Federal and State Tax Treatment of Private Forestland

A Position Statement of the Society of American Foresters

Orignially adopted on April 21, 1986 and subsequently revised and renewed by the SAF Board in December of 2016. This position shall expire in May of 2021, unless, after subsequent review, the Board decides otherwise.

Position

The Society of American Foresters (SAF) believes tax policies based on equity and certainty are required to encourage the nation's private forest landowners to make sustained, long-term capital investments in forest management. Rather than distorting market forces, taxation of private forest landowners should be comparable if not equitable to other capital ventures, including agriculture, as this will encourage practices that retain forests that contribute monetary and societal benefits to the nation. Alleviating any prevailing uncertainty in tax policies relating to forest management is important to forest landowners due to the unique and long-term characteristics associated with timber and forest management investments, including the intergenerational transfer of forestlands and the acceptance of long term risks by forest landowners. Ultimately, the nation should strive for sustainable forests, where the economic, environmental, and social values provided from forests are in balance. Sound tax policy will ensure sustained environmental and social benefits within a predictable economic framework. Incentives such as use value property taxation, expensing of management expenses, capital gains treatment of timber sale revenue and the reforestation expense and amortization are tools to reduce the burden of forest management and should be maintained. To encourage management of healthy forests, equitable tax treatment as well as strong markets and reasonable regulations are necessary.

Issue

Private forests provide essential watershed protection, carbon sequestration, wildlife habitat, and many recreational opportunities, as well as the major share of forest products produced in the United States. As a result, private forest landowners will need to take a leadership role in the practice of sustainable forestry, conservation, and best management practices. Private forest landowners incur costs related to the production of these benefits without often receiving revenues for many years. In addition, private forests can be subject to a variety of development pressures to convert to other land uses. Federal and state tax policies can play an important role in counteracting these pressures that reduce private forests' ability to provide these wide-ranging benefits. Well-crafted tax policy can further the public's interest in promoting adequate investment in, and sustainable management of, the nation's privately owned forests. Also of concern is the ever-changing nature of our tax policies. Forest landowners are invested in the property for the long-term and thus need stability in the tax codes under which they operate. They cannot plan for the future under tax codes that are unstable or in flux with provisions that can be threatened by each legislative session.

Background

The Role of the Private Forest Landowner

Private forestry investments significantly add to the ecological, economic, and social prosperity of the nation. Approximately 445 million acres (58%) of forestland in the United States is owned by private individuals, corporate entities, or other private groups. These lands accounted for more than 90 percent of the nation's wood and paper products (Oswalt et al. 2014). The nation's private forests represent an important pillar of job creation in rural areas where each 1,000 acres of privately owned forest is responsible for the creation of seven jobs. For example, Forest2Market's (2013) 32-state study found that more than 2.4 million people were employed either directly or indirectly in forest-related sectors. In addition to wood fiber, the sustained management of private forests provides wildlife habitat, recreation opportunities, and numerous environmental amenities such as clean water, carbon sequestration, and biodiversity protection. Private forest landowners are also dealing with the very real risk of insect and disease issues, and natural disasters such as hurricanes, tornados, ice and wildfire. Some of these risks can be reduced through forest management practices.

Private forests face tremendous pressures from urban expansion, highway construction, utility rights-of-way, and the aforementioned reliance of society as the primary source of wood fiber. Increasing development pressure on private forests, combined with inconsistent treatment of forest management compared to agriculture in the federal tax system, discourages private forest owners from managing for long- term sustainability and environmental quality (see SAF's Position Statement on Loss of Forest Land:
http://www.safnet.org/policyandpress/psst/loss_of_forest_land.cfm).

The Abbreviated Tax Treatment of Private Forest Lands

Three types of taxes affect private forest landowners: property, income, and estate taxes (Kimbell et al. 2010). The federal government levies income and estate taxes, while state and local municipal governments may collect all three. Property tax systems vary greatly across the country and often within a state. The property tax is often determined at the county or locality level, in most cases with a use tax provision in place for working lands. These use tax provisions allow forest land to be taxed at its current use value rather than its value for development purposes. In some instances, these use tax provisions result in a deferral of property tax which is then collected at the time of a timber sale or an outright reduction in assessed value.

In the federal income tax system, forest landowners generally qualify for long-term capital gains treatment on profits generated from the sale of timber (Greene et al. 2012). Federal tax provisions take into account the long-term nature of forest investments: the treatment of reforestation which allows $10,000 to be deducted in the first year for qualified expenditures, and the amortization of additional expenses for 84 months. Additionally, timber depletion deductions allow forestland owners to recover all or a portion of their investment costs upon liquidation. Deductions also allow for casualty losses, timber theft, public condemnation, and other involuntary conversions (Greene et al. 2012).

The federal estate tax rate can be an important factor in forest management planning. Though the estate tax is more often levied at the state level, studies have demonstrated that the federal estate tax can force heirs to suboptimize their assets, in effect distorting market forces, by either harvesting timber prematurely or selling the timberland outright to pay the levied tax. Greene et al. (2006) estimated that landowners harvest 2.4 million acres of forestland each year to pay the federal estate tax, which causes some forest landowners to fragment and parcelize their lands. However, maintaining the current estate tax package that carries a 40 percent tax on estates over the exemption with the exemption indexed for inflation and includes an allowance for a spouse to carryover unused exemption amounts as opposed to previous tax packages with taxes approaching 55 percent of estate (with exemption values) may influence landowner behavior and result in retention of forests. This package coupled with the ability to utilize section 2032A which can reduce the value of the forested part of the estate by up to $1,110,000 (2016 number, adjusted for inflation each year) may reduce the burdens on heirs that can result in suboptimization of assets.

Many aspects of private forestry infrastructure, including manufacturing plants, in-woods equipment investments, and sustained forest management have been encouraged by federal tax policies, such as tax rates more favorable than ordinary income rates, accelerated depreciation schedules, deductions, and tax credits (USFS 2011). Employing the functionality of the Federal tax code is preferable to subsidy programs since it provides for more equitable participation of private forest landowners.

The Unique Nature of Private Forestland Investments

Investments in private forest management are unique in many respects. Typically, they: must be held for a long period of time (i.e., decades), are subject to substantial physical and economic risk, have a low degree of liquidity, and sometimes yield rates of return that are low relative to other capital investment opportunities. These investment characteristics can have serious adverse consequences for the nation’s private forests where a significant investment might not yield an offsetting return for 20 to 120 years.

Collectively, these factors discourage many forest owners from investing in forest management, and contributes to reduced interest in forest regeneration, decreased timber production, liquidation of timber inventories, and makes forest ownership and timber investments less attractive than nontimber options. The associated adverse impacts are substantial with respect to ensuring a sustained stream of forest products and environmental services into the future from the nation’s private forests. Management of our forests is critical to the production of clean air, clean water, wildlife habitat, recreation as well as wood products. Sound tax policies at the state and federal level along with strong markets and reasonable regulations are key for sound private forest land management that leads to healthy forests.

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