

The Effects of Federal, State & Local Taxes on Family Forest Owners

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Objectives

- Review and compare current federal, state, and local tax policies that affect family forest owners.
- Analyze the impacts of tax policies on family forest owners.
- Identify tax policies that would best encourage keeping family forests as forests and increasing sustainable forest management.

Background

- In the United States, about 35% of the forestland is owned by 10 million family forest owners.
- A wide range of policy tools have been adopted to encourage sustainable family forest management, including technical assistance, outreach education, financial incentives, and regulations.
- Among these policies and programs, financial incentives, particularly tax incentives, play a prominent role.
- Tax incentives include reduced property, estate and inheritance taxes, favorable tax credits and deductions, favorable capital gains treatment of timber income, as well as incentives linked to specific stewardship practices such as wildlife protection, recreation, and reforestation.
- In contrast to the body of literature addressing the financial implications of tax policies, no published studies have analyzed the cumulative impact of tax policies on the decision making behavior of family forest owners.
- This suggests a need for an up-to-date, comprehensive understanding of existing tax policies and programs across the country and their impacts on family forest owners.

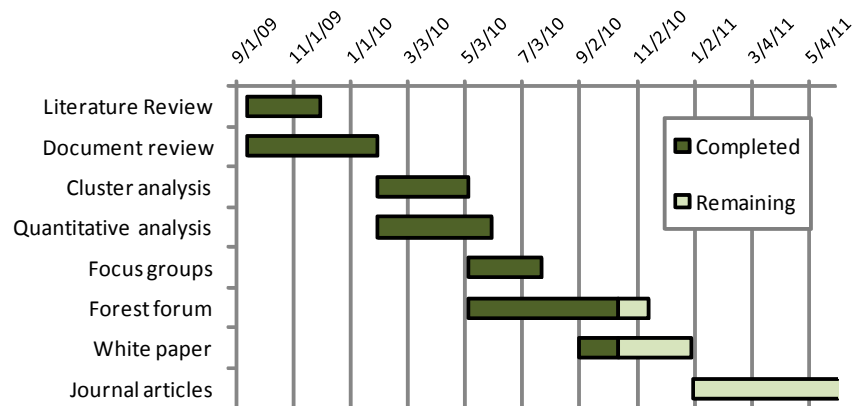
Approach

- Review and synthesize existing literature.
- Review and summarize relevant tax policies at the federal, state, and local levels.
- Conduct interviews with those who implement forest tax policies to verify our understanding of the programs and gain additional insights.
- Conduct focus groups with landowners and forestry professionals to better understand their awareness and use of preferential tax policies.
- Quantitatively assess the impact of tax policies on forest trends.
- Convene a forum to present results and brainstorm solutions.

Final Products

- Booklets, articles, and/or fact sheets for family forest owners.
- A white paper for policy analysts, legislative staffers, and other interested parties.
- Journal articles and conference presentations to convey the findings to research community.

Timeline



Funding

- Primary funding provided by the American Forest Foundation.
- Additional funding provided by the USDA Forest Service and the University of Massachusetts-Amherst.

General State Tax Policy Landscape

Below is a state-by-state look at the policy landscape for taxes effecting Family Forest Owners

