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EXECUTIVE SUMMARY

Study Objectives

- This study was undertaken in order to: document the current landscape of federal, state, and local tax policies affecting family forest owners; evaluate the impacts of these tax policies on family forest owners' decisions; and identify the strengths and weaknesses of these tax policies.

Background

- There are over 10 million family forest owners in the U.S. who collectively own 264 million acres of forest land, 35% of the forest land in the U.S. Amenity values, such as aesthetics, the woods being part of their home site, privacy, nature protection, and family legacy, are among the most common reasons for owning forest land.
- Policy tools to encourage the conservation of family forest lands include technical assistance, outreach education, financial incentives, and regulations. Among these tools, financial incentives, particularly tax incentives, play a prominent role.
- Property, income, and estate/inheritance taxes are the primary taxes affecting family forest owners.

Methods

- A mixed-methods approach was used to address the study objectives:
 - The existing literature was reviewed;
 - The current tax policies were documented, cataloged, and verified;
 - Property tax program administrators were surveyed to evaluate program effectiveness;
 - The impacts of tax policies on forest land loss, parcel size, and forest management were quantitatively analyzed;
 - Focus groups with family forest owners and forestry professionals were conducted; and
 - The results were synthesized with the assistance of select forestry/conservation and tax experts and family forest owners.

Results

- The majority of studies looking at the effects of forest taxation on family forest owners have taken a purely financial approach to examine property, income, or estate/inheritance taxes. No published studies have analyzed the cumulative impact of tax policies on the decision-making behavior of family forest owners.
- Income and, in most years, estate taxes are levied at the federal level. State and local governments are responsible for property taxes and, in some cases, additional income and estate/inheritance taxes. State-level income tax policies exist in 82% of the states, and estate or inheritance tax policies exist in 40% of states. Federal income and estate taxes typically exert greater influence on family forest owners because they have higher tax rates than state-level income and estate/inheritance taxes.

- Property taxes were more commonly mentioned as a problem, in 7 out of 10 focus groups, than income or estate/inheritance taxes. Some forest owners in the focus groups indicated that property taxes are contributing to their decisions to sell land. Other forest owners indicated that preferential property tax programs are enabling them to keep their land.
- All states have policies that allow for the reduction or elimination of property taxes on forest land. In 12 states, these property tax programs are entitlements. In the other states, owners must enroll in a preferential property tax program. Enrollment periods for these programs range from 2 to 50 years, 81% have a withdrawal penalty, and 54% require a forest management plan.
- Five groupings or clusters of preferential property tax programs were identified based on program requirements and policy effectiveness criteria. Rates of forest loss were only marginally different between the groups; change in parcel size and prevalence of management plans did not significantly differ.
- Fifty-one percent of surveyed property tax program administrators agree or strongly agree that their program is effective in protecting forest resources in areas highly susceptible to development.
- Forty-six percent of responding administrators estimated that less than half of eligible family forest owners are enrolled in a preferential property tax program.
- Focus group discussions suggest some preferential property tax programs suffer from considerable confusion on the part of landowners (including program enrollees) who are unclear of program requirements, such as timber harvesting and public access, withdrawal penalties, and in some cases, even whether or not they are enrolled.
- Income taxes were not a large concern among most forest owners who participated in the focus groups. This is largely because most of them did not earn income from their land, or did so infrequently.
- Among forest owners who regularly harvest trees or otherwise earn an income from their land, there was a relatively high awareness of at least some of the preferential income tax provisions, such as capital gains treatment and various allowable deductions.
- While many of the focus group participants expressed issues with transferring land to the next generation, estate/inheritance taxes were not the primary concern. A small number of family forest owners in the focus groups had started to plan for the succession of their land.

Conclusions

- Taxes are one of a number of factors that may influence a forest owner's decision about her/his land. The ultimate question of what is the impact of taxes on family forest owners is still largely unanswered, since the tax "landscape" varies so much between states, and implications depend heavily on the circumstances of individual forest owners. It is likely that the significance of the impact will vary among different segments of forest owners.

- Low awareness, confusion, and misinformation are inhibiting tax programs and policies from reaching their full potential. The communications about these programs should be more targeted, consistent, and readily available.
- In addition to the forest owners, more effort could be made to provide better information to the accountants, estate planners, foresters, and other professionals with whom forest owners interact.
- To be the most beneficial to family forest owners, tax policies should be flexible, appropriate, and simple. The policies should be flexible enough to address the relevant, local issues; appropriate for forest owners' needs and desires; and simple enough to be quickly and easily grasped.
- A sliding scale capital gains tax rate, that decreases the longer an asset is held, could be used to encourage financially motivated owners to hold their land and timber for longer.
- To incentivize the provision of ecosystem services, the income generated from their production could receive a favorable tax treatment or even be exempted from income taxes.
- To assist more people in acquiring forest land, a first time forest owner's tax credit could be created. Stipulations would need to be created to ensure that such a program does not inadvertently contribute to forest parcelization or other undesirable outcomes.
- Better and more simplified information on estate planning is needed. The process should be broken into discrete, digestible bites that owners and their families can deal with at their own pace.
- Subsidies, including cost-share and tax credits, for the creation and updating of estate plans might help forest owners keep their land in the family, thus increasing the likelihood it remains forested.
- Estate tax right of survivorship could be expanded from spouses to all family members to allow land being passed to any family member to be exempt from estate taxes. This could act as an easy way to defer tax payments and as an incentive to keep the land in the family.
- Tax policies could be expanded to further incentivize conservation easements. For example, eased forest lands could be exempt from property and estate/inheritance taxes and donated easements could receive further enhanced beneficial income tax treatment.

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PROJECT OVERVIEW

There are over 10 million family forest owners¹ across the U.S. (Butler 2008). Collectively they control 264 million acres or 35% of the nation’s forest land (Butler 2008; Figure 1); in some states, the percentage of family forest ownership can be over 75% (Figure 2). If the forestry and conservation community is interested in keeping forests as forests and increasing sustainable forest management, the attitudes and behaviors of this diverse and dynamic group of people and the factors that influence their decision-making must be understood.

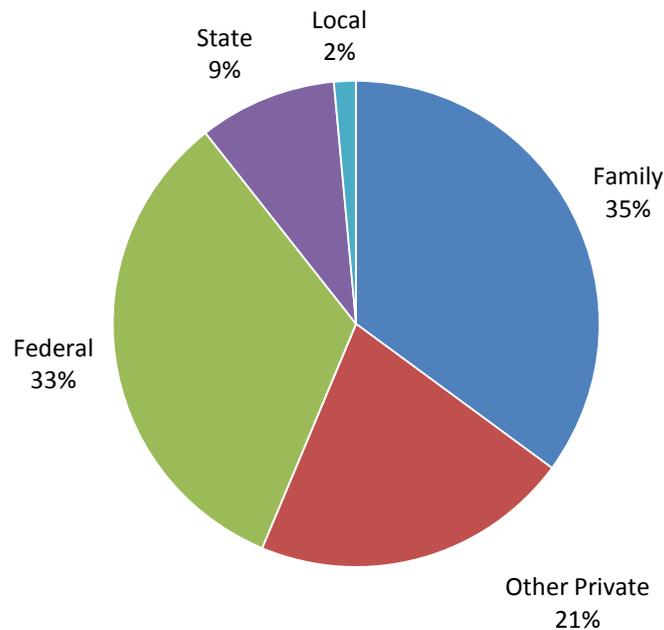


Figure 1. Forest ownership in the U.S. (Source: Butler 2008)

¹ According to the U.S. Forest Service (Butler 2008), this group includes “families, individuals, trusts, estates, family partnerships, and other unincorporated groups of individuals that own forest land.”

Like most Americans, most family forest owners would prefer to pay less in taxes. But what impacts do taxes have on owners' behaviors? Do tax policies affect the rate of conversion of forest to development? Do tax policies influence owners' management practices?

"Nobody likes to pay taxes."
- A Wisconsin Forest Owner

Objectives

This project addresses three questions:

1. What is the current landscape of federal, state, and local tax policies affecting family forest owners?
2. What are the impacts of these tax policies on family forest owners' decisions?
3. What are the strengths and weaknesses of these tax policies?

The first objective is aimed at identifying where specific tax provisions exist and detailing those policies. Based on this, the key similarities and differences among property, income, and estate/inheritance tax policies were summarized.

The impacts of tax policies on forest use, objective number two, were assessed using qualitative and quantitative approaches. Focus groups were conducted to understand, among other tax related topics, how taxes are influencing the behavior of family forest owners. Statistical relationships between tax policies and forest conservation metrics, namely state-level forest conversion rates, changes in sizes of private holdings, and the prevalence of forest management plans, were tested.

By identifying the strengths and weaknesses of the policies, objective number three, the attributes that may encourage participation and enable forest owners to maintain their land as forest and ultimately, to sustainably manage that forest resource, can be ascertained. The identification process began with information gained from the focus groups conducted with family forest owners and was augmented by input from selected forestry/conservation and tax professionals.

Approach

The approach used to address the study objectives was as follows:

- Review and synthesize the existing literature on the influences of tax policies on family forest owners.
- Review and summarize relevant tax policies at the federal, state, and local levels.
- Conduct interviews with tax experts to verify our understanding of the programs and provisions and gain additional insights.
- Survey preferential property tax program administrators to verify program attributes and assess policy effectiveness.
- Conduct focus groups with family forest owners and forestry/conservation professionals to better understand their awareness and use of preferential tax policies and the degree to which taxes influence their decision-making behavior.
- Quantitatively assess the impact of tax policies on forest trends.
- Convene a forum to present results, identify the strengths and weaknesses of existing tax policies, and discuss ideas for tax policy innovations.

Throughout this project, tax policies were examined from the perspective of family forest owners: What are their attitudes and levels of knowledge? How do the policies affect their behavior? Hopefully this perspective will allow a better understanding of what matters to family forest owners and what affects their decision-making.

Timeline

This project was initiated in September, 2009 (Figure 3). The first parts of the project, the literature and policy reviews, were largely conducted in late 2009 and early 2010. Quantitative analysis of the state forest tax policies was largely carried out from February through August, 2010. Focus group planning began in the spring of 2010 and the focus groups were conducted in June and July, 2010. Planning for the forum to discuss the initial results began in June, 2010 and it was held in October, 2010.

