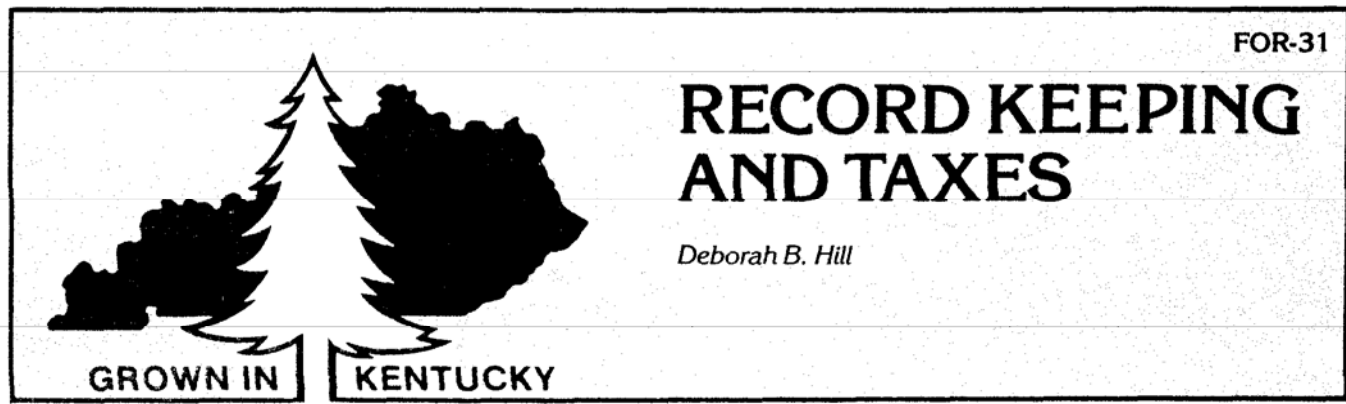


KENTUCKY CHRISTMAS TREE PRODUCTION WORKBOOK

FOR-31



When you are planning to produce Christmas trees as a crop, two kinds of records are important to keep: 1) financial records — detailed documentation of materials, labor, equipment, etc., primarily for tax purposes; and 2) plantation records — equally detailed information on planting, maintenance, spraying, etc.

Financial Records

You should begin to keep financial records on your Christmas tree plantation from the moment you start seriously planning it. Costs of attending workshops and meetings, and costs of materials to help you with your plantation (ground cover seed, Pest Manual, Tax Manual, other manuals) should be recorded. You should keep detailed records (including receipts) of materials and equipment purchases, and of labor.

If you and your family perform the labor, you still should estimate an hourly dollar wage for the various tasks involved. Hiring the family keeps more of the costs and profits within the plantation owner's control. Whatever income from the tree crop gets shifted to lower-income bracket family members reduces your total tax bill, and if you hire your spouse, you can also reduce your tax bill by up to \$1750 for an IRA account. If your family business is **NOT** incorporated, you don't have to withhold FICA taxes, but if it is, you do—note comments below on incorporation. If your family business is substantial—say, a whole farm production business with Christmas trees as one of many crops—family members working for the family business are eligible for whatever benefits you might have for non-family employees, such as medical insurance, bonuses, etc.

Having family members working in the family business requires some specific responsibilities also. Spouse and other family members must be paid a fair wage for their labor—these wage monies should be recorded separately from other household monies. Ideally, working family members should have their own

social security numbers and should have regularly scheduled work periods and pay periods (whatever per hour, per day, per week or per month). Work requirements for family members should be reasonable and consistent with their ages and abilities, particularly where children are involved.

Record keeping for materials and equipment costs, as well as for labor, are important when it comes to taxes. The major tax points for Christmas tree growers are capital gains tax (on the crop), allowable deductions, and proper filing for wholesale, retail and "choose-and-cut" operations.

When the Christmas tree crop is harvestable, income generated from sale of trees is currently eligible for **capital gains tax**. This means the crop is taxed on only 40% of its actual value. The restrictions on using the tax are that (1) you must have owned the land on which the trees grow for at least a year and that (2) the trees are six years old (from seed). Make sure you record age of seedlings when planting—for example, KDF white and Scots pine stock are 2 years old, but Virginia pine stock is only one-year-old. Ages of planting stock from commercial nurseries will also vary.