STATE	PROPERTY	HARVEST	INCOME TAX			ESTATE TAX	
	Policy Type ¹	Harvest Tax on Landowner ²	State-Level Income Tax	Preferential Treatment for Capital Gains	Forestry or Land Conservation Income Tax Credits or Deductions	State-level Estate/Inheritance Tax (2009)	Estate Tax Special Use Valuation
Alabama	PPTP	N	Y	N	N	N	
Alaska	EX	N	N			N	
Arizona	SAC	N	Y	N	N	N	
Arkansas	SAC	N	Y	Y	Y	N	
California	PPTP	Y - All	Y	N	Y	N	
Colorado	PPTP	N	Y	N	Y	N	
Connecticut	PPTP	N	Y	N	N	Y	N
Delaware	PPTP	N	Y	N	Y	Y	N
Florida	PPTP	N	N			N	
Georgia	PPTP	Y - All	Y	N	Y	N	
Hawaii	PPTP	N	Y	N	N	N	
Idaho	PPTP	Y - All Except PPTP - Productivity	Y	N	N	N	
Illinois	PPTP	Y - All	Y	N	N	Y	N
Indiana	PPTP	N	Y	N	N	Y	Y
Iowa	PPTP	N	Y	N	Y	N	
Kansas	SAC	N	Y	N	N	Y	N
Kentucky	SAC	N	Y	N	N	N	
Louisiana	SAC	N	Y	N	N	N	
Maine	PPTP	N	Y	N	Y	Y	N
Maryland	PPTP	N	Y	N	Y	Y	N
Massachusetts	PPTP	N	Y	N	N	Y	N
Michigan	PPTP	N	Y	N	N	N	
Minnesota	PPTP	N	Y	N	N	Y	N
Mississippi	SAC	N	Y	N	Y	N	
Missouri	PPTP	Y - PPTP Enrollees	Y	N	N	N	
Montana	PPTP	N	Y	Y	N	N	
Nebraska	SAC	N	Y	N	N	Y	Y
Nevada	PPTP	N	N			N	
New Hampshire	PPTP	Y - All	N			N	

1: PPTP = Preferential Property Tax Program , SAC = Special Assessment Classification, EX = Exemption

2: If state imposes harvest tax - type of landowner subject to tax indicated

General State Tax Policy Landscape

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New Jersey	PPTP	N	Y	N	N	Y	N
New Mexico	SAC	N	Y	Y	Y	N	
New York	PPTP	Y - PPTP Enrollees	Y	N	Y	Y	N
North Carolina	PPTP	N	Y	N	Y	Y	N
North Dakota	PPTP	N	Y	Y	N	N	
Ohio	PPTP	N	Y	N	N	Y	N
Oklahoma	SAC	N	Y	N	N	Y	N
Oregon	PPTP	Y - All	Y	N	Y	Y	Y
Pennsylvania	PPTP	N	Y	N	N	Y	Y
Rhode Island	PPTP	N	Y	N	N	Y	N
South Carolina	PPTP	N	Y	Y	Y	N	
South Dakota	SAC	N	N			N	
Tennessee	PPTP	N	N			Y	N
Texas	PPTP	N	N			N	
Utah	PPTP	N	Y	N	N	N	
Vermont	PPTP	N	Y	Y	N	Y	N
Virginia	PPTP	N	Y	N	Y	N	
Washington	PPTP	Y - All	N			Y	Y
West Virginia	PPTP	Y - All	Y	N	N	N	
Wisconsin	PPTP	Y - PPTP Enrollees	Y	Y	N	N	
Wyoming	SAC	N	N			N	

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TO QUOTE:

The problem is not having enough income to pay taxes on.

You pay capital tax anyway; you wouldn't have to be paying income tax on it. ... Plus, you can take credit for all the stuff you've done to improve the land. ... You can deduct all that before you even get to the bottom line as to what you're going to claim.

One year because of the income tax thing we had them log part of it in one year and then the next year finished it. It was on two years of taxes instead of one fell swoop.

*My experience is that if [you] sell timber it just adds to your personal income and you pay tax at whatever bracket you're in.
(Family forest owner)*

*I recommend to my clients paying tax as ordinary income on timber instead of calculating their historical basis and taking a depletion deduction."
(Consultant)*

Existing Policy Landscape

- For family forest owners who hold their land to produce income, income taxes have the greatest economic effect of any tax
- The federal income tax has the most impact, because the rates are high compared to other taxes
- The federal tax code includes several provisions that are beneficial to forest owners
- Some are general business provisions, others are specifically for owners of forests and other working lands
- Most state income taxes use federal adjusted gross income or federal taxable income as their starting point, so beneficial federal provisions flow through to the state level

Impacts on Family Forest Owners

Awareness, Knowledge & Usage

- Awareness of beneficial income tax provisions is quite limited among family forest owners
- Awareness is more widespread among tax and forestry professionals, because they deal mostly with production-oriented owners
- Most owners who know about beneficial tax provisions use them
- Misinformation, however, is common among both owners and the professionals they turn to for advice

Barriers & Weaknesses

- The federal tax code is vast, complex, and constantly changing
- The availability of beneficial tax provisions has little short-term effect on owners' management decisions or conservation behavior

[A lot of accountants] are not into that woodlands effect and what the value of the woods is.