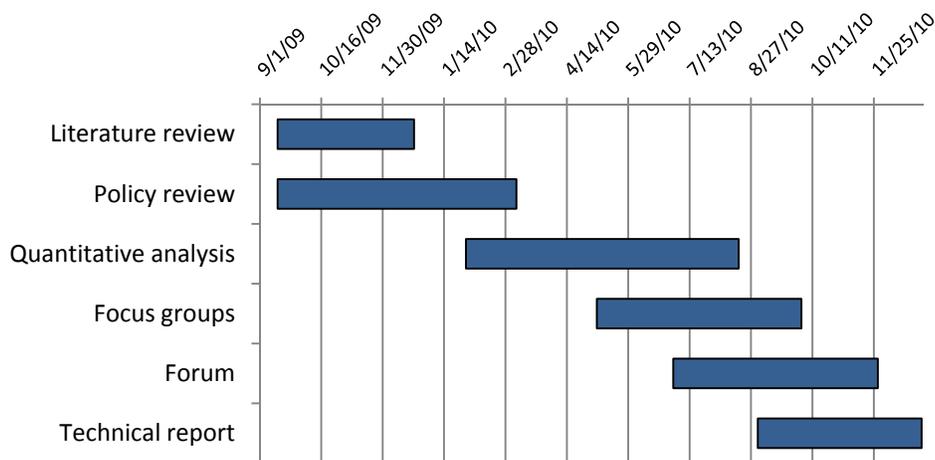


Figure 3. Project timeline.

METHODS

A mixed-methods approach was used to study the impacts of taxes policies on family forest owners of the U.S. Following a review of the existing literature, existing policies were documented, catalogued, and verified; state property tax program administrators were surveyed; impacts on forest land loss, parcel size, and forest management were quantitatively analyzed; focus groups with family forest owners and forestry/conservation professionals were conducted; and results were synthesized with the assistance of select forestry/conservation and tax experts and family forest owners. Below are the details of these methods.

Literature Review

The first step in this project, as in most research projects, was to review the existing literature on the topic of interest – here, tax policies as they relate to family forest owners. Initial efforts were focused on literature that was published in peer-reviewed journals within the past 10 to 15 years. Seminal works published earlier were also examined. Subsequent efforts examined the “grey” or non-peer reviewed

literature. Results are summarized in the Literature Review section below and an annotated bibliography of selected studies is included in Appendix II on the CD that is included with this report.

Policy Review & Verification

The current tax environment for family forest owners was determined by reviewing, cataloguing, and verifying current policies at the federal, state, and local levels. Based on the existing literature, and cross-verified with key informant interviews and forest owner focus groups, we concentrated our efforts on property, income, and estate/inheritance taxes. At the national level, the current income tax and estate tax rules and provisions were documented. For each state, the income and estate/inheritance tax rules and provisions were recorded. We started by reviewing the forest tax data available on www.timbertax.org and then filling in the gaps and updating the data using information available from government websites and other sources.

Preferential property tax programs were defined as programs that obligate owners to specified actions in return for a reduced annual tax burden. The following information was collected on each state preferential property tax program:

- Program goal;
- Minimum acreage requirement;
- Minimum enrollment period;
- Withdrawal penalty;
- Requirement for a written forest management plan; and
- Requirement for timber management.

To gain further insight, one-on-one interviews were conducted with 11 individuals having expertise in the administration of property, income, and estate/inheritance. These interviews were conducted in August and September, 2010 and typically lasted 30 to 60 minutes.

Survey of Preferential Property Tax Program Administrators

To verify and augment the data compiled from the document review, a questionnaire (Appendix III) was sent to individuals, either state forestry agency or department of revenue employees, involved in the administration of preferential property tax programs. The surveys focused on preferential property tax programs which were defined as voluntary programs that obligate owners to restricting the use of their land, having a written forest management plan, or paying a penalty for removing land from the program, in return for a reduced annual tax burden.

The experts were asked to verify the attributes listed above and then use a five-point scale to rate their state's preferential property tax programs according to the eight policy effectiveness criteria identified by Hibbard et al. (2003):

- The program has clearly articulated goals;
- The magnitude of the tax break is significant;
- The program complements other state forestry incentive programs;
- The forest land valuation mechanisms, eligibility requirements, withdrawal penalties, and minimum enrollment periods reflect program goals;
- The program is consistently administered from county to county;
- Funding for the forestry tax program has been stable and predictable;

- The program is periodically reviewed to ensure that objectives are being met; and
- Guidance through the application process is available to forest owners.

The administrators were also asked to estimate the average savings for enrollees in the preferential property tax program, the percentage of the eligible forest owners enrolled, and the overall effectiveness of the program for protecting forest resources in areas highly susceptible to development.

Quantitative Analysis

Following the collection of the tax policy information listed above, a cluster analysis was conducted to identify groupings of states with similar preferential property tax program attributes and policy effectiveness criteria ratings. The results of this analysis were used to examine the impact of state preferential property tax programs on forest trends and as an aid in choosing focus group locations. If a state had more than one preferential property tax program, only the primary program, defined as the program most widely used, was included in the analysis.

As mentioned earlier, state tax program administrators were asked to evaluate the effectiveness of their preferential property tax programs according to eight policy effectiveness criteria. To test for redundancy among the eight policy effectiveness criteria, Cronbach's Alpha was calculated (Hair et al. 1998); a high value, e.g., over 0.7, indicates a high amount of redundancy and suggests the need of a variable reduction technique. Principal component analysis is a variable reduction technique that allows for the transformation of a large number of correlated variables to a smaller set of uncorrelated, composite variables called principal components with a minimal loss of information (Hair et al. 1998). The results of a principal component analysis are usually discussed in terms of principal component loadings. Principal component loadings represent the correlations between the original variables and the principal components and are used to define each principal component. Absolute principal component loadings greater than 0.60 are considered significant and indicate a strong association among the original variables.

Clustering analysis is a multivariate technique that can organize data into discrete segments, such that within-segment similarity is maximized and among-segment similarity is minimized (Hair et al. 1998). The k-means clustering algorithm was used to assign states into exclusive segments based on the variables derived from the principal component analysis, as well as three state-level preferential property program requirement variables (management plan, enrollment period, and withdrawal penalty). Three-, four-, and five-cluster solutions were generated and the final solution was selected by examining the consistency within and across clusters.

Box plots and analysis of variance were used to examine the relationships between property tax policy and forest conservation at the state level. Property taxes were the focus of this analysis because of the purported higher influence of these taxes, as opposed to income or estate/inheritance taxes, on family forest owners and the higher variability of preferential property tax program attributes. Forest conservation was represented by:

- Change in area of private forest land between 1997 and 2007 (Smith et al. 2009);
- Change in size of private forest holdings between 1993 and 2006 (Birch 1996; Butler 2008); and
- Percentage of family forest acres owned by people with written forest management plans in 2006 (Butler 2008).

Focus Groups with Family Forest Owners

Focus groups with family forest owners were conducted in order to understand the impact of property, income, and estate/inheritance taxes on family forest owners' decisions, their awareness of programs and provisions to reduce or defer taxes, their use of these programs and provisions, the reasons why some owners do not use the programs, and what information sources they rely upon. In addition, background information was collected on why they own their land and general concerns regarding ownership. A summary of the focus groups is included below and more detailed findings are included in Appendix IV. An example of the topic guide used to facilitate the focus groups is included in Appendix V.

Ten focus groups, two 2-hour groups in each location with 8-10 family forest owners per group, were held in Manchester, NH, Columbia, SC, Calera, AL, Wausau, WI, and Olympia, WA (Figure 4) in June and July, 2010. These states were selected to represent a broad range of property, income, and estate/inheritance tax policies. The specific towns/cities were selected based on conversations with local experts to identify locations where substantial amounts of private forest land still exist, but which are also subject to significant development pressure.

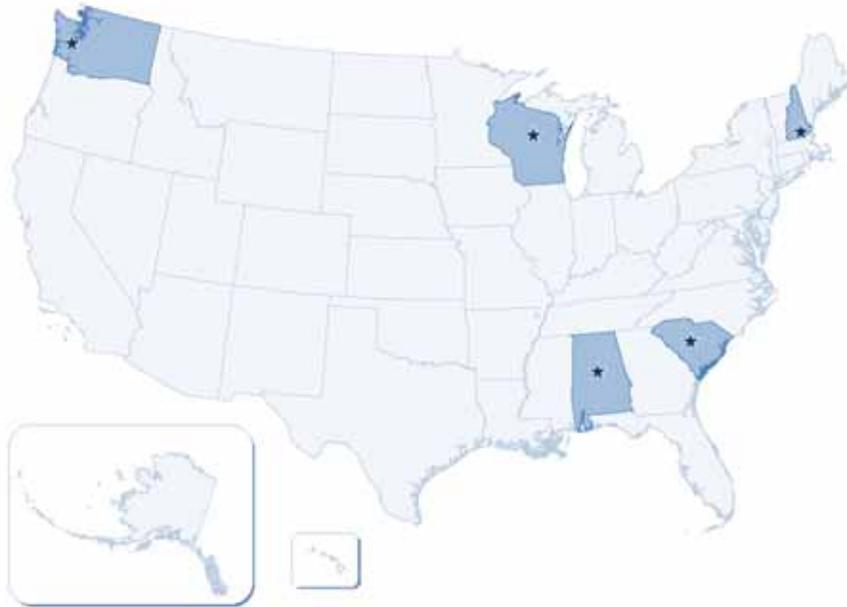


Figure 4. Locations of focus groups.

Landowners were selected from property tax rolls obtained from local assessors' offices. Each landowner had to have a total of between 10 and 999 acres of forest land to qualify for a focus group. A series of questions and recruitment goals, the screener questionnaire (Appendix VI), was used to recruit family forest owners with a mix of: acreages; harvesting experiences; acquisition histories (inheritors and non-inheritors); estate planning actions (those who had and had not taken formal/legal steps concerning their land's future); and demographics (gender, ages, and education). In each location, one

group was planned for owners enrolled in a preferential property tax program and one for non-enrollees².

Focus Groups with Forestry & Conservation Professionals

In New Hampshire, South Carolina, Wisconsin, and Washington, parallel focus groups were conducted with forestry and conservation professionals. No focus group with professionals was conducted in Alabama due to logistical problems. Six to ten people from a combination of state forestry agencies, university extension systems, non-governmental organizations, and private consultants participated in these focus groups. Each forestry professional focus group discussed the same topics covered in the forest owner focus groups.