Legitimate **deductions** for Christmas tree products include the following (list on Farm Income and Expenses IRS Schedule F):

- vegetation control equipment and chemicals
- pesticides
- fertilizer
- real (personal) property taxes
- payroll taxes
- annual labor costs for pruning and shearing
- transportation of labor to plantation.
- gas and oil
- equipment rental
- depreciation on owned equipment

At present, these can be deducted on an annual basis. However, tax law is always changing, so check with a

reputable CPA or tax lawyer to see what the current rules are.

Filing—Declaration of your crop for tax purposes varies with method of sale. Since they are trees, the cutting and sale of Christmas trees are taxed under IRS Code, Sales and Exchanges, Section 631: "Gain or Loss in the Case of Timber," Sections A and B. Section A pertains to cutting and selling your own trees, as in a wholesale or retail operation. The first time you file under this section, you **MUST** state on the tax form that you "elect to treat the cutting of (Christmas trees) as a sale or exchange," which makes the income eligible for capital gains treatment. You should not have to repeat the statement of "election" in subsequent years, but it probably wouldn't hurt. Section B pertains to selling the trees "on the stump" and applies to a "choose-and-cut" operation. It is not necessary to "elect" for sale with Section B—it is automatically assumed that type of sale is eligible for capital gains. (See For-34 for reference on Christmas Tree tax manual.)

Additional notes regarding taxes in special situations include the following:

- If you form a partnership (oral or written) to grow your trees, be sure to file a partnership tax return, especially for Section 631A. If you do not do so you can lose the option to capitalize your profits for three years. It is advisable to carry term life insurance for a partner. Remember, Christmas trees are a long-term crop, relatively speaking, and you never know what can happen in 10 years.
- You can deduct financial losses of the Christmas tree plantation as a whole during the production phases, until the trees reach the size/age of harvesting, without violating the hobby law.
- If your trees are killed by drought, you can deduct the loss as a casualty loss. If you replant for those lost trees, either recapitalize the crop or expense the original trees and write them off on Schedule F as dead tree expense.
- If you **lease** land for your plantation instead of buying land (see attached model lease agreement), note the following:
 - a) Check for pH, fertility, problem ground covers (fescue), drainage, etc. on the proposed lease land.
 - b) Determine your harvesting/marketing options for sale of trees—places to park cars or to yard (stack) cut trees, access to highways, etc.
 - c) Check for liens against property; **you** must deal with the legal owner, regardless of who has it under contract.
 - d) Have **your** lease recorded in the local county so that you will be a prior lienor if the landowner declares bankruptcy.
 - e) Draw up a formal contract, complete with begin-

ning and ending dates (it can always be updated), delegation of responsibility (e.g., you raise trees; they keep all access open), liability responsibility, etc. Have documents checked by lawyers for both sides and notarized.

- f) pay landowner on basis of crop value percentage, not rental on an annual basis. This reduces your costs before you get a return on your investment and also gives the lessor some financial responsibility for losses.

- Live trees (B + B) do not fall under Section 631A and B. Ask your CPA or tax lawyer about taxes on ornamental or nursery stock.

- **KEEP UP TO DATE ON CHANGES IN TAX LAWS REGARDING TIMBER SALE (631A and B) ESPECIALLY WHERE CAPITAL GAINS ELIGIBILITY IS CONCERNED.** If the laws change so that capital gains treatment for Christmas tree crop profits is no longer allowed, you may wish to incorporate your business to protect yourself from being eaten up by taxes.

Plantation Records

Financial records will be more economically important to you on an annual basis, but records of how your plantation grows may be as important, if not more so, to the continuation of profitable Christmas tree production. Ideally, you should have at least a rough map of your plantation, indicating how many trees of what species you have where. Keep track of the following **at least** on an annual basis:

- seedling origin, age, and cost
- planting schedule—date(s) and methods used (equipment, use of hydrogels, etc.)
- survival percent of trees, by species
- establishment of ground cover(s)—materials used, date(s) sown and rate of sowing (lbs/acre), percent coverage, special problems
- weather records (daily high temp/low temp; rainfall; note unusual events (high winds, heavy rains, tornadoes, hail, etc.))
- mowing schedule—date(s), equipment used, etc.
- pruning/shearing—date(s) of activity, equipment used, lengths of leaders and upper whorls
- use of herbicides and/or pesticides (fungicides, insecticides, miticides)—which chemicals at what formulations, calibrations used in applicators, date(s) of application, observation of results
- pest problems—insect, disease, bird, mammal, other
- problem areas (is there one part of the plantation that seems to have more problems than others—a wet spot, a dry spot, a low area, etc.?)
- harvesting/marketing date—numbers sold, species

