Timber Income Tax

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Forestry Cost-share Payments

Chapter 6

Forestry Cost-share Payments

- An exclusion from gross income under IRC § 126 is provided for cost-share payments under various federal and state programs
- Timber owners should check with the NRCS, FSA, State Forestry Agency or Extension Service to discover which programs are currently available and funded. Such programs are constantly being modified.
- Begins on p 6.1

Applicability of IRC § 126

- Two administrative actions are required for § 126 to apply
  1) Secretary of Agriculture must determine that payments are for conservation or a related environmental purpose, and
  2) The Treasury Secretary must determine that they do not substantially increase annual income to recipient from the property
- No rent or compensation for services allowed
- Begins on p 6.1

Reporting Cost-share Payments

- Taxpayers have 2 options for reporting
  1) Include in income – pay income and social security tax; the amount qualifies for expensing up to $10,000 annual limitation on each QTP; excess may be amortized
  2) Exclude all or part by including a statement showing – cost of reforestation, amount of cost-share, date received, payment purpose, exclusion and how exclusion determined
- See p 6.2

What Can Be Excluded?

- Excludable amount is the greater of present value of the “right to receive” annual income from the affected acreage of two (2) amounts:
  1) 10% of the average annual income from the affected property for the 3 open tax years
  2) Or, $2.50 per acre times the number of affected acres
- See p 6.2

Calculation Of Exclusion

- IRS Regulations do not specify the method,
- But, the procedure for valuing farms and forests in IRC § 2032A is tacitly accepted by IRS
- Annual income is divided by applicable Farm Credit (formerly Federal Land Bank) interest rate; see IRS revenue ruling for applicable rates that are issued annually
- Because annual payment are real (net of inflation), discount rate should also be real
- See p 6.3

A Cost-share Example

- 100 acres is reforested for $15,000; Federal cost-share is $5,000, taxpayer harvested $30,000 in 3 open tax years, FCB interest rate = 6%
- With timber income, the **excludable portion** is $16,667 {[($30,000 ÷ 3)(.10)] ÷ 0.06}
- Without income, the excludable portion becomes $4,167 [(100 acres x $2.50) ÷ 0.06] – $10,000 is expensed, the remaining $833 must be amortized
- See p 6.3

Cost-share/Tax Interactions

- Excluded amounts may not be deducted, amortized, depreciated, or depleted
- Amounts spent on property created with cost-share are recaptured as ordinary income if disposed of before 20 years. Recapture is reduced by 10% per year after 10 years
- Generally, taxpayer gains benefits from exclusion by holding down AGI and potential for taxes exceeding available deductions from inclusion.
- Begins on p 6.3