Forest Forum

To present the initial findings from this project and to begin synthesis of conclusions, 15 individuals with forestry/conservation and/or tax expertise, in addition to the project team, were convened under the auspices of the Yale Forest Forum in New Haven, CT on October 14 and 15, 2010. Detailed findings of the forum are available in Reuben and Tyrrell (2010).

BACKGROUND

This section describes general family forest owner characteristics and reviews the literature on forest tax policies affecting family forest owners. A summary of the characteristics of family forest owners provides the basis for an understanding of who family forest owners are and why they own land. The literature review focuses on characterizing how tax policies influence family forest owner decisions.

Family Forest Owners

The U.S. Forest Service conducts the National Woodland Owner Survey (NWOS) to increase forestry professionals', policy analysts', and the general public's understanding of family forest owners (Butler 2008). According to the NWOS, there were over 10 million family forest owners in the U.S. as of 2006. Although most family forest *owners* have between 1 and 9 acres of forest land, the majority of the family forest *land* is in holdings of 50 acres or more (Figure 5).

² There was confusion among some forest owners concerning whether they were enrolled in a preferential property tax program, particularly in states with low enrollment criteria (i.e., Alabama and South Carolina). The focus groups for the enrollees did have more enrollees, but they usually had a few non-enrollees as well. Likewise for the focus groups for the non-enrollees, there tended to be a few forest owners who were in fact enrolled. This confusion was caused by forest owners not knowing the name of the program in which they are enrolled, not knowing if they are enrolled in a program or not, and the recruiters not always using the best descriptor of the program.

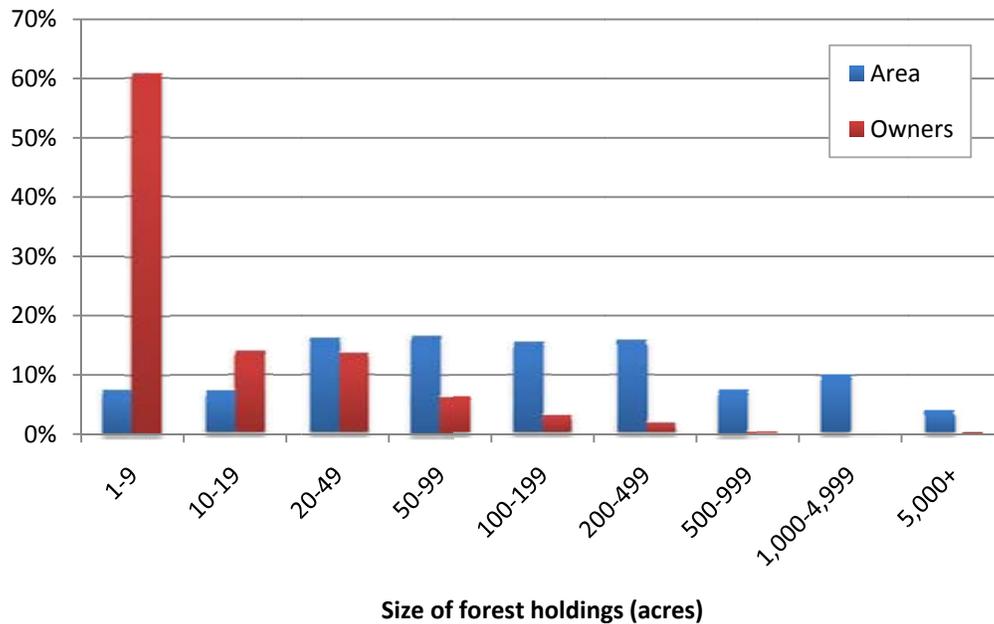


Figure 5. Size of family forest holdings in the U.S., 2006. (Source: Butler 2008)

There are many different reasons why family forest owners own land, and most own for multiple reasons. Amenity values, as a whole, outweigh the importance of financial values for most forest owners (Figure 6). The top reasons for owning are related to aesthetics, the woods being part of their home site, privacy, nature protection, and family legacy (Butler 2008). This is not meant to imply that owners are not interested in actively managing their land. In fact, 27% of the family forest owners, who own 58% of the family forest land, have commercially harvested trees (Butler 2008).

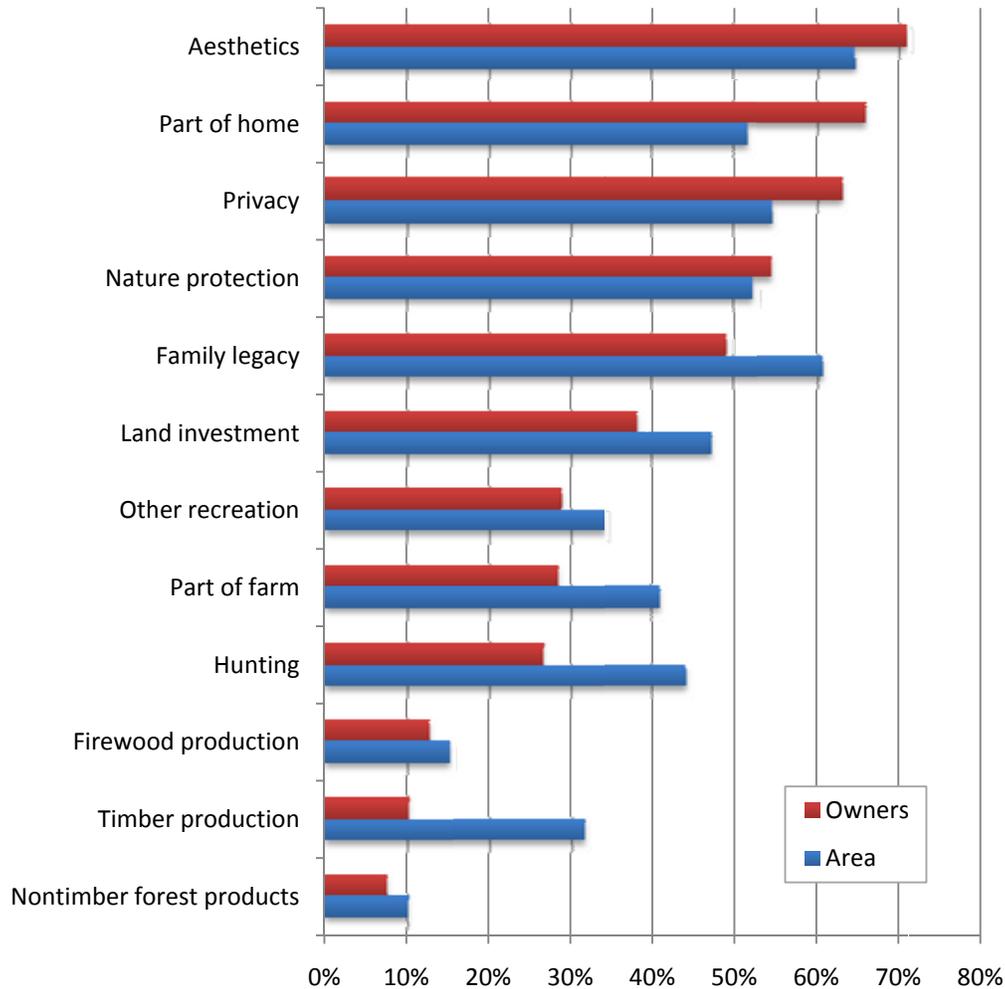


Figure 6. Reasons why family forest owners own forest land in the U.S., 2006. (Source: Butler 2008)

Another way to look at family forest owners is to group them based on their attitudes towards owning forest land as the Sustaining Family Forests Initiative has done (Butler et al. 2007; www.sustainingfamilyforest.org). Using this approach, family forest owners can be classified as: woodland retreat, supplemental income, working the land, or uninvolved owners (Figure 7). Woodland retreat owners are most interested in the amenity values their forests provide and more likely to have their home associated with their forest land. Supplemental income owners are interested in earning money from their land, either through timber harvesting or land sales, and tend to have larger properties. Working the land owners are multiple objective owners, they are interested in a combination of amenity and financial values. Uninvolved owners tend to not have strong ownership objectives.

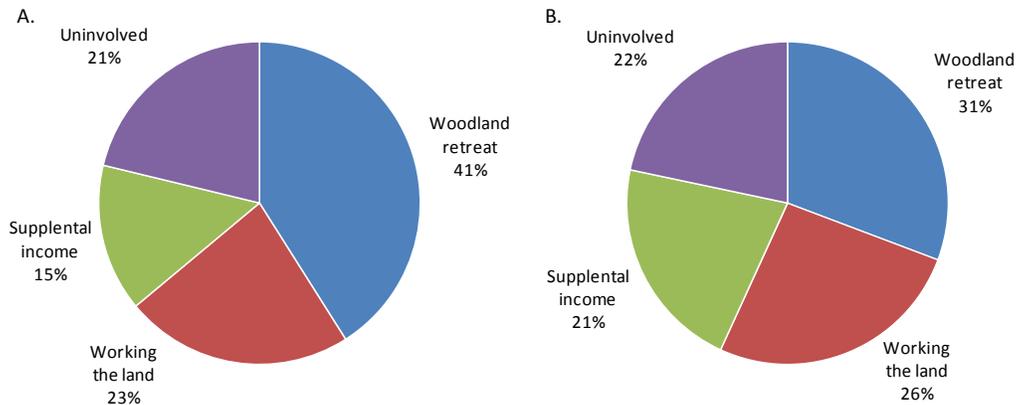


Figure 7. Attitudinal groupings of family forest owners with 10-999 acres of forest land in the U.S., 2006 by A.) percentage of owners and B.) percentage of area. (Adapted from: Butler et al. 2007)

Literature Review

The majority of studies looking at forest taxation have concentrated on property, income, or estate/inheritance taxes – the taxes that have the greatest potential impact on family forest owners. Our primary focus of the literature review was on these three taxes and, more specifically, studies published within the last 10 to 15 years that examined these policies in relation to family forest owners.

Property Taxes

Property tax policy is one of the more widely studied areas of forest economics. These studies tend to describe forest tax programs and policies, analyze financial impacts of these policies on land management decision-making and profitability, or describe participation rates, level of program awareness, impact on management and land use decisions, and/or administrative issues.