It wouldn't hurt to keep a photographic record of the different stages of growth and of various cultural activities, also. Some of those could be done annually, some done only once or twice in the whole production process. Just as constant monitoring of your plantation will

help you catch problems early on and enable you to deal with them effectively while they are small, keeping records of what you do from year to year will give you a head start on continuing useful practices and correcting errors efficiently.

MODEL TREE FARM LEASE

This lease, made this _____ day of _____, 19____, by and between _____ (hereinafter called "Owners") _____ and _____ (hereinafter called "Tenant"), in consideration of the mutual promises contained herein, said parties agree that:

(1) Owners lease to Tenant for the purpose of growing and selling trees, _____ acres, which is a part of the following described premises (hereinafter called "Tree Farm") situated in _____ County, State of _____, more particularly described as follows:

(2) The parties agree to lease said Tree Farm, pursuant to the terms of this lease, for a term of _____ years, commencing on the first day of _____, 19____, and expanding to, and expiring on, the first day of _____, 19____, unless terminated or extended as otherwise provided in this lease.

(3) During the term of this lease, Tenant shall have the exclusive possession, use, control, operation, and management of the Tree Farm. Tenant shall be solely responsible for: management of the Tree Farm; and business conducted on or in connection with the Tree Farm; all costs and expenses directly related to use, control and management of the Tree Farm by Tenant; and all things necessary for Tenant's operation of a business on, or in connection with, the Tree Farm.

(4) As rental for lease of the Tree Farm, Tenant shall pay to Owners a portion of the value of all trees grown on the Tree Farm by Tenant during the term of this lease. Owners' share shall be computed in the following alternative manner, depending on the ultimate use and disposition of such trees by Tenant in its business:

(a) Twenty percent (20%) of the current wholesale value for each type of tree cut or dug for resale (other than retail sale on the Tree Farm); OR,

(b) Ten percent (10%) of the current retail price received by Tenant for each type of tree cut or dug for retail sale on the Tree Farm; Or,

(5) The parties agree and intend that a tree cut or dug for purpose of retail sale or wholesale shall entitle Owners to receive remuneration from Tenant for each such tree by December 31 in the year each such tree is actually harvested for such retail sale or wholesale resale.

(6) In the event that Owners and Tenant cannot reasonably agree on the current wholesale value of such trees, two independent appraisers, possessing knowledge about the specific type of trees planted and their current wholesale value, shall be engaged to make independent appraisals as to each type of tree's current wholesale value, as they then stand in the field. Owners and Tenant agree that the average of those two appraisals shall then be considered the wholesale value for each type of tree. Owners and Tenant shall share equally in the cost of said appraisals.

(7) Owners and Tenant covenant they have entered into this lease with the understanding that Tenant shall own all trees grown on the Tree Farm until such trees reach maturity, at which time they will be sold or otherwise disposed of by Tenant. Owners shall receive payment from Tenant for such trees, as provided in Paragraph 4. Owners further understand that Tenant may plant some trees which are intended to be sold or disposed of prior to their maturity. Such plantings shall be called "Nursery Stock", and are an exception to those intended to be grown and sold or disposed of at maturity. Owners shall receive payment from Tenant for Nursery Stock sales in the same manner as set forth in Paragraph 4.

(8) If such trees grown on the Tree Farm by Tenant are severely damaged, destroyed, or reduced in value by fire, flood, wind, insects, disease or other calamities over which the Tenant has no control, thereby substantially reducing the number, value and/or quality of trees expected to be sold by Tenant, the Owners' total payments for same under this lease shall still be computed on the basis of the formula set forth in Paragraph 4.

(9) Owners shall pay all real estate taxes and assessments levied against the Tree Farm real estate, and shall maintain all existing fences on the Tree Farm. Tenant shall be responsible for, and pay, all personal property, gross income, sales or other taxes arising solely from its sale or other disposition of trees grown on the Tree Farm, or its operation of a business on the Tree Farm.

