

Paying for a New Forest without Cost-Share Funding



Reforestation cost-share funds are limited in many ways—some programs only pay for a limited number of acres, some only apply for certain situations, and sometimes the funding is simply insufficient for the number of applicants. Landowners who face this problem need to be aware that the federal and state tax systems provide a way to recover reforestation costs for commercial timber species. A reforestation deduction, amortization, and even a Mississippi tax credit are available to most taxpayers.

Taxpayers in the higher tax brackets may find that these tax incentives reduce costs better than cost-share. Plus, there is no waiting in line to qualify.

Federal Income Tax

Congress has recognized that private landowners need to recover reforestation expenses quickly. The current tax remedy is to allow the landowner to expense (deduct) up to \$10,000 each year for the expenses incurred in reforestation. This limit is applied to each qualified timber property (QTP), not to each taxpayer. Any amount over \$10,000 is amortized or deducted over 84 months using a specific formula.

These special provisions relate only to landowners growing commercial timber species. Landscaping trees or trees planted for personal use are not deductible under the federal provisions.

Lands that are in a trust follow a different rule. These landowners are not allowed to expense the first \$10,000. They may amortize the entire amount, however, over the standard 84 months.

Allowable expenses include a wide variety of practices—whatever is reasonable and necessary to create a commercial forest with seedlings that are free to grow. These practices might include clearing land, raking, piling, burning, subsoiling, applying herbicides, bush-hogging, fertilizing, disking, and planting seedlings. Practices should be reasonable, ordinary, and necessary—generally what the forestry industry is willing to invest establish a forest of commercially valuable species.

Let’s look at an example:

Ned and Nellie Rowan wanted to reduce their farming acreage and decided to plant 200 acres of cropland with loblolly pine trees. They applied for cost-share from the Natural Resource Conservation Service and the Mississippi Forestry Commission, but funds were not available. Instead of waiting 1 to 2 years for possible cost-share assistance, the Rowans decided to invest their own money into reforestation and recover costs with federal and state tax incentives.

In 2017, the Rowans hired a consulting forester to develop a reforestation plan, hire vendors, purchase seedlings, and ensure a quality job. The forester charged 5 percent above actual costs for this service. No site preparation was recommended because the land was still clean following an earlier crop harvest. A vendor agreed to plant 600 trees per acre for a fee of \$45 per acre, or \$9,000 for 200 acres. The Rowans chose to plant second-generation improved loblolly pine trees at a cost of \$63.10 per thousand. To achieve a planting density of 600 per acre, 120,000 seedlings were purchased for \$7,572. The total cost in 2017 to the Rowans was \$17,400 (\$16,572 plus 5 percent for the forester).

The Rowans considered this 200 acres as one qualified timber property. Therefore, the deduction limit was \$10,000 on their federal income tax return. The remainder of \$7,400 will be amortized over 84 months, or eight tax returns. The rules state that the first year’s amortization will be treated as if it occurred on July 1—in essence, a half-year’s deduction. A year’s deduction will be taken for the next 6 years. The final half-year’s deduction will be taken in year 8 (Example 1).

Example 1. Using federal tax incentives to recover costs totaling \$17,400.		
Owners: Ned and Nellie Rowan		
Tax Incentives	Amortization Amount	Tax Deduction
Deduction in 2017		10,000
Amortization Basis	7,400	
2017	1/14	529
2018	1/7	1,057
2019	1/7	1,057
2020	1/7	1,057
2021	1/7	1,057
2022	1/7	1,057
2023	1/7	1,057
2024	1/14	529
Ending Basis in Account		0

Because the Rowans are farmers, they will be able to claim reforestation expenses as part of their farming operation on Schedule F, Profit or Loss from Farming. In 2017, the initial deduction of \$10,000 and \$529 of amortization were reported as “other expenses” (Table 1). Reforestation expenses are identified as “RFST” on tax forms.

Amortization deductions are first recorded on Form 4562, Depreciation and Amortization, Part VI (Table 2). The reference to Section 194 of the Internal Revenue Code guides the IRS agent handling the return to look up the provision. The amortized amount reported on Form 4562 is then transferred to Schedule F (Table 1).

An election or notice is required for the first of these amortization deductions. The Rowans made their election in 2017 on a plain piece of paper, but they could have used Form T: Forest Activities Schedule, Part 4, Reforestation and Timber Stand Activities.

This election states how much was spent, the date they spent it, practices involved, species of timber planted, and the purpose of growing timber (Example 2).