Sampson and DeCoster (2000) and Mehmood and Zhang (2001) stated that property taxes were a key determinant in forest parcelization and fragmentation in the U.S. Sanborn-Stone and Tyrrell (In review) found that 27% of surveyed forest owners in two New York state watersheds who had parcelized their forest land reported the burden of property taxes was the number one reason for having done so, while nearly half cited the tax as among the top three reasons for subdividing their land. In contrast, Polyakov and Zhang (2008) found that in Louisiana the probability of land use change was not significantly impacted by changes to the amount of tax due.

There is great variety among property taxation systems and a diversity of approaches have been used to study them. A few studies have taken a national look at preferential property taxation systems, but most have examined specific state programs. The state-level studies have focused on forest owner awareness of programs, rates of enrollment, impacts on management and conversion to non-forest land, and administrative issues.

Hibbard et al. (2003) classified preferential property taxation programs as:

- Ad valorem – valuation based on fair market value;

- Current use – valuation according to use in a forested condition;
- Flat – taxed at a fixed, per acre value;
- Exemption – forest land is exempt from property taxation all together;
- Additive – levies placed on timber at the time it is harvested (yield or severance); or
- Hybrid – commonly a combination of current use and ad valorem values.

Based on fiscal neutrality, tax burden, revenue stability, and administrative simplicity, Chang (1996) concluded that the optimal property tax system should be based on the average net annual revenue derived from the forests. This system, according to Chang, has no influence on optimal rotation age, places a lighter burden on less productive land, provides a stable annual tax revenue, since tax rolls need infrequent updating, and is relatively simple to administer.

In contrast to England and Mohr (2003), whose theoretical modeling led them to conclude that preferential property tax programs “unambiguously delay development,” Williams et al. (2004) found that Tennessee’s Forest Greenbelt Program did not dissuade forest owners from converting their land. At least theoretically, programs should be effective when tax rates are high or discount rates are low (England and Mohr 2003).

In a survey of forestry agency officials, awareness of preferential property tax programs by private forest owners was ranked higher than awareness of other incentives, but the officials ranked tax programs lower in helping forest owners meet their objectives (Jacobson et al. 2009). A lack of awareness of Tennessee’s Forest Greenbelt Program was cited by Williams et al. (2004) as the principal reason why less than a quarter of eligible participants had taken advantage of the program. In a survey sent to all forest owners in a three-county region of the state’s heavily forested Cumberland Plateau, 80% of the respondents had never heard of the Greenbelt program or they felt they did not have sufficient information about it. In addition to a lack of awareness regarding the program’s existence (62%), Fortney et al. (2011) found enrollment in West Virginia’s Managed Timberland program to be low due to the ability of some forest owners to qualify for the state’s farmland classification (23%); land under West Virginia’s farmland classification is taxed at even lower rates than is forest land. Another reason cited for not enrolling in West Virginia’s Managed Timberland program was due to concerns about property rights (16%).

An investigation of factors influencing participation in Minnesota’s Sustainable Forest Incentives Act identified five significant predictors of enrollment: compensation amount, intention to obtain a forest management plan, opposition to the program’s land covenant, prior awareness of the program, and total acres of forest land owned (Kilgore et al. 2008). Dennis and Sendak (1992) found participation rates to be positively correlated with forest owner education level. Kilgore et al. (2008) suggested that Minnesota’s Sustainable Forest Incentives Act increase financial incentives, remove the requirement of deed restrictions placed on enrolling property, and/or increase publicity regarding the program to increase enrollment rates. Some programs have enrollment criteria that are so restrictive that a high percentage of a state’s forest owners are ineligible (Kernan 2004).

The effectiveness of many programs, at least in terms of mitigating forest loss, have been called into doubt because of the higher rates of enrollment in rural areas compared to the areas facing greater development pressures (Dennis and Sendak 1992; Brockett and Gebhard 1999). Brockett and Gebhard (1999) concluded that Tennessee’s preferential property tax program was little more than a windfall for participating forest owners, while failing to serve those along the development front where taxes were

most burdensome. Dennis and Sendak (1992) attributed decreased rates of enrollment nearer population centers to forest owners not wishing to limit future options given a potential increase in land value perceived to accompany areas experiencing rapid growth. In contrast, rates of enrollment in West Virginia's Managed Timberland program were found to be higher in the eastern panhandle region of the state, an area subject to a relatively high degree of development pressure, than were rates in other regions of the state (Fortney et al. 2011). However, Fortney et al. (2011) noted that participants in this region received unusually high assessments for a forest tax incentive program, and in some cases enrolled forest owners in this area were paying more in tax, per acre, than their counterparts elsewhere in the state who were not enrolled in the program.

In many states, programs require a forest management regime dedicated to timber production as a condition for enrollment. A study of Minnesota's taxation of forest land found that participants in its Tree Growth Tax Law program took a more active approach to management as compared to their non-enrolled counterparts (Rathke 1996). Jacobson and McDill (2003) highlighted the fact that Pennsylvania's Clean and Green program emphasized timber production even though timber management was seldom cited by private forest owners as a primary ownership objective.

Gamponia and Mendelsohn (1987) found that annual property taxes could impact the length of timber rotations, as in the case of a forest owner needing to harvest timber in order to pay her/his property tax. In contrast, the imposition of a yield or severance tax at the time timber is cut may serve to effectively extend rotational lengths as forest owners attempt to minimize the impacts of such a tax (Gamponia and Mendelsohn 1987).

Administrative difficulties are a challenge for many preferential property tax programs. In a number of states, the county or other local assessing agency is tasked with program oversight and administration. Researchers studying Pennsylvania's Clean and Green program found that although the commonwealth sets assessed values based on forest type classification to account for differences in the values of product grown, because the program did not require forest owners to have a management plan, assessors were often not able to determine forest type composition of individual parcels and frequently resorted to using a single weighted-average value based on coverage for the entire county. This results in forest owners with high-value forest types paying the same per acre tax as those with low-value forest types (Jacobson and McDill 2003).

Income Taxes

While this study is primarily an investigation of how taxes impact family forest owners, much of the peer-reviewed literature regarding the impacts of income tax has focused on provisions specifically relating to the treatment of income from harvesting timber, as well as credits and incentives aimed at forest health and reforestation, for all private forest owners.

Using a utility maximization model, Uusivuori and Kuuluvainen (2008) showed that the effects of taxes on income is unlikely to be the dominant factor in forest owner decisions to harvest timber. This trend increases as the relative importance of amenity values increases.

Federal income tax provisions available to some forest owners, depending on whether they hold timber for personal use, investment, or as a business, include (Greene et al. In press):

- Long-term capital gains treatment for qualifying income;
- Depletion deductions;

- Deductions for casualties and other types of losses;
- Enhanced charitable deductions for qualifying donations of conservation easements;
- Annual deductions of management costs;
- Depreciation and the section 179 deduction;
- Deduction of qualifying reforestation costs; and
- The ability to exclude part or all of qualifying cost-share payments from gross income.

The first four provisions are available to owners in all three categories, although owners who hold timber for personal use face strict limits on the amount they can deduct for a loss. Most of the remaining provisions are available to owners who hold their land to produce income, either as an investment or a business. Investors are limited in their ability to deduct management costs, however, and only the relatively few owners who meet the Internal Revenue Service tests for holding their timber as a business can take a section 179 or non-casualty loss deduction.

A study of South Carolina family forest owners found that only 25% of the owners were aware of all of the tax provisions surveyed, while 13% were not aware of any of the provisions (Greene et al. 2004). The most commonly known provision was long-term capital gains treatment of qualifying income, while the least well-known was the ability to exclude qualifying cost-share payments from gross income. Among owners who were aware of a provision, long-term capital gains treatment and annual deductions of management expenses were utilized by the greatest number, while deductions for casualties and other types of losses was utilized by the fewest. By failing to take advantage of the beneficial tax provisions, forest owners may lose a third or more of their revenue from a harvest due to income taxes (Bailey et al. 1999).

Although the federal tax code calls for taxpayers to establish their basis in capital assets at the time they are acquired, many family forest owners do not (Stier 1997). By neglecting to do so, they lose the ability to take depletion deductions from the gross sale proceeds for their “adjusted cost basis” in the timber sold, with the result that they pay tax on a higher percentage of their timber revenue.

To maximize their land expectation value (LEV), forest owners should take advantage of all available income tax provisions, most significantly is the treatment of income from timber sales as a long-term capital gain rather than ordinary income. “Forest owners who treat management expenses and property taxes as ordinary costs and who fail to deduct, amortize, or deplete reforestation costs can expect to lose between 12.1% and 76% of their land expectation value” (Smith et al. 2008, p. 126).

In addition to federal income taxes, most forest owners also face state income taxes when selling timber. In the western U.S., roughly 10 to 20% of owners’ total income tax liability on harvested trees was attributable to the state income tax (Bettinger et al. 1991). In the Northeast and Midwest, 7 to 26% of the total income taxes were attributable to state taxes (Siegel et al. 1996).

Many income tax provisions are aimed solely at timber production and are incompatible with many family forest owners’ objectives and practices. Koontz and Hoover (2001) criticized the current provisions as being limited to timber growth, excluding environmentally sensitive lands, burdening forest owners with complicated requirements, and being subject to policy changes. They suggested the following changes to the federal tax code:

- Allow the same tax treatment as reforestation costs for “qualified conservation practices”;

- Allow forest owners to deduct conservation expenses that increase the value of their property rather than requiring that the expenses be capitalized;
- Allow forest owners to choose between receiving cost-share or taking a tax deduction; and
- Allow forest owners to treat expenses they incur for conservation as a charitable contribution.

Reforestation tax incentives have been available for a number of years. As currently structured, the incentives provide the greatest benefits to forest owners with high levels of non-timber income and large forest properties, and are least favorable to forest owners with small holdings (Straka and Greene 2007).

Estate & Inheritance Taxes

The federal tax code also includes provisions that reduce or eliminate the impact of the federal estate tax, helping family forest owners keep their properties intact through a transfer from one generation to another and reducing the need to sell timber or land in order to pay the tax. The most important provisions include (Siegel et al. 2009):

- Stepped-up basis for property transferred by an estate;
- The marital deduction;
- The effective exemption amount for estates;
- Deferral and extension of estate tax;
- Special use valuation; and
- An exclusion for land subject to a qualified conservation easement.