(10) Tenant may at any time sell, assign or otherwise transfer its interest in this lease, and in any trees grown by it on the Tree Farm, to any other person, provided that Owners are given a prior opportunity to purchase said interest of Tenant at their fair market value then.

(11) Tenant may at any time elect to terminate or abandon this lease by giving Owners at least thirty (30) days prior written notice of same, at which time all Tenant's rights to, and interests in, the trees grown on the Tree Farm shall revert to Owners, and Tenant shall deliver possession of the Tree Farm to Owners. After such time Tenant shall have no further responsibility or liability to Owners under this lease, including the obligation to make any further rental or other payments of any kind.

(12) Owners may elect to terminate this lease to be effective as of the end of the calendar year, upon giving at least thirty (30) days prior written notice of same to Tenant, and upon paying Tenant the value of all trees then grown by it on the Tree Farm. The payment price for same shall be not less than the fair market cost of replacing such trees at their maturity by Tenant, less the anticipated actual costs of growing such trees to maturity on the Tree Farm. Owner may also elect to terminate this lease to be effective prior to the end of the calendar year, upon giving at least ninety (90) days prior written notice of same to Tenant, but subject to Tenant's rights to fully harvest all growing trees on the Tree Farm during the calendar year, and Tenant's rights to receive the payment previously specified.

(13) Owners may sell, assign, mortgage or otherwise obligate all, or any portion of, the real estate included in this lease, provided that Tenant's rights and interests in this lease, the trees grown by Tenant on the Tree Farm, and the business operated by Tenant on or in connection with the Tree Farm, are preserved, protected and secured.

(14) Owners expressly covenant and warrant that Tenant, so long as it complies with the terms of this lease, shall peacefully hold, occupy, and enjoy possession of the Tree Farm during the term of this lease, without interruption or interference by Owners, or any person rightfully claiming under Owners, except as otherwise provided in this lease. In the event of interruption or interference with Tenant's possession for any reason by Owners, by any person rightfully claiming under Owners, by the legal owners of the Tree Farm premises (in the event that Owners shall default upon, or fail to fully perform, an installment contract purchase of real estate, including the Tree Farm premises) or by operation of law (such as condemnation), then this lease shall be deemed terminated and Owners shall promptly pay Tenant for the value of all trees then grown by it on the Tree Farm, with the payment price for same to be not less than the fair market cost of replacing such trees at their maturity on the Tree Farm. Owners further warrant to Tenant that Owners have full lawful authority to lease the Tree Farm and to enter into this lease, and Owners agree to indemnify and hold Tenant harmless from all damages, costs, fees and expenses resulting from any breach of this express warranty.

(15) This lease shall be binding upon, and inure to the benefit of, the heirs, personal representatives, assigns, and successors of the parties, in the same manner as upon the original parties.

(16) Neither this lease, any of its terms, nor any actions taken by the parties under it, shall be construed as creating a partnership, joint venture, agency or any other such relationship between the parties (except as landlord and tenant), and neither party shall be liable for any debts or obligations incurred by the other, unless mutually agreed in advance, in writing signed by both parties.

(17) Tenant shall have the right at any time during the term of this lease, to erect, maintain, and remove (at its sole expense), signs, lights, temporary fences, and moveable buildings or structures on or adjacent the Tree Farm, in connection with its business there, so long as same do not permanently damage Owner's real estate.

(18) All notices to be given under this lease shall be delivered to Owners at Owners' residence, _____, or such other place as Owners may designate in writing, and to Tenant at _____, or such other place as Tenant may designate in writing.

(19) This lease shall be executed in proper form for legally recording, and either party may record this lease at that party's sole expense.

(20) This lease contains the entire agreement of the parties, and there are no other understandings, verbal or otherwise. This lease may be amended at any time by the prior mutual written agreement of the parties.

IN WITNESS WHEREOF, the said Owners and Tenant have duly executed this lease on the date first written above.

OWNERS

TENANTS

State of _____ }
County of _____ } SS:

Before me, a Notary Public, in and for said County and State, on this _____ day of _____, 19____, personally appeared _____ and _____, over the age of 18 years, and also appeared _____, and each acknowledged the execution of the above and foregoing Tree Farm Lease as their voluntary, duly authorized, act and deed. Witness my hand and Notarial Seal on the aforesaid date.

My Commission expires:

Residing in _____ County.

Notary Public

This Instrument was prepared by:

Attorney at Law

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