Table 1. The Rowans claim reforestation deduction and amortization on Schedule F, Profit or Loss from Farming.

Part II Farm Expenses—Cash and Accrual Method. Do not include personal or living expenses. See instructions.								
10	Car and truck expenses (see instructions). Also attach Form 4562	10			23	Pension and profit-sharing plans	23	
11	Chemicals	11			24	Rent or lease (see instructions):		
12	Conservation expenses (see instructions)	12			a	Vehicles, machinery, equipment	24a	
13	Custom hire (machine work) .	13			b	Other (land, animals, etc.) . .	24b	
14	Depreciation and section 179 expense (see instructions) .	14			25	Repairs and maintenance . .	25	
15	Employee benefit programs other than on line 23 . . .	15			26	Seeds and plants	26	
16	Feed	16			27	Storage and warehousing . .	27	
17	Fertilizers and lime	17			28	Supplies	28	
18	Freight and trucking	18			29	Taxes	29	
19	Gasoline, fuel, and oil	19			30	Utilities	30	
20	Insurance (other than health)	20			31	Veterinary, breeding, and medicine	31	
21	Interest:				32	Other expenses (specify):		
a	Mortgage (paid to banks, etc.)	21a			a	<u>RFST Deduction</u>	32a	10,000
b	Other	21b			b	<u>RFST Amortization</u>	32b	529
22	Labor hired (less employment credits)	22			c	-----	32c	
					d	-----	32d	
					e	-----	32e	
					f	-----	32f	

Table 2. The Rowans claim one-fourteenth of amortization basis the first year on Form 4562, Depreciation and Amortization. A similar amount will be claimed the eighth year. The deduction is reported on Schedule F.

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
42 Amortization of costs that begins during your 2017 tax year (see instructions):					
<u>RFST</u>	<u>7/1/2017</u>	<u>7,400</u>	<u>194</u>	<u>6/84</u>	<u>529</u>
43 Amortization of costs that began before your 2017 tax year				43	
44 Total. Add amounts in column (f). See the instructions for where to report				44	529

Form **4562**

Example 2. Election to amortize costs under Section 194, IRC.

Ned and Nellie Rowan attached this to Form 4562:

Under Section 194, we elect to amortize \$7,400 of reforestation expenses in Any County, Mississippi. Payment was made on January 27, 2017. The 84-month amortization period begins July 1, 2017. The expenses were for planting improved loblolly pine seedlings for commercial timber production on the tract known as Granny B's Farm.

For their 2018 tax return, the amortization deduction will increase to \$1,057 as shown in **Table 3**. They also will transfer the amortization deduction onto Schedule F (as shown previously in **Table 1**). The Rowans will continue to file the appropriate amortization deduction until they have deducted all their reforestation costs.

Only farmers should use Schedule F. If the forest is not part of a farming operation, it may be considered either a business or an investment. Business owners would use Schedule C or other appropriate business forms instead of Schedule F. Investors would file their initial deduction and amortization deduction on the front of the 1040 as shown in **Table 4**.

Investors should write in the reforestation deduction on the front of IRS Form 1040 (**Table 4**). Write in "RFST" and the deduction on the next-to-last line of the Adjusted Gross Income section on IRS Form 1040.

Mississippi Income Tax

Mississippi offers a tax credit for new forest establishment. The requirements are somewhat different than those for the federal tax incentives. Only Mississippi taxpayers reforesting Mississippi land they own may claim a credit on Form 80-315. The tax credit allows Mississippi taxpayers to recover up to 50 percent of the cost of qualified expenses.



Since the Mississippi Reforestation Tax Credit is applied to taxes owed, the taxpayer reduces his or her tax burden by the amount of the tax credit. This credit is much better than a deduction, where the reduction in taxes paid equals the amount of the deduction times the marginal tax rate. For example, a \$100 tax credit reduces taxes by \$100, but a \$100 deduction for a taxpayer in the 25 percent tax bracket reduces his tax by \$25.

Table 3. The Rowans will claim one-seventh of amortization basis the second through seventh years. The deduction will be reported on Schedule F.

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
42 Amortization of costs that begins during your 2017 tax year (see instructions):					
43 Amortization of costs that began before your 2017 tax year			RFST 2017	43	1057
44 Total. Add amounts in column (f). See the instructions for where to report				44	1057

Form 4562

Table 4. Example of an investor reporting a \$10,000 reforestation deduction plus a \$529 amortization deduction.