In a study on the effect of estate taxes on members of forest land owner groups, 9% of survey respondents reported having been involved in the transfer of an estate (Greene et al. 2006). A majority of those involved (62%) reported that no federal estate tax was due. In the cases where estate taxes were due, 22% of the respondents reported timber was sold in order to pay all or part of the estate tax bill, with 75% of the sales necessary because other estate assets were inadequate to cover the liability. In 19% of the cases where estate taxes were due, the respondents reported land was sold off to pay all or part of the tax, with 57% of the sales necessary because other estate assets were inadequate.

States use two methods to tax estate property (Walden et al. 1987; Walden et al. 1988):

- Estate tax – levied on the estate bequeathing the property; and
- Inheritance tax – levied on the heirs receiving the property.

Historically, every state had at least one tax structured as a “piggy-back” or “pick-up” tax equal to the available amount of the federal credit for state estate or inheritance taxes. This approach apportioned part of what would have been the federal estate tax to the state, with no additional tax on the estate or heirs. Recent federal legislation, however, phased out the credit for state taxes, eliminating “piggy-back” and “pick-up” taxes. In response, many states “decoupled” their taxes from current federal law. Others allowed their taxes to phase out with the federal credit, while a few repealed their taxes or crafted stand-alone estate or inheritance taxes (Siegel et al. 2009).

Some states levy deductions, exemptions, credits, and special rates that also impact estate and inheritance taxes. Some states limit the marital deduction, with the result that a surviving spouse can face a substantial tax bill (Walden et al. 1987; Walden et al. 1988).

Peters et al. (1998) showed that with both federal and state taxes, estate planning techniques such as special use valuation, gifting coupled with minority discounts, deferral and extension, and the donation of a conservation easement, can result in significant tax savings.

Cumulative Impacts of Taxes

While there are numerous studies on the effect of individual taxes on forest owners, there are relatively few on the combined effect of multiple layers of tax (Smith et al. 2008; Siegel et al. 2009). Cushing (2006) was the only study identified that addressed the cumulative effect of all local, state, and federal taxes. In this study, the author calculated the cumulative burden of property, severance, yield, and income taxes on land expectation value (LEV) for 22 timber-producing states in the country based on:

- Common management practices;
- Reforestation and intermediate treatment expenses;
- Average stumpage prices;
- Property tax information;
- Yield or severance tax rates;
- State income tax rates; and
- Federal income tax rates.

The study did not address estate taxes. The results are predicated on an active and perpetual management regime for a forest owner with a financial motivation for owning forest land. After all taxes were imposed, land actively devoted to timber production was worth 50 to 80% of its pre-tax value.

In spite of considerable within-region variation in property tax liabilities, there were significant differences among regions. Among forest owners who managed their properties for timber and utilized the available preferential property tax programs, those in the North were subject to a much higher average property tax than those in the South or Northwest. Percent reduction in LEV due to property tax averaged 18% in the North, compared to 8% in the South and 4% in the Northwest. Federal and state income taxes were responsible for reductions in LEV that averaged, respectively, 19% and 6%. Reductions for severance and yield taxes averaged less than 2%.

Conservation Easements

Although not a tax policy, per se, conservation easements can have significant implications for property, income, and estate taxes. Federal and state tax incentives have been available to forest owners who donate conservation easements to qualifying organizations. There is a paucity of studies on the effects of tax incentives for conservation easements on the actual amount of land put under easements, but there is considerable anecdotal evidence that incentives have prompted many forest owners to obtain an easement. Following passage of enhanced federal incentives for conservation easements in 2006, there was a 36% increase in eased lands across the U.S. (Land Trust Alliance n.d.).

Conclusions from the Literature Review

Although there have been a number of studies examining tax programs and policies as well as the impacts thereof on forest land, there is not much in the way of research on how taxes affect the average family forest owner. The “average” family forest owner owns a relatively small acreage property and, consequently, is likely to be ineligible for preferential property tax programs in many states. The

average family forest owner does not own her or his land for timber production and is unlikely to be eligible for income tax treatment as an “active business” and is, therefore, unable to take advantage of deductions for carrying expenses, such as property tax payments. The average family forest owner does not have a written management plan and is unlikely to take advantage of reforestation incentives or tax credits. The average family forest owner does, however, harvest trees, at least on occasion, does care about keeping the land intact for her or his heirs, and does own forest property that contributes to the healthy functioning of larger ecosystems.

Of course there is no “average” family forest owner. Instead, there is tremendous variation among the 10 million family forest owners in the U.S. How taxes impact these owners is a result of not just tax policies, but also the priorities and management decisions made by each forest owner and the pressures, such as development, that she or he faces.

This current study attempts to fill in the gaps related to the impacts of tax policy on family forest owners. Whereas previous studies have examined the range of policies, or performance of policies from an administrative standpoint, this study will incorporate an integral, and heretofore missing component – the perceptions, perspectives, attitudes, and behaviors of the family forest owners themselves.

RESULTS & DISCUSSION

The results presented below are the products of the literature review, document review and verification, survey of preferential property tax program administrators, forest owner and forestry/conservation professional focus groups, quantitative analyses, and insights gained from the forest forum.

Setting the Context

It is important to understand the perspective of the individuals who are being studied, in our case, family forest owners. Information about their reasons for owning land, their vision for the land, and the concerns they have about it is presented. This will set the stage for discussions of the specific tax policies.

The Owners and their Land

In general, the characteristics of the focus group participants are similar to other family forest owners from across the U.S. who own between 10 and 999 acres of forest land. The focus group participants did tend to have slightly larger forest holdings than the general population of forest owners (Figure 8). This was done purposefully to ensure representation of owners with larger forest holdings. The age distributions are very similar (Figure 9), but the focus group participants tend to be more educated than the general population of family forest owners (Figure 10).

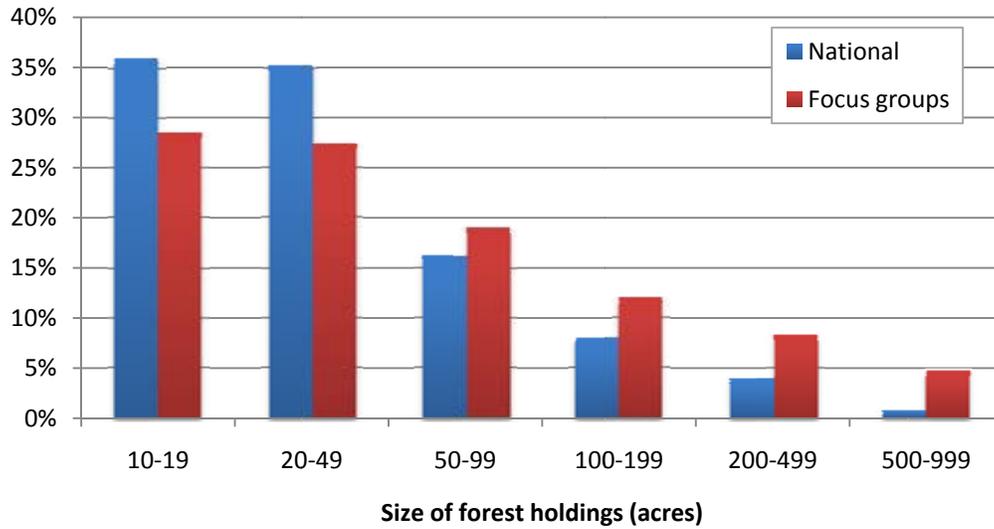


Figure 8. Size of forest holdings of family forest owners in the U.S. with 10-999 acres of forest land (Butler 2008) and focus group participants.

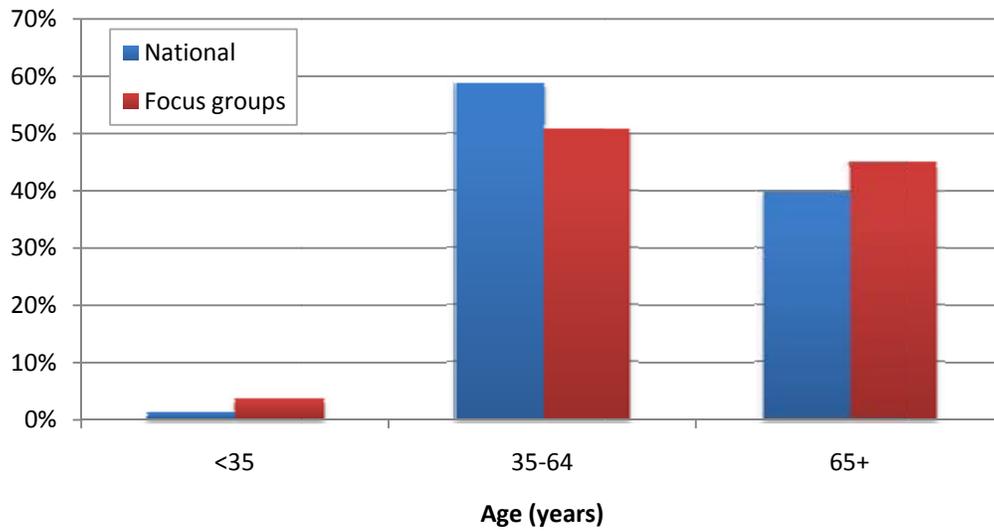


Figure 9. Age of family forest owners in the U.S. with 10-999 acres of forest land (Butler 2008) and focus group participants.

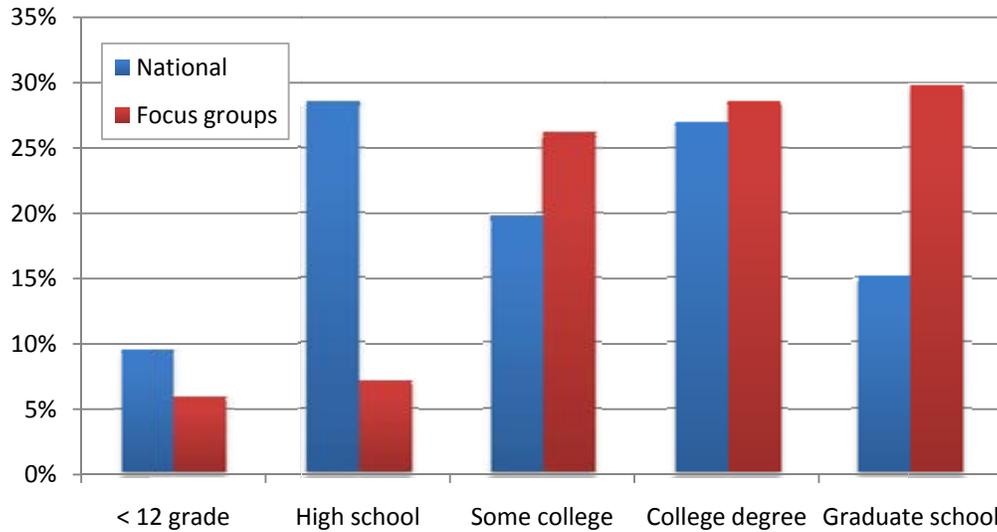


Figure 10. Levels of educational attainment of family forest owners in the U.S. with 10-999 acres of forest land (Butler 2008) and focus group participants.