[It] destroys the atmosphere of what you've got, what you're working for.

I really didn't want to cut the timber, but I wasn't going to let it rot.

You could ... say "I need to have somebody before I go see this accountant" or who you're going to go see, through extension or some of these agencies.

At the DNR you can get a pamphlet on forest taxation or the Forest Service has a publication called [Forest Landowners Guide to the Federal Income Tax]. You can read all that stuff so you understand what they mean by capital gains. You don't become an expert but you understand when you get to the accountant, the buzzwords he's using, a little bit better by reading these things beforehand.

Impacts on Family Forest Owners *(continued)*

- Owners often limit their chances to use beneficial tax provisions by not establishing their timber basis or not keeping adequate records
- Some owners are opposed to harvesting timber

Strengths & Opportunities

- The current federal income tax policy is largely favorable to family forest owners
- Knowledgeable owners are happy to describe how they have used beneficial tax provisions and other owners are interested to hear their stories
- Income tax credits are more beneficial than deductions for owners in lower tax brackets
- Tax information is widely available through extension, state forestry agencies, and reliable internet sites

Implications for Forest Conservation

- Most family forest owners seem to consider income taxes less of a burden than property tax
 - For owners who harvest, the tax occurs at a time when they have income to pay it
 - For owners who don't harvest, income tax is not an issue
- Opportunity: Provide venues for landowner-to-landowner exchanges
- Opportunity: Develop talks and brochures targeted to specific owner groups, e.g., "How to run your forest business to keep taxes low" for material participants

The Effect of Federal, State & Local Taxes on Family Forest Owners

TO QUOTE:

“You’ve just got to do prior planning... You’ve just got to start thinking about it ahead of time. There’s trusts, there’s all kind of things you can do but you’ve got to work at it.”

“A lot of families have big falling-outs over this. Make sure you have a very good will that tells exactly what’s going to happen so there’s no big fights after you’re dead.”

And only because I sort of read about all this – You have to really plan out that 20-year span of knowing you’re going to give your kids something. It takes over 20 years to lessen the tax burden.

Existing Policy Landscape

FEDERAL

- Federal estate tax exemptions have been a “moving target”, ranging from \$675,000 in 2000 to \$3.5 million in 2009. For 2010 there currently is no estate tax; but unless Congress takes action, the exemption will return to \$1 million for 2011.
- Federal law has provided for special use valuation of forestland and/or timber, and can be used to reduce value within an estate.
However:
 - Value reduction of land is limited to \$1million and there is a long list of stipulations & requirements that apply.
- Internal Revenue Code provides an estate tax exclusion of up to 40% of the restricted value of land protected by conservation easement; with that exclusion capped at \$500,000.

STATE

- States vary in their adoption of a state-level tax. In 2009, 20 states imposed their own state-level estate or inheritance tax, with exemption amounts ranging from \$3,500 to \$3.5 million and tax rates ranging from 1% to 19%.
- In response to changes in the federal estate tax, state-level taxes have undergone recent policy revisions as well.
- Like the federal estate tax, some states (primarily those with significant forest cover) have provisions for special use valuation of forest property.

LOCAL

- No local estate taxes found.

You don't sit on your laurels and hope that there'll be something. You've got to go look into it and find the answers. Tax attorney is usually the best guy to go talk to. If it costs you a thousand dollars it's a thousand dollars well spent. Because he's going to be able to tell you how to get from paying Uncle Sam.

“Small forestland owners, we're tighter than ticks. That works to our advantage most of the time. But there are a lot of times when you just need to suck it up and hire somebody that knows that the hell they're doing and get it done right. I've made many mistakes because I was trying to save buck. I ended up costing myself a hell of a lot more”.

“I tell you, I spent \$10,000 in 2006 and I was proud I did it. It was worth \$100,000”.

