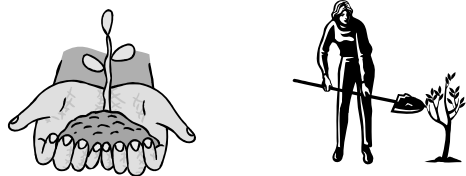


## Reforestation Tax Incentives

Ag. Handbook 718, pages 26-29  
Updated for Revenue Ruling 2003-59 and  
the American Jobs Creation Act of 2004



HEATHCLIFF



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## Reforestation Tax Incentives

- ▶ Incentives provided in the Internal Revenue Code reduce or eliminate the need to hold expenses associated with reforestation – or afforestation – in a capital account until you sell timber or timber products
- ▶ The American Jobs Creation Act of 2004 changed the nature of reforestation incentives

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## Reforestation Tax Incentives

- ▶ For reforestation done before Oct. 23, 2004, you could take a 10-percent reforestation investment tax credit on and amortize (write off) up to \$10,000 of qualifying expenses per year over 8 tax years
- ▶ For reforestation done after Oct. 22, 2004, you can deduct outright the first \$10,000 per year of qualifying expenses and amortize *any* additional amounts over 8 tax years

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### Who is Eligible

- ▶ Individual taxpayers, estates, partnerships, and corporations are eligible for both the deduction and amortization provisions
  - ✓ Trusts are not eligible for the deduction, but they are eligible for amortization

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### What Qualifies

- ▶ Reforestation expenses on tracts:
  - ✓ At least 1 acre in size
  - ✓ Located in the U.S.
  - ✓ Held to produce commercial timber products
  - ✓ Includes practices to encourage natural regeneration

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### What Qualifies

- ▶ Reforestation expenses reimbursed under an approved public cost-share program that you *do not* elect to exclude from your taxable income
- ▶ Until 2003 this *always* included CRP cost-share payments, because all CRP payments had to be included in gross income

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### What Qualifies

- ▶ Under Rev. Rul. 2003-59, you now can exclude CRP cost-shares from gross income, although you *cannot* exclude CRP rental or incentive payments
- ▶ NOTE: Under IRC Section 175, you also can deduct tree-planting expenses paid using a CRP cost-share, to a limit of 25 percent of your income from *farming*

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### What Does Not Qualify

- ▶ The cost of planting non-timber trees:
  - ✓ Christmas trees      ✓ Nut trees
  - ✓ Shelterbelts          ✓ Fruit trees
  - ✓ Windbreaks          ✓ Ornamentals
- ▶ Reforestation expenses reimbursed under an approved public cost-share program that you *do* elect to exclude from your taxable income
- ▶ The cost of intermediate treatments

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### Expenses Up To \$10,000 per Year

- ▶ Deduct any direct expenses incurred in establishing a stand of timber, to a maximum of \$10,000 per year – \$5,000 for married couples filing separately – for each qualified timber property
- NOTE: You cannot combine qualified timber properties for calculating timber depletion deductions or casualty loss deductions

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### Expenses Up To \$10,000 per Year

- ▶ Investors take the deduction on the front of Form 1040, as an adjustment to income
  - ✓ Write RFST and the amount on the dots for the adjustments to income line (37 for 2008)
- ▶ Participants in a trade or business take the deduction on a business form
  - ✓ Form 1040, Schedule C for a business or Schedule F for a farm; use the “Other expenses” line

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### Expenses Over \$10,000 per Year

- ▶ Reforestation expenses over \$10,000 per year must be amortized (written off)
  - ✓ The amortization period is nominally 84 months (7 years), but a half-year convention applies, so you:
    - Take a half-deduction in year 1 (1/14th)
    - Take a full 1/7th deduction in years 2–7
    - Take the final 1/14th deduction in year 8

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### **Expenses Over \$10,000 per Year**

- ▶ You must specifically elect to amortize reforestation expenses on a timely-filed return for the tax year in which they are incurred (including extensions)
  - ✓ Make the election and report the amount of deductions taken on Form 4562, Part VI

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### **Expenses Over \$10,000 per Year**

- ✓ You cannot make the election on an amended return, but once it is made, you can take amortization deductions you forgot about
- ▶ Investors again take the deduction on the front of Form 1040, as an adjustment to income
- ▶ Participants in a trade or business again take the deduction on a business form

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### **Recapture Provisions**

- ▶ Any tax saved by using either reforestation tax incentive is subject to recapture if you dispose of the trees within 10 years
  - ✓ Disposals by gift are excepted
  - ✓ Like-kind exchanges, involuntary conversions, tax-free transfers, and transfers at death also are generally excepted

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**EXAMPLE:** Say you reforested 80 acres last year at a cost of \$175 per acre, or \$14,000 in all. You received no cost-share payment, so your total expense is more than \$10,000. Calculate the reforestation incentives you are eligible for.

