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- Investment tax credit (ITC) -- Repealed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)]
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.
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).
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
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
The depletion unit equals
- Adjusted basis divided by the total volume
- It is the $ investment per unit of timber measure

Deductible 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
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”. Note that managed forests with a name, location, management units and stand level designations have “unique stand identifiers”.

- Amounts exceeding $10,000 may be amortized.
- Expense deductions are subject to the passive activity loss rules – business must be active.
ITC was 10%; coordinated with amortization

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
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.