Impacts on Family Forest Owners

Awareness, Knowledge, Usage

- Although estate taxes did not rise as a top concern among landowners in the current study, challenges in transferring land to heirs did.
- Many landowners are keenly aware of the uncertainty in the present policy landscape; this appears to prevent some from embarking on succession planning.
- Landowners with a desire for their land to stay in the family have an understanding of the need to “do something”; but many take action such as adding heirs directly to the property deed, which may have unintended consequences.

Strengths & Opportunities

- Even without an estate tax, there is a high likelihood that forestland will become parcelized and/or developed, due to differing family member lifestyles and priorities.
- For some, the federal estate tax triggers succession planning.

Barriers & Weaknesses

- While succession planning may help landowners avoid the tax, the expense of employing professionals deters many landowners who tend to distrust financial professionals.
- Special use valuation provisions are too stringent and limit landowner management options.

Implications for Forest Conservation

- The federal estate tax has the potential to have a considerable impact on family forestland depending on future exclusion amounts, and rates of taxation.
- A study of impacts of estate taxes found that of those owing estate taxes, a segment of landowners did liquidate timber (22%) or sell off land (19%) to pay part or all of estate taxes.

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TO QUOTE:

I don't care, tax me a million dollars an acre but the thing is, the property should make a million and a half dollars an acre so you can afford to pay that taxes. If you can't get the income back from your property, they shouldn't be taxing you for it.

I will say that having my land in current use has kept me from selling it off and developing it...when the downturn really hit me I was beginning to toss around the idea of should I sell this off, subdivide it. I never wanted to do that.

Part of that was playing into it but also part of it was the incentive that it creates; the tax liability that the current use program creates kind of maybe knocked me on the head - "hey, don't do that." That little incentive that they built into it is a good double-edged sword.

They should focus on having some sort of arm of information to give to landowners in terms of how to structure things so that you don't have to break up your land - making sure they know about current use, estate planning in regards to the land

Existing Policy Landscape

- All states have policies which reduce or eliminate property taxes for forest land.
- 38 states have one or more preferential property tax programs¹ for family forest owners that promote timber management, open space and other forest resource values.
- Preferential property tax program attributes vary considerably across states.
 - 54% of states require a forest management plan.
 - 81% of states have a withdrawal penalty.
 - Enrollment periods range from 2 to 50 yrs (13 yrs is avg.).
 - 59% of states estimate property tax savings of at least 75%.

Impacts on Family Forest Owners

Awareness, Knowledge & Usage

- Property taxes are by far the type of taxes of greatest concern to most family forest owners.
- Use of state preferential property tax programs is variable.
 - 39% of state administrators estimate less than 25% of their eligible private forest land enrolled.
 - 21% of state administrators estimate more than 75% of their eligible private forest land enrolled.
- States indicating the greatest percent of eligible private forest land enrolled in preferential property tax programs are generally located in the western US.

Strengths & Opportunities

- 49% of states indicate the majority of their private forest land is enrolled in a preferential property tax program.
- 83% of state administrators estimate their program reduces a landowner's annual property tax burden by at least half.
- There are examples of state preferential property tax programs that require landowners to actively manage their forest land.
- Approximately half of the states believe their property tax policy is effective in retaining forest land in areas highly susceptible to development.

and not breaking it up, that sort of thing. It would be a one-time fee and then making sure you keep updated on the changes. It would allow private owners to have more flexibility in how they preserve the land.

The property that we have in the family partnership was family land forever and ever. We don't want to sell it but we actually have some for sale now because of the proximity [to the airport]. It's 100 acres in what Shelby County considers very valuable property. The taxes have just skyrocketed 'til between the insurance and taxes it's not a good investment money-wise for us although sentimentally the family would like to keep it. We literally have some of it for sale now because it's a luxury. It's a sentimental luxury. There are seven of us who are partners in the family partnership. Part of it belonged to my great grandfather, my grandfather. My dad expanded part of it. We would all love to keep it. Ultimately we will have to sell part or all of it, probably all of it, because it's a luxury at this point.

