

Income Tax Treatment of Forest Carbon Credit Payments to Landowners

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Tax Is Important to Private Forests

- Tax is consistently listed as one of the top concerns for private woodland owners

Selling Carbon Offset Ranked Top by Woodland Owners

- **Income from selling ecosystem services—especially carbon offset—are hot issues**

From USDA Forest Service, National Woodland Owner Survey

Private Forests Key for Carbon Offset

- **Domestic forests absorb about 10 percent of US fossil fuel emissions**

From New York Times and Land Trust Alliance website

General Tax Principles

- **Income: capital gains better than ordinary income**
- **Loss: ordinary loss better than capital loss**

Tax Rates

- **Ordinary Income:**
10% - 35%
- ***Long-term* capital gains:**
0% - 15%

Tax Status Is Key

- **Timber property is taxed either as:**
 - **an income-producing property (i.e. investment) or**
 - **a business**

Forms of Forestry Carbon Projects

- Individual forest landowners contract with aggregator to create a pool to be sold via the CCX

For example: landowners in the South was reported to receive checks for carbon credits sold, averaging \$1,000 per owner

From the Forestry Source, December 2008

Requirements of Forestry Carbon Projects

- Enrolled forests are to be maintained by set standards
- Requires third-party verification by authorized verifier
- Acceptable forestry projects include
 - Afforestation (planting trees)
 - managed existing forests
 - long-lived wood products

From the Forestry Source, December 2008

How Forest Carbon Payment Is Taxed

- **Currently there are no clear guidance from the tax law or rules**
- **Thus reporting of carbon offset income may vary case from case**

1) Ordinary Income

- If forestry carbon offset is an incidental part of timber holding, carbon income may be ordinary income
 - As “other income” by timber investment or business taxpayers

1) Ordinary Income (Cont'd)

- For timber growing business filers, ordinary income is subject to self-employment taxes
 - on Schedule SE
 - about 2.9%-7.65% on net profit

2) Rental/Royalty Income

- If forestry carbon offset is treated like a lease (e.g. a hunting lease), the carbon income could then be rental income
 - Rental income are *ordinary* income but
 - It is not subject to self-employment tax (while ordinary business income does)

3) Is Carbon Offset a Capital Asset, Inventory or Intangible Asset?

- **Capital gains apply to sale of “capital asset” and “business use” asset**
 - **“Capital asset” include all property, such as:**
 - personal ([house](#), [car](#)) or investment ([stocks](#), [timber](#)) property, with a list of exceptions:
 - [inventory](#) or [property used in business](#) (such as [business truck](#))

3) Is Carbon Offset a Capital Asset, Inventory or Intangible Asset?

- **Typical byproduct from timber is ordinary income**
 - **Firewood, nuts, maple syrup (Revenue Ruling 56-434)**
 - **An exception: capital gains is provided for tree stumps from cutover land held as investment (Revenue Ruling 57-9)**

Deduction of Establishment Costs

- **Costs in developing the property for carbon offset are capital costs that may not be written off in whole in the year it was incurred**
- **You must deduct them over a period of time**

Deduction of Operating Expenses

- **Ordinary and necessary expenses are deductible:**
 - **Forester's fee**
 - **Verification fee**
 - **Other compliance costs**

Tax Resources

by US Forest Service

- **National Timber Tax Website:**
www.timbertax.org
- **Provide timber tax workshops**

Tax Publications

by US Forest Service

- Annual Timber Tax Tips
- The Forest Landowner's Guide to the Federal Income Tax
- Federal Income Tax on Timber: A Key to Your Most Frequently Asked Questions
- **2009 Edition: Estate Planning for Forest Landowners—available now**