

Christmas Trees



Agriculture Handbook 718,
pages 91-94

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Facts about Christmas Trees



- 32.8 million households in the United States purchased a live-cut Christmas tree in 2005
- 36 million live-cut Christmas trees are produced each year, and 98 percent of these trees are shipped or sold directly from Christmas tree farms

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Facts about Christmas Trees



- **Top producers:** North Carolina, Oregon, Michigan, Washington, Wisconsin, Pennsylvania, New York, Minnesota, Virginia, California, and Ohio. (Christmas trees are grown in all 50 States).
- There are more than 21,000 growers of Christmas trees in the United States, and approximately 100,000 people are employed in the live-cut Christmas tree industry
- The retail value of all Christmas trees harvested in 2005 was \$1.4 billion

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Generally

- Most Christmas tree producers are subject to the same Federal income tax provisions as timber owners.
- The term "timber" includes evergreen trees that are more than 6 years old at the time severed from their roots and sold for ornamental purposes. This definition includes Christmas trees.

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However ...

- The reforestation deduction and 7-year amortization do **NOT** apply to Christmas trees.

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Business or Investment?

- Christmas tree growing generally constitutes a “trade or business”. As such, capital gains treatment depends on qualifying under Section 631 (a) if you cut the trees yourself, or Section 631(b) if you sell the trees “on-the-stump”. The rules are the same as for any timber grower.

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Business or Investment?

- It is possible, but unlikely, that a person who sells standing Christmas trees on an occasional basis could be considered an investor. In that case, the rules for investors apply.

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Operating expenses & carrying charges

- The rules for deducting timber-related operating expenses and carrying charges apply to Christmas trees if the trees are more than 6 years old when cut or sold.
- Since Christmas tree growing is almost always a business, the favorable rules for deducting business costs are applicable; however, the passive loss rules apply.

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Timber Sale Income

- Income realized from the sale of Christmas trees is subject to the same rules as timber. However, there are some unique aspects that must be considered.

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Timber Sale Income

- Section 631(b)— Use Section 631(b) to report capital gain for **STANDING** trees.
 - ◆ Usually, the unit of measurement would be the individual tree, or expressed in terms of linear feet.
- After December 31, 2004, Christmas trees sold “lump sum” qualify for capital gains treatment under Section 631(b).

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Timber Sale Income

- Section 631(a)—use this provision to report sale proceeds as capital gains of **CUT** Christmas tree for the wholesale market.
 - ◆ It is immaterial whether you cut the trees yourself or hire someone to cut them.

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Determining Fair Market Value

- Under Section 631(a), you must determine the fair market value (FMV) of Christmas trees on January 1 (or the first day of your tax year) of the sale year.

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Example: Christmas Trees

- You are a calendar year taxpayer who own 11,000 mature Christmas trees with an adjusted basis of \$2,270 (\$.21 depletion unit). You sold 6,000 trees for \$4.30 each in November and incurred \$1,800 cut and sale expenses.

*Adopted from Example 11-1, Ag. Handbook 718, p.93

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Example: Christmas Trees

- Since you are selling **CUT** trees, you correctly elect to treat the cutting and sale as a Section 631(a) transaction.

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Example: Christmas Trees

- The value on January 1 can be estimated by discounting the value when cut for 10 months as follows:
 - ◆ Assume the trees are worth \$3.60 each on November 1 when cut.
 - ◆ the applicable local interest rate is 6%.

Then on Jan. 1, the tree is worth:

$$\frac{\text{Value}}{(1+(i/12))^N} = \frac{\$3.60}{(1+(.06/12))^{10}} = \underline{\underline{\$3.42}}$$

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Example: Christmas Trees

- Gain from standing timber:

6,000 trees X \$3.42 per tree as of Jan. 1	\$ 20,520
Less basis of \$0.21 per tree	- \$ 1,260
Gain on timber (taxed as capital gain)	\$ 19,260

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Example: Christmas Trees

■ Gain on sale of cut trees:

6,000 trees sold at \$4.30 each	\$ 25,800
Less:	
6,000 trees x \$3.42 per tree as of Jan. 1 st	– \$ 20,520
Cost of cutting and delivery	– \$ 1,800
Gain (taxed as ordinary income)	<u>\$ 3,480</u>

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Example: Christmas Trees

- If you decide to sell the **STANDING** trees to a jobber, rather than harvest them yourself, how do you determine your taxable gain?

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Example – Sec. 631(b)

- This is a sale of standing Christmas trees, use Sec. 631(b) to report the sale as capital gains

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Example: Christmas Trees

6,000 trees at \$3.60/tree	\$ 21,600
Less:	
Basis of \$0.21 per tree	– \$ 1,260
Sales expenses	– \$ 120
Gain	<u>\$ 20,220</u>

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