Impacts on Family Forest Owners (continued)

- Landowners have highly positive views of state property tax programs overall, citing several benefits including significantly lowering property taxes, enabling some to keep their land, keeping open space and promoting sustainability, encouraging tree planting and growth, and providing a positive management plan experience.

Barriers & Weaknesses

- There is no statistical relationship between a state's property tax program attributes and forest loss over time.
- Considerable confusion exists among enrollees and non-enrollees regarding requirements and implications of program participation.
- Obstacles to participation are a combination of lack of awareness, negative impressions, misunderstandings, rejection of certain provisions, and philosophical objections.
- Only one-third of the state administrators agree their property tax program contains the attributes of effective property tax policy.
- The reduction in tax burden provided by preferential property tax programs is orders of magnitude less than the financial gain associated with the sale of forest land for development.

Implications for Forest Conservation

- Property taxes are repeatedly cited as the sole or a contributing factor influencing landowners' consideration of selling forest land.
- There is no empirical evidence documenting the degree to which high property taxes actually affect a landowner's decision to sell forest land.
- Property tax policy can be used to incentivize forest stewardship. There are examples of property tax policy that have been successful in promoting good stewardship through forest management, timber harvesting, and forest certification (e.g., WI's Managed Forest Law).
- Property tax policy, by itself, is ineffective in retaining forest land in areas subject to high development pressure. Other policy tools (e.g., zoning, conservation easements) are more effective at protecting forest land in these areas.

Preferential Property Tax Programs* Relevant to Family Forest Owners

* Programs requiring something of landowners - active management, commitment to enrollment period, penalty for use change - in exchange for reduced taxes.

STATE	PROGRAM NAME/IDENTIFIER	PRIMARY GOALS ¹	MINIMUM ACREAGE TO ENROLL ²	REQUIRES MANAGEMENT PLAN ²	DURATION OF ENROLLMENT (YEARS) ³	WITHDRAWAL PENALTY
Alabama	Current Use	AG	5	CD	Cont.	N
Alaska	<i>No Preferential Property Tax Program</i>					
Arizona	<i>No Preferential Property Tax Program</i>					
Arkansas	<i>No Preferential Property Tax Program</i>					
California	Timberland Production Zones	FOR	160	Y	10	Y
Colorado	Forest Ag	FOR	40	Y	Cont.	N
Connecticut	Public Act 490 - Forest Land	OS	25	N	Cont.	Y
Delaware	Commercial Forest Plantation Act	FOR	10	Y	30	Y
Florida	Greenbelt or Agricultural Lands Classification	AG/OS	CD (No Min., 10, or 20)	CD	Cont.	N
Georgia	Conservation Use Assessment	OS	CD No Min. to 25	N	10	Y
Hawaii	<i>Each County/Island Has Own Individual Set of Programs</i>					
Hawaii Co.	Tree Farm Designation	FOR	N/A	Y	10	Y
Hawaii Co.	Native Forest Dedication	HAB	3	Y	20	Y
Honolulu Co.	Agricultural Use Dedication	AG/FOR	10	Y	Options: 1, 5, or 10	Y
Kauai Co.	Agricultural Property Tax Reduction	AG/FOR	N/A	N/A	10 or 20	N/A
Kauai Co.	Agricultural Property Tax Exemption	AG/FOR	10	N/A	10 or 20	N/A
Maui Co.	Dedicated Land	N/A	N/A	N	10 or 20	Y
Idaho	Bare Land & Yield	FOR	5	CD	10	Y
Illinois	Conservation Stewardship	OS	5	Y	10	N
Indiana	Classified Forest and Wildlands	OS	10	Y	Cont.	Y
Iowa	Forest Reservation	N/A	2	N	Cont.	Y
Kansas	<i>No Preferential Property Tax Program</i>					
Kentucky	<i>No Preferential Property Tax Program</i>					
Louisiana	<i>No Preferential Property Tax Program</i>					
Maine	Tree Growth Tax Law	FOR	10	Y	10	Y
Maine	Open Space Tax Law	OS	No Minimum	N	Cont.	Y
Maryland	Forest Conservation & Management	OS	5	Y	15	Y
Massachusetts	Forest Land (Ch. 61)	FOR/OS	10	Y	10	Y
Massachusetts	Open Space or Recreation (Ch. 61B)	OS	5	N	Cont.	Y
Michigan	Commercial Forest	FOR	40	Y	Cont.	Y
Michigan	Qualified Forest Property	FOR	20	Y	Cont.	Y
Minnesota	Sustainable Forest Incentive Act	FOR	20	Y	8	Y
Minnesota	2c Managed Forest Land	FOR	20	Y	Cont.	N

