

Timberland Excess Cost-Share Payments

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Introduction

As a general tax rule, 26 U.S. code Section 61(a) states, "Except as otherwise provided...gross income means all income from whatever source derived...". In plain terms, it means assuming sources of revenue are taxable unless there is a specific exclusion saying otherwise.

Timberland owners often enroll in programs such as the Conservation Stewardship Program (CSP), Environmental Quality Incentives Program (EQIP), or other United States Department of Agriculture cost-share arrangements. If the landowner meets the requirements of these programs, they receive payments to incentivize land management practices that the Natural Resource Conservation Service (NRCS) finds valuable. Examples include (but are not limited to) removal of invasive species, prescribed burns, managing water and runoff, and other general land and habitat improvement activities. The Internal Revenue Code (IRC), as found in Section 126, allows a portion of these payments to be excluded from gross income if certain requirements are met. Section 126 grants an exclusion for qualifying cost-share payments that: (1) are for capital expenses, (2) do not substantially increase annual income from the property, and (3) are certified as primarily conservation related. The calculation to determine excludable amounts can be complex and is not covered in detail here. Payments to cover non-capital deductible expenses are generally included in income with the resulting deductions taken, if allowed.

Examples

A scenario that has become common is when a taxpayer receives payments that are more than the cost of the practices undertaken. For example, a taxpayer enrolls in a program to eradicate invasive species on their property. They received \$10,000 a year in support of these practices. (Note: The taxpayer should receive an [IRS Form 1099-G, Certain Government Payments](#) from the paying entity substantiating the \$10,000 program payment.) Perhaps the owner was very efficient at eradication and was able to remove the invasive plants for \$6,000. What happens to the additional \$4,000 of revenue? Generally, the excess payment is subject to taxation; however, how

it is reported depends on the intent of the landowner. For article purposes, it is assumed the cost-share payments are not being excluded under IRC Section 126.

The previous example and many other timber-related questions are impacted by how the owner is managing or intending to use the forestland. There are differences between being a (1) hobby owner, (2) an owner holding for investment, and (3) someone who is in the business of timber farming. This article will not detail all the nuances of those distinctions, but will mention how each of the three types of owners are affected by these payments.

Someone who is merely a landowner, and uses the property recreationally but does very little management or intention to profit from the resources, is considered a hobby owner. In the instance of a (1) hobby owner receiving payments, they would be obligated to report the revenue as income on their tax return via [IRS Schedule 1 \(Form 1040\), Additional Income and Adjustments to Income](#), line 8j. They are not allowed any current deductions for hobby expenses, but they could increase the basis of capital assets, like the land or trees, if the activities relate to improvement of those assets. Examples of capital improvement activities would include major pruning, tree replacements, installing irrigation, and other activities that improve the trees' life or infrastructure long-term. Thus, the hobby landowner will report \$10,000 on [IRS Schedule 1 \(Form 1040\), Additional Income and Adjustments to Income](#), Line 8j, and either nothing for the \$6,000 cost of activities, or an increase in basis if it is for capital improvement. The owner would want to maintain records to substantiate these claims. In total, they will have increased their current-year taxable income by the \$10,000 payment with no current offsetting deduction.

For the (2) investment owner who receives payments, the \$10,000 revenue is also reported as income but on [IRS Schedule 1 \(Form 1040\), Additional Income and Adjustments to Income](#), line 8z. The \$6,000 of activity expense may qualify as an IRC Section 212 deduction for ordinary and necessary expenses to (1) produce income or (2) manage, conserve or maintain income-producing property. However, as of 2026, miscellaneous itemized deductions are permanently eliminated. Under IRC Section 266, "carrying charges" are allowed to be capitalized. These include expenses to acquire, finance, and hold property. In total for the current year, the investment landowner would report \$10,000 of income with no offsetting expense for the current year. They may be entitled to capitalize the current year carrying charges to reduce taxable income in a future year when the assets are sold. If the \$6,000 charges are for capital investment, they will go toward increasing the basis of those assets,

such as the land or timber account. Again, the owner should maintain records to substantiate these claims. *IRS Form T (Timber), Forest Activities Schedule* is not required but may be helpful as a personal recordkeeping tool.

For the (3) owner in the business of timber farming, they will report their conservation stewardship program payments on *IRS Schedule F (Form 1040), Profit or Loss From Farming*, line 4a / 4b. Any offsetting deductions for the activities will be reported on *IRS Schedule F (Form 1040), Profit or Loss From Farming*, Part II, line 12 (conservation expenses). If the payments are for capital improvements, they will increase the basis of the land or timber assets. For the current year, the taxpayer will recognize \$10,000 of revenue, with \$6,000 of deductible expense in the current year on *IRS Schedule F (Form 1040), Profit or Loss From Farming*, Part II, or a \$6,000 increase to asset basis (either timber or land account) which will be tracked through *IRS Form T (Timber), Forest Activities Schedule*.

Conclusion

In summary, the level of involvement and management intent by the landowner determines how conservation or cost-share payments are treated for income tax purposes. These programs are intended to be beneficial in helping a landowner build their timber stands and create long-term resiliency. However, it is advisable for property owners to understand how these payments should be reported and how it may impact them for tax purposes. Further discussion could be had regarding payment exclusion under IRS Section 126. Lastly, it is recommended to seek tax advice from a knowledgeable tax professional on individual situations.

IRS Publications

IRS forms and publications can be found by going to www.irs.gov and typing in the name of the publication/form or the publication/form number in the search bar toward the top of the webpage. Publications may be viewed online or downloaded.

Additional Topics

This fact sheet was written as part of Rural Tax Education, a national effort including Cooperative Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved,

other fact sheets and additional information related to agricultural income tax please see RuralTax.org.

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