9

Expensing and Amortization
After 10/22/04

- Qualified reforestation expenditures up to $10,000 per year may be expensed for each “qualified timber property” (QTP), defined as one having a unique “stand identifier”
- Forests with a name, location, management units and stand designations have “unique stand identifiers”
- Break along roads, SMZs, site characteristics, etc.
- Amounts exceeding $10,000 may be amortized
- Expense deductions are subject to the passive activity loss rules – business must be active

Unique Timber Property (QTPs)

- Using Form T, Part IV, Line 4a constitutes an election to expense reforestation costs with
  - Stand identifier -- block, etc.
  - Activities – site prep, planting, etc.
  - Acres treated
  - Total expenditures
  - QTPs must be kept separately and given a “unique stand identifier

Investment Tax Credit Repealed

- ITC linked with amortization for reforestation was repealed on October 22, 2004

Revenue Ruling 2004-62 Revises Treatment Of Fertilizer

- IRS's withdrawal of GCM 39371 signaled a lack of agreement on fertilizer, and with no published authority, policy was left to district supervisors
- Generally, it was capitalized when reforesting, but, expensing in established stands was based on the useful life of fertilizer
- Following Rev. Ruling 2004-62, taxpayers may expense fertilization in established stands