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### Solution

- ▶ Deduct outright the first \$10,000 of your expenses
- ▶ And begin writing off the amortizable amount

$$1/14 \times (\$14,000 - \$10,000) = \$286$$

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### Solution

- ▶ In your returns for years 2–7 you would write off a full 1/7th of the amortizable amount

$$1/7 \times (\$14,000 - \$10,000) = \$571$$

- ▶ And in your return for year 8 you would write off the final 1/14th

$$1/14 \times (\$14,000 - \$10,000) = \$286$$

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See Tax Forms and Examples for Reforestation section following the slide handouts for this section for:

Filled in Form 4562, Part VI on Page 1

And filled in Form T, Part IV on Page 2

If you are required to file a Form T, you also should fill in and submit Form T, Part IV

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### Maximizing the Benefit

- ▶ Other reforestation strategies would enable you to better utilize the reforestation incentives, for example:

- ✓ You could divide the reforestation operation – and the expenses – between 2 tax years, or
- ✓ You could use excludable cost-share payments to bring your direct expenses below \$10,000

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## **Maximizing the Benefit**

- ▶ ***But remember***, you should base your forest management decisions on their full silvicultural, financial and planning implications, not just their tax effect

# **Tax Forms and Examples**



## **Reforestation Tax Incentives**

**Part V Listed Property** (Include automobiles, certain other vehicles, cellular telephones, certain computers, and property used for entertainment, recreation, or amusement.)

**Note:** For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete **only** 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.

**Section A—Depreciation and Other Information (Caution: See the instructions for limits for passenger automobiles.)**

**24a** Do you have evidence to support the business/investment use claimed?  **Yes**  **No** **24b** If "Yes," is the evidence written?  **Yes**  **No**

(a) Type of property (list vehicles first)	(b) Date placed in service	(c) Business/investment use percentage	(d) Cost or other basis	(e) Basis for depreciation (business/investment use only)	(f) Recovery period	(g) Method/Convention	(h) Depreciation deduction	(i) Elected section 179 cost
<b>25</b> Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use (see instructions) . . . . .						<b>25</b>		
<b>26</b> Property used more than 50% in a qualified business use:		%						
		%						
		%						
<b>27</b> Property used 50% or less in a qualified business use:		%				S/L -		
		%				S/L -		
		%				S/L -		
<b>28</b> Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1. . . . .						<b>28</b>		
<b>29</b> Add amounts in column (i), line 26. Enter here and on line 7, page 1. . . . .							<b>29</b>	

**Section B—Information on Use of Vehicles**

Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

	(a) Vehicle 1		(b) Vehicle 2		(c) Vehicle 3		(d) Vehicle 4		(e) Vehicle 5		(f) Vehicle 6	
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
<b>30</b> Total business/investment miles driven during the year ( <b>do not</b> include commuting miles) . . . . .												
<b>31</b> Total commuting miles driven during the year . . . . .												
<b>32</b> Total other personal (noncommuting) miles driven . . . . .												
<b>33</b> Total miles driven during the year. Add lines 30 through 32 . . . . .												
<b>34</b> Was the vehicle available for personal use during off-duty hours? . . . . .												
<b>35</b> Was the vehicle used primarily by a more than 5% owner or related person? . . . . .												
<b>36</b> Is another vehicle available for personal use? . . . . .												

**Section C—Questions for Employers Who Provide Vehicles for Use by Their Employees**

Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who are **not** more than 5% owners or related persons (see instructions).

	Yes	No
<b>37</b> Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees? . . . . .		
<b>38</b> Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners . . . . .		
<b>39</b> Do you treat all use of vehicles by employees as personal use? . . . . .		
<b>40</b> Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received? . . . . .		
<b>41</b> Do you meet the requirements concerning qualified automobile demonstration use? (See instructions.) . . . . .		

**Note:** If your answer to 37, 38, 39, 40, or 41 is "Yes," do not complete Section B for the covered vehicles.

**Part VI Amortization**

(a) Description of costs	(b) Date amortization begins	(c) Amortizable amount	(d) Code section	(e) Amortization period or percentage	(f) Amortization for this year
<b>42</b> Amortization of costs that begins during your 2008 tax year (see instructions):					
<b>43</b> Amortization of costs that began before your 2008 tax year. . . . .				<b>43</b>	
<b>44 Total.</b> Add amounts in column (f). See the instructions for where to report. . . . .				<b>44</b>	

**Part IV Reforestation and Timber Stand Activities** (see instructions)

Account, block, tract, area, or stand ID for each Qualified Timber Property (QTP)	Kind of activity (burning, chopping, spraying, planting, seeding, thinning, pruning, fertilizing, etc.)	Number of acres treated	Total expenditures
<b>1</b>			
<b>2</b> Total . . . . .			
<b>3</b> Total reforestation expenses . . . . .			
<b>4a</b> Amount to be expensed under section 194(b). (See instructions for limitations) . . . . .			
<b>b</b> Amount to be amortized under IRC 194(a), including remaining reforestation expenditures not expensed under section 194(b) . . . . .			

**Part V Land Ownership**

Show all changes in land accounts. Attach as many additional sheets as needed, following the format of lines 1 through 6.

1 Name of block and title of account ▶ ..... .....	Acres	Total cost or other basis. Give amount of March 1, 1913 appreciation, if included	Average rate per acre
<b>2</b> Balance at beginning of year . . . . .			
<b>3</b> Acquisitions during year. . . . .			
<b>4</b> Sales during year . . . . .			
<b>5</b> Other changes. . . . .			
<b>6</b> Balance at end of year. Add lines 2 and 3, subtract line 4 and add or subtract line 5 . . . . .			

**Additional Information.**

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