TECHNICAL NOTES

U.S. DEPARTMENT OF AGRICULTURE SOIL CONSERVATION SERVICE

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TAX CONSEQUENCES OF SOIL AND WATER CONSERVATION PRACTICES

The tax consequences of soil and water conservation practices take on three forms:

1. Treat expenditure as an operating expense and deduct the entire expense of the practice from current year taxable income (deductions).

2. Treat the expenditure as a capital investment and deduct a percentage of that expenditure annually for a specified period (depreciation).

3. Use as a tax credit if an investment is made to purchase depreciable physical property used as an integral part of the farm business (investment tax credits).

DEDUCTIONS: A person engaged in the business of farming may choose to deduct from current taxable income certain soil and conservation expenditures that would otherwise be treated as capital expenditures.

Deductible expenditures include (but are not limited to): 1) The treatment or movement of earth, such as leveling, conditioning, grading, terracing, contour furrowing, or restoration of fertility; 2) The construction, control, and protection of diversion channels, drainage ditches, irrigation ditches, earthen dams, watercourses, outlets, and ponds. 3) The eradication of brush; 4) The planting of windbreaks. Note: Soil and water conservation expenditures that benefit farmland as well as land that does not qualify as farmland, must be allocated to the percentage of land benefited that qualifies as farmland before a deduction is taken.

DEPRECIATION: A capital expenditure is paid to acquire, improve, or restore an asset having a useful life of more than one year. Capital investments are recovered through annual allowances. Again, most expenditures made on soil and water conservation practices may be deducted from current taxable income.

INVESTMENT TAX CREDITS: An investment tax credit is a decrease in the amount of tax owed, or an increase in the amount refunded, and is not a deduction from taxable income. The regular credit is 10% of the eligible investment. The following are improvements that may qualify for the investment tax credit (and may also be depreciable):

Fences	Tile drainage
Paved barnyards	Orchards and vineyards
Water wells	Storage facilities

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For more detailed information on how expenditures on soil and water conservation practices may change a farmer's tax liability, see IRS Publication 225: "Farmer's Tax Guide."

TAX EXAMPLE

PRACTICE: Farmstead and Feedlot Windbreak
EXPECTED LIFE: 30 years

Assume: $2,000 installation cost
$3,000 fencing and trees
$200 annual maintenance costs

1. Treat installation cost as a deductible expenditure:

Before deduction:	$30,000	Farmer's initial taxable income
	x .20	Tax rate
	=$6,000	Amount of tax liability

After deduction:	$30,000	Farmer's initial taxable income
	- 2,000	Deductible installation cost
	28,000	Revised taxable income
	x .18	New tax rate
	=$5,040	New amount of tax liability

Plus, can deduct $200 per year in annual maintenance costs.

2. If installation costs are treated as a depreciable capital expenditure, the investment tax credit may be used for the fencing and tree costs.

Example:	$30,000	Farmer's taxable income
	- 240	Depreciation of installation costs ($2,000 x 12%)
	29,760	Revised taxable income
	x .20	Tax rate
	$ 5,952	Amount of tax liability
	- 300	Investment tax credit (10% of fencing and tree cost)
	=$5,652	Tax liability (in Year 1)

Plus, can futher depreciate installation costs over following years, and can deduct $200 per year in annual maintenance costs. Investment tax credit can only be used in Year 1.