The reasons for owning forest land were also similar between the focus group participants and the general population of family forest owners (Figure 6). Excerpts from the focus groups are included below to provide deeper meaning and more insights.

Owners have land because it is their piece of heaven:

I just love where I am. Not everybody has paradise in their backyard. (New Hampshire)

For some it is a religious experience:

It's a very wonderful spiritual experience. It seems like that's where we belong. It's what we've been in touch with for several million years before the last few centuries when we all moved to the cities. (Alabama)

They have their privacy:

You can pretty much go outside and do whatever you really feel like doing without worrying about whether the neighbors can see you. (South Carolina)

The peace and quiet:

It's just something I like to walk around and relieve stress mostly. Just nice to hear the birds sing. Walk around. I make trails through the woods. It's just healthy air, it's peaceful. You don't hear no cars or nothing. Just get away from everyday stress. (Wisconsin)

They have nature at the backdoor:

There's something about walking out on a piece of property and the deer. You hear the birds singing. At night when I go down there and build a fire you can look up and see the stars the sky is so clear. (Alabama)

They have a place to raise their kids, to recreate, and live the country life:

We have kids and one of the biggest things for me is that they can just go out and explore and just go play in the woods instead of being inside. (New Hampshire)

Some are trying to protect nature:

On my property, of course, we don't cut a tree – even a scrub oak, as bad as they look. We love trees and that's the thing I appreciate about my property. (South Carolina)

They have a legacy:

It's been in the family for so many generations that I feel like I want to hang on to it and keep the basic property intact, utilize it. (Washington)

Many want the land to stay just as it is:

It's the aesthetic joy, it's the animals, it's the quiet, it's the exploring, following the old stone walls. I mean, it's just beautiful. I personally hope that development could stop right now and just leave everything the way it is. (New Hampshire)

A stewardship ethic is strong among many of the owners:

We have a duty to keep this little treasure somehow. I feel like a steward of this land and it's a heavy responsibility. (Washington)

But these attitudes can also change over time:

As you grow older you change in your thinking on wildlife. I shot enough [big bucks] in my lifetime but now as I grow older I put the bow aside and now I do my hunting with a camera. (Wisconsin)

There are those with more of a pragmatic perspective:

I'm not that romantic about it. I harvest the firewood and lumber out of my woods. I enjoy seeing the large trees grow. More interested in what I can get from it I guess than anything else. (Wisconsin)

And while most do have a deep connection with the land, there are exceptions:

I didn't purchase it. I inherited it so I don't have that, hate to say, love of just being out where there's nothing. I'm not an outdoor country person. I grew up here, I was born here, but I was raised in New York. When I retired I moved here. (South Carolina)

Landowner Concerns

After having the family forest owners in the focus groups describe their land and why they own it, they were asked about what challenges they face. At this point in the focus groups, the moderator did not bring up the topic of taxes nor were the focus groups billed as having to do with taxes. The forestry and conservation professionals were asked what they thought were the greatest challenges facing the family forest owners with whom they interact.

The most frequently cited issues, mentioned in at least eight out of ten forest owner focus groups, related to families and unauthorized public access (Table 1). Many owners are worried that their children are not interested in the land or, at least, they are too far away to

We're concerned [because] our children are not interested.

- A South Carolina Landowner

want it. Others talked about concerns regarding multiple heirs and how to equitably divide it among them.

Table 1. Concerns of family forest owners as reported by family forest owners and forestry professionals.

Frequency	Forest owners	Forestry professionals
Very frequent		
	Family	Family
	Public access	Forest management
Moderately frequent		
	Development	Government regulations
	Government regulations	Markets
	Property taxes	Property taxes
	Wildlife	
Infrequent		
	Estate/inheritance taxes	Estate/inheritance taxes
	Forest health	Income taxes
	Forest management	Public access
	Markets	Wildlife

Issues associated with trespassing and vandalism were common concerns. Dumping of trash was also a common complaint of many owners. Another major issue was the unauthorized use of all-terrain vehicles (ATVs) and the rutting and noise they create.

“If you've got open land, people will drop stuff, their garbage and everything else. They use it as a dump.”
- A South Carolina Forest Owner

Concerns mentioned moderately frequently, in three to seven of the ten focus groups, included development, government regulations, property taxes, and wildlife related issues. Development threatens the benefits of country living that are important to many forest owners (e.g., privacy, peace, and quiet) and reduces the amount of green space, impacting both aesthetics and wildlife habitat. Development was largely seen as an unstoppable trend and some expressed a desire to leap frog developing areas and move, once again, to a rural area.

“Development is huge. I just had an argument with one of the neighbors. They bought three acres, want to build a house on it right next door to another neighbor. I said “if you want to build that close why don't you build in town?” They complain about the neighbor's manure on the field. Stay in town then. Why live out in the country and bother everybody else? That's how I feel. It's the country for a reason.”
- A Wisconsin Forest Owner

Depending on the state and local government policies, many owners felt that regulations unfairly limit what they can do with their land. Many of these issues centered on riparian management or zoning issues. They discussed the infringements on their ability to do what they want with their land, expenses associated with complying with the regulations, uncertainty or dynamic nature of some regulations, and lack of compensation. Yet, a few forest owners talked about the need for regulations to preserve the local environment. Eminent domain, the taking of land by the government for the public good, came up only a handful of times.

“You own land, 40 or 80 acres [and] depending upon where it is and what it is, you can't do what you want to do with the land. There are so many rules and regulations. If there's a navigable creek running through it, you can't do squat to it.”
- A Wisconsin Forest Owner

Though when it did, it was fervently discussed by those who felt they had been deeply wronged by the government.

Taxes were mentioned with moderate frequency when the family forest owners were asked about their general concerns and problems. Once the subject was introduced by the moderator, most owners railed against them, particularly property taxes. In most groups there was a person or two who defended taxes because they provide the revenue by which schools, police, fire protection, roads, and other public benefits are funded. Property taxes are discussed in more detail below.

Concerns that were mentioned unaided in only one or two of the ten focus groups included forest health, forest management, markets for timber products, and estate/inheritance taxes.

Many of the issues facing forest owners are interrelated. For example, although property taxes are one issue cited as influencing some owners' decisions, these actions are often exacerbated by other financial challenges. Some owners are struggling to make a living from their land (e.g., a tree farm, raising alpacas, or breeding horses); others have lost their job due to the economic downturn. And "it's expensive to live out in the country," as one owner from Wisconsin put it.

Visions and Challenges

When asked about the future of their land, only a few focus group participants were considering selling their land. According to the National Woodland Owner Survey, 14% of forest owners in the U.S. are planning to sell or transfer their land in the near future (Butler 2008). For most owners in the focus groups who were contemplating doing so, there was usually a combination of factors that were contributing to their decision. High property taxes were one contributing factor often brought up, but usually in the context of other issues, such as job loss and other financial pressures. Other reasons cited were a desire to make money, to move away from an over-developed area, or a lack of attachment to an inherited property.

Not surprisingly, older owners had more concrete ideas about what will happen to the land than younger owners. However, a number of older owners have apparently given the subject little thought and a few younger owners are thinking ahead. Most owners would like their land to remain basically how it is, neither developed nor parcelized.

There is a strong belief among some forest owners that their children or other heirs should be free to decide whether or not to sell the land after they inherit it. "I want it to be my children's choice when they inherit" is a typical statement. A key obstacle to land staying in the family is that children simply aren't interested in it. They live far away (or far enough that they don't want a long ride into the country), don't want to return to the area they grew up, have established lives

"The value of that land went up extremely since all the development right here around central Shelby County. It's one of the fastest growing places on earth now. It's a little over-populated for me. As soon as my son graduates next year, I'm getting out of this high tax county. You can't breathe deep."

- An Alabama Forest Owner

"I've got two kids. I worry about it a lot because since the little girl went off to college, I don't know if she'll ever come back to C___. I thought the little boy was kind of like me but he got a girlfriend and now I never see either one of them. I'm not sure what I'm going to do but it does worry me."

- A South Carolina Forest Owner

"I've seen a lot of problems with people that pass away. It goes to their kids but it's an undivided interest. Then one or two wants out and the others can't afford to buy him out. Then they have to sell the place to pay him off and nobody has it."

- A Washington Forest Owner

elsewhere, and/or prefer city life. “The younger generation doesn't have the same feelings about the land,” one respondent said. Some forest owners aren't upset by their family members' attitudes but others said they worry about it deeply.

“I just see the growth in my lifetime through 60 years. It's inevitable that it will march in those directions. It's kind of sad.”

- A Wisconsin Forest Owner

Land being split up because of family conflicts among heirs or because of the number of heirs is also a concern. Plans to keep the land can change when values rise or when one heir wants or needs the money. Forest owners face issues not just with their children, but with the people whom their children marry: “Sometimes they [the children] might want to live there but they marry somebody that doesn't,” according to a South Carolina forest owner.

General Tax Landscape

Income and, in most years, estate taxes are levied at the federal level. State and local governments are responsible for property taxes and, if they so legislate, additional income and estate/inheritance taxes. These policies change over time and many are quite complex. All states have policies that allow for the reduction or elimination of property taxes on forest land: 38 states have programs that require varying commitments from forest owners, 11 states have entitlement programs in which forest land is enrolled with no commitment required, and Alaska levies no property taxes on forest land (Table 2). In 11 states, forest owners are subject to either a severance tax or a yield tax when timber is harvested; in some states all forest owners must pay a tax if they harvest and sell trees, in other states it is only the people enrolled in specific property tax programs, and in Idaho, owners enrolled in one of the preferential property tax programs are exempt from the tax. Forty-one states have an income tax, seven of these states have a long-term capital gains provision, and fifteen states have income tax incentives for the donation of conservation easements. Twenty-one states have an estate and/or inheritance tax and five of these states have provisions for special use valuation of forest land.

