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 are affected by the Forestry Land Enhancement Program (FLEP), Wetland Reserve, Wildlife Habitat Incentives and Environmental Quality, and after RR 2003-59, the Conservation Reserve (CRP) Programs
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
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; 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
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
**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 on applicable rates issued annually
- Because annual payment are real (net of inflation), discount rate may also be real
A Cost-share Example

- 100 acres is reforested for $15,000; FLEP 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 \left\{\frac{\left(\frac{30,000}{3}\times0.1\right)}{0.06}\right\}
- Without income, the excludable portion becomes $4,167 \left[\frac{\left(100\text{ acres} \times 2.50\right)}{0.06}\right] - $10,000 is expensed, the remaining $833 must be amortized
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 by exclusion.