

# TIMBERLAND AND STANDING TIMBER

## "EXCHANGING THIS VALUABLE RENEWABLE (AND GROWING) RESOURCE"



To qualify for tax deferral under Internal Revenue Code §1031, both the property relinquished and the property acquired in the exchange must be "like kind" and the taxpayer must hold the properties "for productive use in a trade or business, or for investment." Property held primarily for sale (or inventory) is not held for use in a trade or business or for investment. With respect to real estate, the IRS and courts have construed the "like kind" requirement broadly such that an interest in a parcel of real estate is generally like kind to all other interest characterized as real estate under state law, whether such real estate is improved or unimproved. Subject to a few exceptions, real estate will be considered like kind regardless of the use put to the land. Thus, a fee interest in raw land can be exchanged for a fee interest in parcel improved with a commercial building or a parcel with standing timber. See e.g., Rev. Rul. 78-163 approving an exchange of timberland owned by a producer of forest-related products for bare land of lesser value owned by a state. See also, Rev. Rul. 72-515 approving an exchange of unencumbered fee title to timberlands that differed in timber quality and quantity.

Ordinarily, growing timber is considered part of the land. In *Hutchins v. King*, 68 U.S. 53, 59 (1863), the Supreme Court stated that "timber growing upon the land constituted a portion of the realty. Additionally, in *Laird v. United States*, 115 F. Supp. 931 at 933 (W.D. Wis. 1953), growing timber was part of the land. Thus, the quantity, quality, age and/or species of timber may relate to the grade or quality of the timberland, but does not impact the question whether the timberland is like kind to other real estate, whether or not the replacement land is timberland. See Rev. Rul. 72-515 and PLR 200541037 where the IRS ruled that a fee interest in timberland is "like-kind" to a scenic conservation easement under §1031. See also PLR 8621012 and Rev. Rul. 78-163 approving an exchange of timberland owned by a producer of forest-related products for bare land.

Despite the generous definition of like kind in the context of real estate, however, there are a few areas where some care is warranted to ensure that the like kind requirements are satisfied. One such area is an exchange of an interest in land for an interest in cut timber or timber to be cut. In *Oregon Lumber Co*, 20 TC 192 (1953), acq., the Tax Court considered a case in which a timber harvesting company exchanged certain timberland with the United States government for the right to cut certain timber marked for cutting on other timberland owned by the United States. The exchange agreement contained a provision obligating the exchanger to cut certain timber marked for cutting within a certain time period. The Tax Court decided that the conveyance of timberland for other timber land owned by the federal government was not like kind because: (i) under Oregon law, the right to cut timber is a right to acquire goods only (personal property), and (ii) under the exchange agreement at issue, the exchanger acquired the right (and the obligation) to cut timber marked for cutting and such right was limited in duration. Thus, cut-over timber land for a right to cut timber on another person's land. One is a fee interest in real property; the other, under local law, is an interest in personal property. Similarly, in a 1995 Technical Advice Memorandum, the IRS considered whether an exchange of standing and cut timber located on 60 acres owned by the exchanger for a fee interest in three parcels of timber land qualified as a like kind exchange. Since the relinquished property consisted of a conveyance by "timber deed" of all standing a cut timber located on the 60 acres that would be removed within a specified period (any remaining timber reverted to the exchanger), the relinquished property consisted of personal property. The two-year contract period amounted to a de facto restriction on the number of trees that could be removed, so the duration of interests was dissimilar. TAM 9525002.

In a properly structured transaction, standing timber can be exchanged for other qualifying real property interests. The question of whether a property interest is personal property or real property is resolved under state law. Differences in state law do exist, so competent legal counsel is necessary whenever fee title to the property is not being sold. Factors to consider when timber interests are exchanged include:

1. Is the timber right being conveyed limited or perpetual?
2. Are the timber rights being conveyed with a fee interest or pursuant to a lease with a term greater than 30 years including options?
3. Are rights to cut timber in the nature of a service contract as opposed to a property right?
4. Are the rights to harvest timber conveyed by deed, or bill of sale or license agreement?
5. Does the conveyance instrument contain an obligation to cut and remove timber?



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