Table 2. Property, harvest, income, and estate/inheritance tax policies by state, 2010 (unless noted otherwise).

State	Type of preferential treatment for forest land ¹	Harvest tax on forest owner	State-level income tax	Preferential treatment for capital gains	Forestry or land conservation income tax credits or deductions	State-level estate and/or inheritance tax (2009)	Estate tax special use valuation
Alabama	PPTP	No	Yes	No	No	No	—
Alaska	EX	No	No	—	—	No	—
Arizona	AS	No	Yes	No	No	No	—
Arkansas	AS	No	Yes	Yes	Yes	No	—
California	PPTP	Yes - All	Yes	No	Yes	No	—
Colorado	PPTP	No	Yes	No	Yes	No	—
Connecticut	PPTP	No	Yes	No	No	Yes	No
Delaware	PPTP	No	Yes	No	Yes	Yes	No
Florida	PPTP	No	No	—	—	No	—
Georgia	PPTP	Yes - All	Yes	No	Yes	No	—
Hawaii	PPTP	No	Yes	No	No	No	—
Idaho	PPTP	Yes - All except PPTP - productivity enrollees	Yes	No	No	No	—
Illinois	PPTP	Yes - All	Yes	No	No	Yes	No
Indiana	PPTP	No	Yes	No	No	Yes	Yes
Iowa	PPTP	No	Yes	No	Yes	No	—
Kansas	AS	No	Yes	No	No	Yes	No
Kentucky	AS	No	Yes	No	No	No	—
Louisiana	AS	No	Yes	No	No	No	—
Maine	PPTP	No	Yes	No	Yes	Yes	No

Table 2. (continued)

State	Type of preferential treatment for forest land ¹	Harvest tax on forest owner	State-level income tax	Preferential treatment for capital gains	Forestry or land conservation income tax credits or deductions	State-level estate and/or inheritance tax (2009)	Estate tax special use valuation
Maryland	PPTP	No	Yes	No	Yes	Yes	No
Massachusetts	PPTP	No	Yes	No	No	Yes	No
Michigan	PPTP	No	Yes	No	No	No	—
Minnesota	PPTP	No	Yes	No	No	Yes	No
Mississippi	AS	No	Yes	No	Yes	No	—
Missouri	PPTP	Yes - PPTP enrollees	Yes	No	No	No	—
Montana	PPTP	No	Yes	Yes	No	No	—
Nebraska	AS	No	Yes	No	No	Yes	Yes
Nevada	PPTP	No	No	—	—	No	—
New Hampshire	PPTP	Yes - All	No	—	—	No	—
New Jersey	PPTP	No	Yes	No	No	Yes	No
New Mexico	AS	No	Yes	Yes	Yes	No	—
New York	PPTP	Yes - PPTP enrollees	Yes	No	Yes	Yes	No
North Carolina	PPTP	No	Yes	No	Yes	Yes	No
North Dakota	PPTP	No	Yes	Yes	No	No	—
Ohio	PPTP	No	Yes	No	No	Yes	No
Oklahoma	AS	No	Yes	No	No	Yes	No
Oregon	PPTP	Yes - All	Yes	No	Yes	Yes	Yes
Pennsylvania	PPTP	No	Yes	No	No	Yes	Yes
Rhode Island	PPTP	No	Yes	No	No	Yes	No

Table 2. (continued)

State	Type of preferential treatment for forest land ¹	Harvest tax on forest owner	State-level income tax	Preferential treatment for capital gains	Forestry or land conservation income tax credits or deductions	State-level estate and/or inheritance tax (2009)	Estate tax special use valuation
South Carolina	PPTP	No	Yes	Yes	Yes	No	—
South Dakota	AS	No	No	—	—	No	—
Tennessee	PPTP	No	No	—	—	Yes	No
Texas	PPTP	No	No	—	—	No	—
Utah	PPTP	No	Yes	No	No	No	—
Vermont	PPTP	No	Yes	Yes	No	Yes	No
Virginia	PPTP	No	Yes	No	Yes	No	—
Washington	PPTP	Yes - All	No	—	—	Yes	Yes
West Virginia	PPTP	Yes - All	Yes	No	No	No	—
Wisconsin	PPTP	Yes - PPTP enrollees	Yes	Yes	No	No	—
Wyoming	AS	No	No	—	—	No	—

1: AS-Assessment; EX-Exemption; PPTP-Preferential property tax program.

Property Taxes

Property taxes are by far the tax of greatest concern to the family forest owners spoken with during this project. These taxes were mentioned unprompted as concerns during 7 of the 10 focus groups. This is not surprising as virtually all forest owners have to pay property taxes on an annual basis, as opposed to income and estate taxes that can be rare or once-in-a-lifetime events. For most owners, property taxes are perceived as high (especially outside of the South), out of sync with what the land is currently worth, and inevitably increasing.

"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 the taxes."

- A Wisconsin Forest Owner

"Every year it seems your property taxes go up anywhere from \$100 to \$300 a year. It seems like it's almost inevitable."

- A New Hampshire Forest Owner

Existing Policy Landscape

The value of real property, land and the improvements made thereon, is commonly taxed to raise funds for local governments. The means for assessing the value of forest land varies by state and sometimes even varies within a state. All states have policies that reduce or eliminate property taxes for forest land. Thirty-eight states have one or more preferential property tax programs that promote timber management, open space, and/or other forest resource values (Figure 11). A preferential property tax program is defined as one that obligates the owner to some action in return for a reduced annual tax burden. Of the remaining dozen states, 11 have policies which automatically classify and assess forest land at discounted or lower rates, without the forest owner having to "do" anything. The remaining state, Alaska, apart from some municipalities, exempts materials laid down by natural processes, including timber and forest land.

Preferential property tax programs vary considerably across states (Table 3). Twenty-eight states offer a single program to forest owners, while the remaining states offer two or more programs from which forest owners may choose. The stated goals of the programs are to encourage sustainable forestry, help maintain open space, encourage sustainable agriculture, and/or enhance and maintain wildlife habitat (Figure 11).

Minimum acreage requirements of preferential property tax programs range from 0.5 acres in one Hawaiian county to 160 acres in California, with an average of 16.5 acres required to enroll across the states with such requirements. Five states report no statutory acreage requirement while in four others the requirement is left up to the county to decide. Required enrollment periods range from 2 to 50 years (13 years is average). Most of these programs (81%) have some type of withdrawal penalty, ranging from payment of back taxes to a percentage of the fair market value of land withdrawn. Just over half (54%) of the programs require a forest management plan, but the definition of what constitutes a plan varies from a few bullet points written on a piece of paper by the forest owner to extensive documents prepared by certified professionals and approved by state forestry agencies.

The reductions in property tax burdens within a given state under these programs vary significantly depending on a suite of factors. These include the mechanism by which the enrolled land is assessed, local tax rates, whether programs reduce taxes according to fixed rates, flat per acre rates, or based on individual or regional site characteristics.

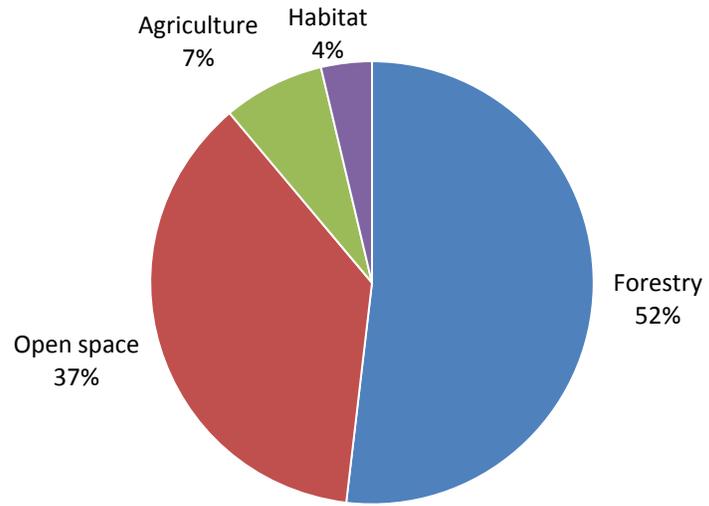


Figure 11. Goals of state-level preferential property tax programs.

Table 3. Attributes of preferential property tax programs that are applicable to family forest owners, 2010.

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.	No
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	Yes	10	Yes
Colorado	Forest Ag	FOR	40	Yes	Cont.	No
Connecticut	Public Act 490 - Forest Land	OS	25	No	Cont.	Yes
Delaware	Commercial Forest Plantation Act	FOR	10	Yes	30	Yes
Florida	Greenbelt or Agricultural Lands Classification	AG/OS	CD (No minimum, 10 or 20)	CD	Cont.	No
Georgia	Conservation Use Assessment	OS	CD No minimum to 25	No	10	Yes
Hawaii	Each county/island has own program					
Hawaii Co.	Agricultural Use Dedication	AG/FOR	No minimum	Yes	10	Yes
Hawaii Co.	Native Forest Dedication	HAB	3	Yes	20	Yes
Honolulu Co.	Agricultural Use Dedication	AG/FOR	10	Yes	1, 5, or 10	Yes
Kauai Co.	Agricultural Property Tax Reduction	AG/FOR	No minimum	N/A	10 or 20	Yes
Kauai Co.	Agricultural Property Tax Exemption	AG/FOR	10	N/A	25	Yes
Maui Co.	Dedicated Land	N/A	0.5	No	10 or 20	Yes
Idaho	Bare Land & Yield Option	FOR	5	CD	10	Yes
Idaho	Productivity Option	FOR/OS	5	CD	10	Yes
Illinois	Conservation Stewardship	OS	5	Yes	10	No

Table 3. (continued)