1: AG = Sustain Agriculture, FOR = Sustain Forestry, HAB = Habitat Conservation, OS = Maintain Open Space

2: CD = County Dependent; counties differ on requirements

3: Cont. = Enrollment is continuous until land changes use or is withdrawn

Preferential Property Tax Programs* Relevant to Family Forest Owners

* Programs requiring something of landowners - active management, commitment to enrollment period, penalty for use change - in exchange for reduced taxes.

STATE	PROGRAM NAME/IDENTIFIER	PRIMARY GOALS ¹	MINIMUM ACREAGE TO ENROLL ²	REQUIRES MANAGEMENT PLAN ²	DURATION OF ENROLLMENT (YEARS) ³	WITHDRAWAL PENALTY
Mississippi	<i>No Preferential Property Tax Program</i>					
Missouri	Forest Cropland	FOR	20	Y	25	Y
Montana	Forest Lands Tax Act	FOR	15	N	Cont.	Y
Nebraska	<i>No Preferential Property Tax Program</i>					
Nevada	Agricultural Use	OS	7	N	Cont.	Y
New Hampshire	Forest Land	OS	10	N	Cont.	Y
New Hampshire	Forest Land with Documented Stewardship	OS	10	Y	Cont.	Y
New Jersey	Farmland Assessment Act of 1964	AG	5	Y	2	Y
New Mexico	<i>No Preferential Property Tax Program</i>					
New York	Forest Tax Law, Sec 480a	FOR	50	Y	10	Y
North Carolina	Forestland	FOR	20	Y	3	Y
North Carolina	Wildlife Conservation Program	HAB	20	Y	Cont.	Y
North Dakota	Forest Stewardship Tax	FOR	10 if natural, 5 if planted	N	5	N
Ohio	Ohio Forest Tax Law	FOR	10	Y	Cont.	N
Oklahoma	<i>No Preferential Property Tax Program</i>					
Oregon	Small Tract Forestland Program	FOR	10	N	Cont.	Y
Oregon	Forestland Program	FOR	2	N	Cont.	Y
Oregon	Open Space Assessment	OS	No Minimum	N	Cont.	Y
Oregon	Wildlife Habitat Conservation & Management Program	HAB	No Minimum	N	Cont.	Y
Pennsylvania	Clean and Grean	OS	10	CD	Cont.	Y
Rhode Island	Farm, Forest and Open space Act	OS	10	Y	15	Y
South Carolina	Agricultural Assessment Reform Act of 2009	AG/FOR	5	CD	Cont.	Y
South Dakota	<i>No Preferential Property Tax Program</i>					
Tennessee	Greenbelt -Forest	OS	15	Y	Cont.	Y
Texas	Timberland (1-d-1)	FOR	CD	CD	Cont.	Y
Texas	Open Space	OS	CD	Y	Cont.	Y
Utah	Farmland Assment Act aka Greenbelt Act	AG	5	N	2	Y
Vermont	Use Value Appraisal	FOR/OS	25	Y	10	Y
Virginia	Forestry Land Use Assessment	FOR/OS	20	N	Cont.	Y
Washington	Designated Forest Land	FOR	20	N	Cont.	Y
Washington	Open Space - Timberland	FOR/OS	5	Y	Cont.	Y
West Virginia	Managed Timberland	FOR	10	Y	Cont.	N
Wisconsin	Managed Forest Law	FOR	10	Y	Option: 25 or 50	Y
Wyoming	<i>No Preferential Property Tax Program</i>					

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