



Forestry Fact Sheet 29
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Tax Treatment of Reforestation Costs

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Many landowners are unaware that expenses for reforestation and afforestation¹ are eligible for a tax credit and as a deduction when calculating their federal income taxes. Since standing timber is considered a capital asset, reforestation costs are eligible for recovery in two ways.

Capitalization and Addition to Timber Basis

Expenses borne by landowners to establish new timber stands are considered to be capital costs for income tax purposes and must be "capitalized". This means that the costs of reforestation may not be expensed or deducted from taxable income now. Instead, they are added to the timber basis for the new plantation, and are deducted in the future from timber sale income when a harvest occurs. For most new plantations, this may not occur for 25 or more years.

Reforestation Amortization and Tax Credit

An alternative to carrying the reforestation costs until timber harvest is provided by the federal income tax code. The Reforestation Amortization and Tax Credit includes special provisions for land owners to deduct most of their reforestation expense from their taxable income over an eight-year period (amortization) and to receive a direct tax credit of 10% of a their reforestation expenses. Landowners should use IRS Form 3468 for the tax credit and Form 4562 for the amortization of expenses.

To qualify, these costs must be "out-of-pocket" expenses such as those for purchasing seedlings and paying for planting labor. Although many landowners spend a considerable amount of their own time in reforestation, the cost of their labor is not included in the allowable expenses. Only hired labor, which may include family members who are not owners of the property and who are paid, is an allowable expense.

Landowners may treat up to \$10,000 of their reforestation costs under the Reforestation and Amortization Tax Credit provisions of the federal income tax. These provisions are not applicable to planting costs for Christmas trees or nursery stock.

The amortization portion of the provision allows 95% reforestation expenses to be deducted from income over eight years. The schedule is such that 1/14 of the expenses are allowed as deductions from taxable income in the first year, 1/7 of them are allowable in each of the next six years, and 1/14 is allowable in the eighth year.

Reforestation Costs

For many private landowners reforestation is their biggest forestry expense. These expenses can include:

1. site preparation - removing brush, weeds, and stumps from a site; plowing, disking or otherwise making the site suitable for tree planting or seeding;
2. plant material – tree seed or seedlings; and
3. planting or seeding - labor and tools used in sowing the seeds or planting the seedlings, including supervision of the job.

¹ Reforestation will refer to both re-establishment of forests and establishment of a forest where there previously was none.

Example:

A landowner reforested 10 acres in 1993, and had the following costs:

Item	Cost per Acre
Seedlings	\$135
Site preparation	\$ 44
Planting labor and equipment rental	\$ 23
Total	\$202

His or her total reforestation costs were \$2020. Since this is less than \$10,000, all of the costs are eligible for Reforestation Amortization and Tax Credit. On his or her tax filing for 1993, the year of reforestation, the landowner would claim a tax credit of 10% of \$2020 or \$202. Also in that year he or she would deduct 1/14 of 95% of the reforestation cost from taxable income. This deduction would equal $1/14 * 95% * 2020$ or \$137. In each of the next seven years the landowner would deduct 1/7 of 95% of the expenditures or \$274. In the eighth year, the landowner would deduct the final portion of \$137. Thus, a total of \$1,918 of the original expense can be recovered.

Tax Year	Tax Provision	Amount
1993	Tax Credit	\$202
1993	Deduction from Income	\$137
1994-2000	Deduction from Income	\$274 (per year, 6 years)
2001	Deduction from Income	\$137
Total Amount Deducted		\$1,918 = 95% of total expense

Taking a tax credit and amortizing reforestation expenses reduces the dollar investment a landowner had in his or her timber. The IRS, therefore, requires that the landowner's timber basis be reduced by the amount of the tax credit and amortization (see Forest Fact Sheet 1 for additional information regarding establishing a timber basis).

Cost Share Payments

Landowners who receive cost share payments from public programs for reforestation may either:

- 1) declare the payment as income and use the entire cost in their reforestation Tax Credit and Amortization calculations, or
- 2) subtract the cost share payment from their costs and use the net amount for their Reforestation Tax Credit and Amortization calculations

Where to Go For Help

Bulletins and advice on timber taxes are available from local MSU Extension and Michigan Department of Natural Resources, Forest, Minerals and Fire Management offices. The Extension Service also periodically offers evening programs on timber taxes for landowners. Private consulting foresters can help in determining the timber basis and depletion allowance. Some tax preparers and accountants have participated in special timber tax training programs sponsored by the Michigan Forest Association and the MSU Extension Service and are also knowledgeable about timber taxation issues.



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