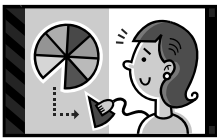


# Cost-share and Conservation Payments

Agriculture Handbook  
718, pages 58-61



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## Cost-share Payments Overview...

- Generally, you are required to report Government cost-share payments as part of your gross income:
  - ◆ To report income from all sources.
  - ◆ To reconcile the Form 1099G you receive for the payment.

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<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0120	
PAYER'S name, street address, city, state, ZIP code, and telephone no.		1 Unemployment compensation	<b>2009</b> Form 1099-G
		2 State or local income tax refunds, credits, or offsets	
PAYER'S federal identification number	RECIPIENT'S identification number	3 Box 2 amount is for tax year	4 Federal income tax withheld
RECIPIENT'S name		5 ATAA payments	6 Taxable grants
Street address (including apt. no.)		7 Agriculture payments	8 Box 2 is trade or business income <input type="checkbox"/>
City, state, and ZIP code		9 Market gain	<b>Copy B For Recipient</b> This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
Account number (see instructions)			
Form 1099-G		(keep for your records)	Department of the Treasury - Internal Revenue Service

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## Cost-share Payments Overview...

- However, under Section 126 of the IRS Code, all, or part of, certain government cost-share programs **MAY** be excluded from gross income.

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## Cost-share Payments Overview...

- Nevertheless, even if you choose to exclude an approved government cost-share payment, **YOU MUST REPORT IT** on your return showing how the exclusion was determined

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## Requirements for Exclusion

- In general, a portion or all of a cost-share payment is excludable from income if two conditions are met:

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## First Requirement for Exclusion

- The payment is determined by the Secretary of Agriculture to be primarily for the purpose of conserving soil and water resources, protecting or restoring the environment, improving forests, or providing habitat for wildlife, and

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## What Programs Are Excludable?

- According to Section 126 of the IRS regulations and revenue rulings, these Federal and State conservation cost-share programs have been approved by the Agriculture and Treasury Departments for exclusion:

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## Approved Federal Programs

- Excludable Federal Programs that may affect timberland owners include:
  - ◆ Forest Land Enhancement Program (FLEP)
  - ◆ Conservation Reserve Program (CRP)
  - ◆ Environmental Quality Incentives Program (EQIP)
  - ◆ Wetland Reserve Program (WRP)
  - ◆ Wildlife Habitat Incentive Program (WHIP)
  - ◆ Forest Health Protection Cost Share

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## Approved State Programs

- The several approved State cost-share programs that most often affect timberland owners include:
  - ◆ Forestry Development Program..... NC
  - ◆ Reforestation of Timberlands Act Program..... VA
  - ◆ Forest Resource Development Program..... MS
  - ◆ Forest Improvement Program..... CA
  - ◆ Forest Renewal Program..... SC
  - ◆ Forestry Development Program..... IL
  - ◆ Forestry Productivity Program ..... LA

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## Conservation Reserve Program

- Conservation Reserve Program (CRP) cost-share payments are **now** excludable based on IRS Revenue Ruling 2003-59. (This reverses the previous IRS position.)
- The exclusion applies to cost-share payments only.

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## Conservation Reserve Program

- Section 126 specifically eliminates any Government payment that is in the nature of rent or compensation for services from qualifying for exclusion from gross income.
- Hence, recurring annual payments under CRP do not qualify for exclusion.

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## Conservation Reserve Program

- CRP rental payments are excluded from self-employment income for retirees and disabled taxpayers.
- Effective for rental payments made after December 31, 2007.

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## Conservation Reserve Program

- CRP cost-share payments used for reforestation expenses are eligible for the 7-year amortization and reforestation tax deduction.

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## Conservation Reserve Program

- Also, as an alternative to the amortization and deduction, qualified farmers may deduct annually some or all of the reforestation cost for CRP tree planting under Section 175.

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## TSI Cost-share Payments

- If the cost-share payment received is used for **Timber Stand Improvement** (TSI) practices, it **must** always be included in gross income.
- TSI payments, however, are generally eligible for deduction as a **current expense** in the year incurred.

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## Second Requirement for Exclusion

- It is determined by the Secretary of the Treasury as not substantially increasing the annual income from the property.

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## Condition #2 “Substantial” defined...

- The IRS regulations define an increase in annual income as “substantial” if it exceeds the greater of:

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## Condition #2 “Substantial” defined...

- The present value of 10% of the average income from the affected acres for the last three tax years, or
- The present value of \$2.50 times the number of affected acres.

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## Present Value?

- Example: What is the present value of \$2.50 at 8%?
- Solution:  $\$2.50 / .08 = \$31.25$

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## What Interest Rate Do You Use?

- The IRS regulations do not specify which interest rate to use, nor suggest how to determine it.
- Taxpayers are responsible for choosing their own interest rate. **This is a subjective determination.**

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## What Interest Rate Do You Use?