Adjusted Gross Income	23	Educator expenses	23				
	24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24				
	25	Health savings account deduction. Attach Form 8889	25				
	26	Moving expenses. Attach Form 3903	26				
	27	Deductible part of self-employment tax. Attach Schedule SE	27				
	28	Self-employed SEP, SIMPLE, and qualified plans	28				
	29	Self-employed health insurance deduction	29				
	30	Penalty on early withdrawal of savings	30				
	31a	Alimony paid b Recipient's SSN 	31a				
	32	IRA deduction	32				
	33	Student loan interest deduction	33				
	34	Tuition and fees. Attach Form 8917	34				
	35	Domestic production activities deduction. Attach Form 8903	35				
	36	Add lines 23 through 35 RFST \$10,529	36				
	37	Subtract line 36 from line 22. This is your adjusted gross income 	37				

Write-in the reforestation deduction and amortization on line 36

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form 1040

Using the Mississippi Reforestation Tax Credit requires the services of a registered or graduate forester. The forester prepares a simple prescription of reforestation practices, including a map of the area and legal description of the property. He or she also signs the Mississippi Reforestation Tax Credit form to certify that the plan was made and the work was carried out.

Consulting foresters routinely help landowners claim reforestation credit. Their services may be included as part of their duties following a timber sale. Otherwise, services are negotiated for a fee. Other sources of help are foresters who are also vendors who plant seedlings and/or prepare sites for planting. The Mississippi Forestry Commission office also can prepare a plan. The cost is a contract rate, based on the actual cost of providing the service.

There are other limitations on the use of the Mississippi Reforestation Tax Credit. Generally, tax credit and cost-share cannot be claimed for the same practice on the same acreage the same year. Both may be used at the same time only when a taxpayer's adjusted gross income is below the federal income credit level. In 2017, this amount was \$50,597 for a married couple filing jointly with two children.

For land owned by a pass-through entity such as a partnership or an s-corporation, the limits to using the tax credit apply to the pass-through entity level as well as to the investor. Married couples can each have a \$10,000 credit if they own land individually and pay for practices on their individually owned properties. If their land is owned jointly, their total limit is \$20,000 for the couple. Under the new law, the lifetime limit will be \$75,000 per taxpayer.

Let's see how the Rowans use the MSRTC:

The Rowans are Mississippi taxpayers planting trees on their property in Mississippi. Therefore, they are eligible to use the Mississippi Reforestation Tax Credit. Their consulting forester wrote the required plan for the Rowans as part of the total tree planting cost and oversaw the planting of trees.

The Rowans filled out the cost worksheet for the Mississippi Reforestation Tax Credit (Form 80-315) as shown in Table 5. Their consultant signed the form and mailed a copy of the worksheet to the Mississippi Forestry Commission as required.

The Mississippi Reforestation Tax Credit limits the per-acre cost of each practice. These limits are based on cost-share rates and are changed yearly. As a result, the amount eligible for the Mississippi Reforestation Tax Credit may be less than the actual amount spent. The lesser value is used to compute the 50 percent tax credit. In our example, the Rowans actually spent \$17,400, and the allowable upper limit is \$19,000 as determined by filling out the worksheet (Table 5). The Rowans then transferred the lower value to the front of Form 80-315 and took a tax credit of 50 percent of \$17,400, or \$8,700. This reduced their Mississippi taxes by \$8,700. If they are unable to use all the credit now, they will carry it forward until it is totally used.

After subtracting the tax credit, the remainder may be claimed as a reforestation deduction or amortization using federal guidelines. The Mississippi State Tax Commission

has not rewritten the MSRTC regulations following the changes in federal reforestation tax due to the 2004 American Jobs Creation Act. We have used our best estimate of the way to handle these expenses. Check with your tax advisor for advice based on your particular facts and circumstances.

Net Investment

Using the federal tax incentives and Mississippi Reforestation Tax Credit enables landowners to recover a good portion of their reforestation costs. Each landowner's actual recovery percentage will vary according to the marginal tax rate of the individual and the amount actually spent. If a landowner has taxable Mississippi income, it may be much more advantageous to use the Mississippi Tax Credit than to obtain cost-share funding for the forest establishment costs.

Table 5. The allowable upper limit for reforestation expenses was calculated by the Rowans. This cost worksheet is on Form 80-315, Mississippi Reforestation Tax Credit 2017.