- The rate should be a reasonable one—such as the rate the IRS charges for overdue taxes, or the rate charged for a fixed rate 30-year home mortgage.

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## Interest Rate Effects

- The interest rate used for calculating the present value will strongly affect the amount that may be excluded.
- The lower the interest rate used, the larger will be the exclusion.

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## 4-step Procedure to Compute the Excludable Portion

- Step 1: Calculate 10 percent of the average annual income from the affected acres during the past 3 years.
- Step 2: Multiply \$2.50 times the number of affected acres..

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## 4-step Procedure to Compute the Excludable Portion

- Step 3: Calculate the present value of the larger number from steps 1 and 2.
- Step 4: Compare the number from step 3 with your cost-share payment; the smaller of the amount you can exclude from your gross income.

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## Determining the Excludable Portion

- If the cost-share payment is less than or equal to the computed value, it may be entirely excluded from gross income.
- If the cost-share payment is greater than the computed value, only the amount from Step 3 can be excluded, and the excess must be included in gross income.

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## Cost-share Example I

- Last year you harvested 40 acres and received \$84,500 for the timber.
- This was the only income from the property in many years.
- This year, you replanted the 40 acres at a cost of \$6,000 (\$150/acre).
- You received \$3,900 in cost-share payments (eligible for exclusion) to cover the cost of replanting.

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## Cost-share Example I

- How much of \$3,900 cost-share payment can be excluded from your gross income?

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## Solution

- Step 1:  
Compute 10% of the average annual income for the 3 previous years:  
 $0.10 \times (\$84,500/3) = \$2,817$
- Step 2:  
Multiply \$2.50 times the number of affected acres  
 $\$2.50 \times 40 = \$100$

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## Solution

- Step 3:  
Compare the two values. \$2,817 is larger.  
Divide by the interest rate (assumed to be 9.32% -- a Farm Credit Bank rate)  
 $\$2,817 / 0.0932 = \$30,225$
- Step 4:  
\$30,225 is larger than \$3,900; you can exclude the entire payment from your gross income.

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## Cost-share Example II

- Your neighbor, Claire Waters, converted 12 acres of streamside pasture to a filter strip by planting trees.
- The practice cost \$1,800, and she received a \$1,350 EQIP cost-share payment.
- Claire calculates that the converted acres contributed an average of \$280 per year to her livestock production income during the 3 years prior to planting the trees.

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## Cost-share Example II

- How much of the EQIP payment can she exclude if she uses interest rate of 4.58%?

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## Solution

- Step 1:  
 $0.10 \times \$280 = \$28$
- Step 2:  
 $\$2.50 \times 12 = \$30$
- Step 3:  
 $\$30 / 0.0458 = \$655$
- Step 4:  
Clair can now deduct \$655 of the payment.

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## If You Exclude ...

- If you decide to exclude part or all of a cost-share payment from gross income, attach a statement, on a **plain piece of paper**, to your tax return stating specifically:

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## If You Exclude ...

- The amount of the cost-share payment;
- The date you received it;
- The amount of the payment that qualifies for exclusion;
- The amount you choose to exclude; and
- An explanation of how you determined the excludable amount.

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## Recapture Provisions

- If the property established with an excluded cost-share payment is disposed of within 20 years, recapture provisions apply.

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## Recapture Provisions

- The recapture amount during the first 10 years is the LESSER of:
  - ◆ the amount of the cost-share payment excluded, or
  - ◆ the amount of the gain from disposal.

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## Recapture Provisions

- The base recapture amount is reduced by 10% for each year, or portion of a year, if the disposal occurs between 10 and 19 years.
- It is recaptured as ordinary income on **Form 4797**.



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## Reforestation Tax Incentives and Cost-share Payments

- To the extent that a cost-share payment is included in gross income, and is used for planting or seeding of trees for commercial production of timber products, it may qualify for the 7-year reforestation amortization and reforestation tax deduction.

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## Reforestation Tax Incentives and Cost-share Payments

- If the cost-share payments are excluded, however, they can not be included for the deduction and amortization.

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### **If You Include Cost-share Payments:**

- They may also be subject to self-employment tax, since self-employment income includes all items of business income—including government conservation cost-share program payments.

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### **If You Include Cost-share Payments:**

- They may also be subject to state income taxes in those states that have an income tax.

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### **Including Cost-share Payments in Gross Income**

- For taxpayers who report as investors: report as “miscellaneous income” on the front of **Form 1040**.
- For taxpayers whose timber holdings are treated as a business: report on **Schedule C, Form 1040**.
- For farmers: report on **Schedule F, Form 1040**.

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### **Include or Exclude?**

- Whether to include or exclude cost-share payments depends on the “facts and circumstances” of each individual taxpayer.

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## Include or Exclude?

- Do whichever will give you the best tax advantage!

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# Tax Forms



# Cost Share and Conservation Payments