I. Regeneration			
	Column A COST SUMMARY PER ACRE	Column B NUMBER OF ACRES	Column C EXTENDED COST (Col. A x Col. B)
Tree Planting (1)			
Pine			
Seedlings / Bare Root	45.00	200	9000.00
Labor	50.00	200	10000.00
Containerized Longleaf			
Seedlings	85.00		.00
Labor	78.00		.00
Containerized Loblolly or Slash			
Seedlings	70.00		.00
Labor	60.00		.00
Hardwood			
Seedlings	68.00		.00
Labor	71.00		.00
Mixed Stand Regeneration			
Seedlings	37.00		.00
Labor	33.00		.00
Site-Preparation	125.00		.00
Natural Regeneration			
Site-Preparation	100.00		.00
II. Site-Preparation			
Chemical	95.00		.00
Mechanical	190.00		.00
Bush Hog	35.00		.00
Post Planting Site-Preparation (2)	80.00		.00
Sub-Soil	50.00		.00
Site-Preparation Burn	38.00		.00
TOTAL (Enter the total of Column C here and on page 1, Part I, line 2)			19000.00

Returning to our example again:

The Rowans are in the 25 percent federal marginal tax bracket and the 5 percent Mississippi tax rate. Their total expenses for reforestation were \$17,400. Their cash recovery was \$13,483 as shown in **Table 6**. If the Rowans had waited for cost-share, they would have only saved a total of \$10,540 (60 percent of cost recovered). The cost-share payment would have been \$7,600, federal tax savings \$2,450, and Mississippi tax savings \$490.

As can be seen from **Table 6**, the Rowans recovered \$11,767 or 67 percent of their investment in the first year, largely due to the Mississippi Reforestation Tax Credit. At the end of the eighth year, they had recovered \$13,483 or 77 percent of their investment. Of course, this does not take into account the time value of money, but it still shows a significant reduction in the cost of investing in a new forest.

Table 6. Estimated recovery of reforestation costs by the Rowans using federal and Mississippi tax incentives. A federal marginal tax rate of 25 percent and a 5 percent Mississippi rate are assumed.

Year	Federal Tax Deduction	Value of Deduction (deduction x .25 federal marginal tax rate)	Mississippi Tax Credit	Mississippi Tax Deduction	Value of Deduction (deduction x .05 state marginal tax rate)	Total Savings in Taxes
2017	10,529	2,632	8,700	8,700	435	11,767
2018	1,057	264				264
2019	1,057	264				264
2020	1,057	264				264
2021	1,057	264				264
2022	1,057	264				264
2023	1,057	264				264
2024	529	132				132
Savings in Taxes		4,350	8,700		435	13,483



Summary

We encourage landowners to compare tax incentives to cost-share. Your individual facts and circumstances will determine which is best. Tax incentives are very attractive, especially when landowners are placed on waiting lists for cost-share funds. Reforesting now with tax incentives will usually beat waiting 2 or 3 years for cost-share.

Waiting for cost-share can increase site preparation costs by allowing weeds and brush to become well-established on the planting or seeding site. It also increases the wait for harvest returns from the new forest, thus reducing overall net returns. Many taxpayers who reforest their property may be pleased to find that their tax incentives could exceed cost-share payments in terms of cost recovery.

Information Sources

This publication provides some guidance to landowners who are ready to invest in a new forest without using cost-share. Your individual situation may not be exactly the same as the example used for illustration. In particular, lands held in trusts are not eligible for some of these provisions, and hobby owners are ineligible. For more details on taxation and forest establishment costs, visit <http://extension.msstate.edu/natural-resources/forestry>, or find the National Timber Tax website at www.timbertax.org. Here are several free publications that may provide further information on recovering the costs of establishing a new forest:

Farmers Tax Guide. IRS Publication 225. Available from www.irs.gov, or order from the IRS tax hotline at (800) 829-3676.

Timber Tax Overview. MSU Extension Publication 2307. Available at <http://extension.msstate.edu/publications/publications/forestry-income-tax-series-timber-tax-overview>, or call your local county Extension office to request a copy.

Tax Tips for Forest Landowners for the 2018 Tax Year. U.S. Forest Service Publication (updated each year with changes in the federal tax code relating to forestry). Download from www.timbertax.org.

Form 80-315 Mississippi Reforestation Tax Credit and 80-315i Instructions for Mississippi Reforestation Tax Credit.

Download current forms and instructions from the Mississippi Department of Revenue website at www.dor.ms.gov. Under the Forms tab, select Income Tax Forms for the current year, then Individual Income Tax. There, you will find forms 80-315 and 80-315i. To request forms be mailed, call (601) 923-7000.

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