State	Program name/identifier	Primary goals ¹	Minimum acreage to enroll ²	Requires management plan ²	Duration of enrollment (years) ³	Withdrawal penalty
Indiana	Classified Forest and Wildlands	OS	10	Yes	Cont.	Yes
Iowa	Forest Reservation	N/A	2	No	Cont.	Yes
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	Yes	10	Yes
Maine	Open Space Tax Law	OS	No minimum	No	Cont.	Yes
Maryland	Forest Conservation & Management	OS	5	Yes	15	Yes
Massachusetts	Forest Land (Ch. 61)	FOR/OS	10	Yes	10	Yes
Massachusetts	Open Space or Recreation (Ch. 61B)	OS	5	No	Cont.	Yes
Michigan	Commercial Forest	FOR	40	Yes	Cont.	Yes
Michigan	Qualified Forest Property	FOR	20	Yes	Cont.	Yes
Minnesota	Sustainable Forest Incentive Act	FOR	20	Yes	8	Yes
Minnesota	2c Managed Forest Land	FOR	20	Yes	Cont.	No
Mississippi	<i>No Preferential Property Tax Program</i>					
Missouri	Forest Cropland	FOR	20	Yes	25	Yes
Montana	Forest Lands Tax Act	FOR	15	No	Cont.	Yes
Nebraska	<i>No Preferential Property Tax Program</i>					
Nevada	Agricultural Use	OS	7	No	Cont.	Yes
New Hampshire	Forest Land	OS	10	No	Cont.	Yes
New Hampshire	Forest Land with Documented Stewardship	OS	10	Yes	Cont.	Yes
New Jersey	Farmland Assessment Act of 1964	AG	5	Yes	2	Yes
New Mexico	<i>No Preferential Property Tax Program</i>					

Table 3. (continued)

State	Program name/identifier	Primary goals ¹	Minimum acreage to enroll ²	Requires management plan ²	Duration of enrollment (years) ³	Withdrawal penalty
New York	Forest Tax Law, Sec 480a	FOR	50	Yes	10	Yes
North Carolina	Forestland	FOR	20	Yes	3	Yes
North Carolina	Wildlife Conservation Program	HAB	20	Yes	Cont.	Yes
North Dakota	Forest Stewardship Tax	FOR	10 if natural, 5 if planted	No	5	No
Ohio	Ohio Forest Tax Law	FOR	10	Yes	Cont.	No
Oklahoma	<i>No Preferential Property Tax Program</i>					
Oregon	Small Tract Forestland Program	FOR	10	No	Cont.	Yes
Oregon	Forestland Program	FOR	2	No	Cont.	Yes
Oregon	Open Space Assessment	OS	No minimum	No	Cont.	Yes
Oregon	Wildlife Habitat Conservation & Management Program	HAB	No minimum	No	Cont.	Yes
Pennsylvania	Clean and Green	OS	10	CD	Cont.	Yes
Rhode Island	Farm, Forest and Open space Act	OS	10	Yes	15	Yes
South Carolina	Agricultural Assessment Reform Act of 2009	AG/FOR	5	CD	Cont.	Yes
South Dakota	<i>No Preferential Property Tax Program</i>					
Tennessee	Greenbelt -Forest	OS	15	Yes	Cont.	Yes
Texas	Timberland (1-d-1)	FOR	CD	CD	Cont.	Yes
Texas	Open Space	OS	CD	Yes	Cont.	Yes
Utah	Farmland Assessment Act (also known as the Greenbelt Act)	AG	5	No	2	Yes
Vermont	Use Value Appraisal	FOR/OS	25	Yes	10	Yes
Virginia	Forestry Land Use Assessment	FOR/OS	20	No	Cont.	Yes
Washington	Designated Forest Land	FOR	20	No	Cont.	Yes
Washington	Open Space - Timberland	FOR/OS	5	Yes	Cont.	Yes

Table 3. (continued)

State	Program name/identifier	Primary goals ¹	Minimum acreage to enroll ²	Requires management plan ²	Duration of enrollment (years) ³	Withdrawal penalty
West Virginia	Managed Timberland	FOR	10	Yes	Cont.	No
Wisconsin	Managed Forest Law	FOR	10	Yes	25 or 50	Yes
Wyoming	<i>No Preferential Property Tax Program</i>					

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

The states were grouped according to the program attributes and the policy effectiveness criteria rated by the program administrators for their primary preferential property tax program. The eight policy effectiveness criteria are sufficiently correlated (Cronbach's Alpha = 0.71) to require the use of a data reduction procedure and hence, a principal components analysis was performed. Table 4 displays the first three principal components. Based on the factor loadings, principal component 1 was defined as having administrative advantage, principal component 2 as having financial advantage, and principal component 3 as having consistent program requirements and goals. Combined, these three principal components accounted for 65% of the total variance in the state preferential property tax program effectiveness criteria.

Table 4. Principal component loadings (PC) and unique variances from the principal components analysis of preferential property tax program effectiveness criteria.

Variable	PC1	PC2	PC3
<i>Unique variance</i>			
Clearly articulated goals	0.658	0.004	-0.012
Significant tax break	0.523	-0.659	0.167
Complements other programs	0.768	-0.002	0.123
Requirements reflect goals	0.588	-0.151	0.648
Administered consistently	0.603	0.026	-0.365
Stable funding	0.091	0.808	0.491
Periodic program reviews	0.607	0.429	-0.357
Straight forward application process	0.724	0.115	-0.225

The k-means clustering algorithm was used to assign states into segments based on the three clustering variables derived from the principal component analysis, as well as three program requirement variables (management plan, enrollment period, and withdrawal penalty). The five cluster solution yielded the most reasonable results (Table 5 and Figure 12). States in group 5 all have primary preferential property tax programs that require a management plan and have withdrawal penalties and have, on average, the highest administrative advantages, PC1. By contrast, the states in group 4 have primary preferential property tax programs that are the least likely to require a management plan and have, on average, the least administrative advantages.

Table 5. Summary of preferential property tax program attributes by group.

Group	Management plan required	Specified enrollment period	Has withdrawal penalties	PC1	PC2	PC3
1	0.44	0.44	0.89	0.05	-1.00	-0.33
2	0.50	0.17	0.67	-0.04	-0.47	1.09
3	1.00	0.33	0.33	0.37	0.85	-1.61
4	0.22	0.44	0.89	-1.06	0.38	-0.05
5	1.00	0.89	1.00	1.16	0.65	0.19

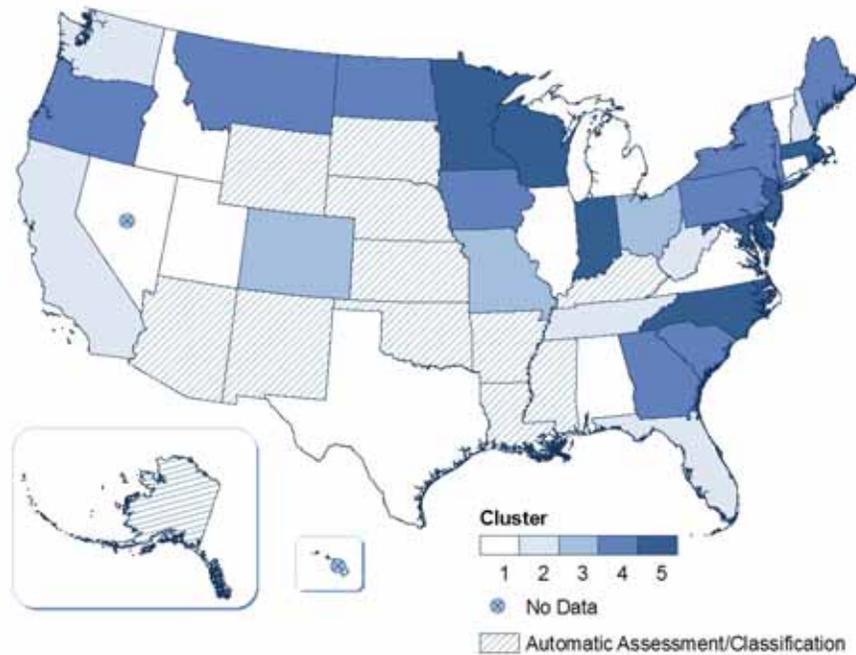


Figure 12. Groupings of states by attributes of their primary preferential property tax program.

As mentioned earlier, box plot and ANOVA analyses were used to examine the relationships between preferential property tax programs and forest conservation at the state level. The differences in change in area of private forest land between 1997 and 2007 (Figure 13) (Smith et al. 2009) among the clusters was marginally significant (p -value=0.09). Differences among clusters were not significant for the change in size of private forest holdings between 1993 and 2006 (Figure 14) (Birch 1996; Butler 2008), and percent of family forest acres covered by written forest management plans in 2006 (Figure 15) (Butler 2008).

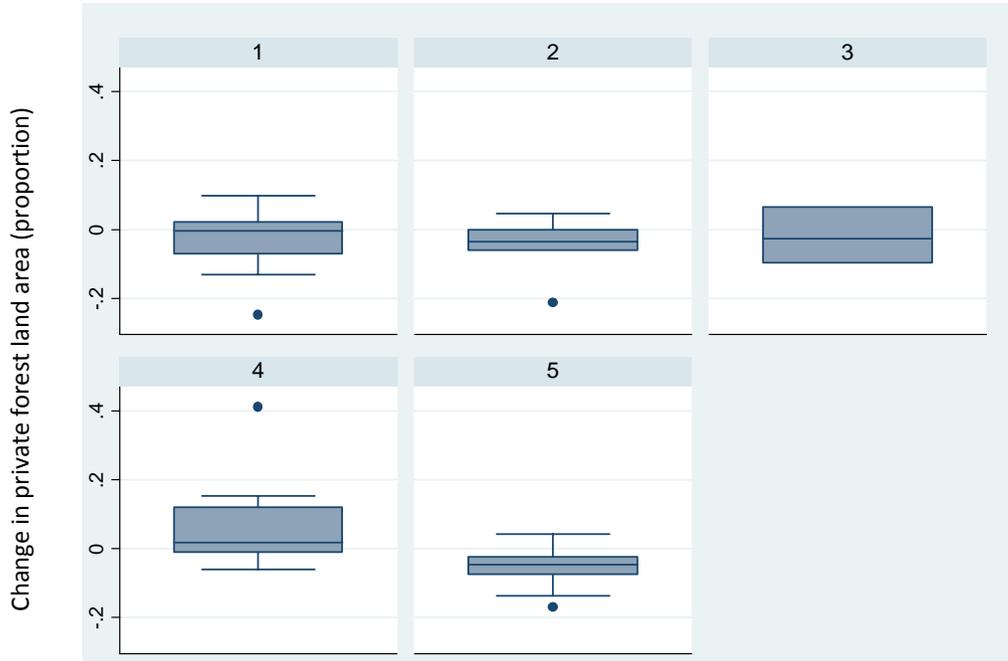


Figure 13. Box plots of change in private state-level forest land area between 1997 and 2007 (Smith et al. 2009) by preferential property tax program cluster.

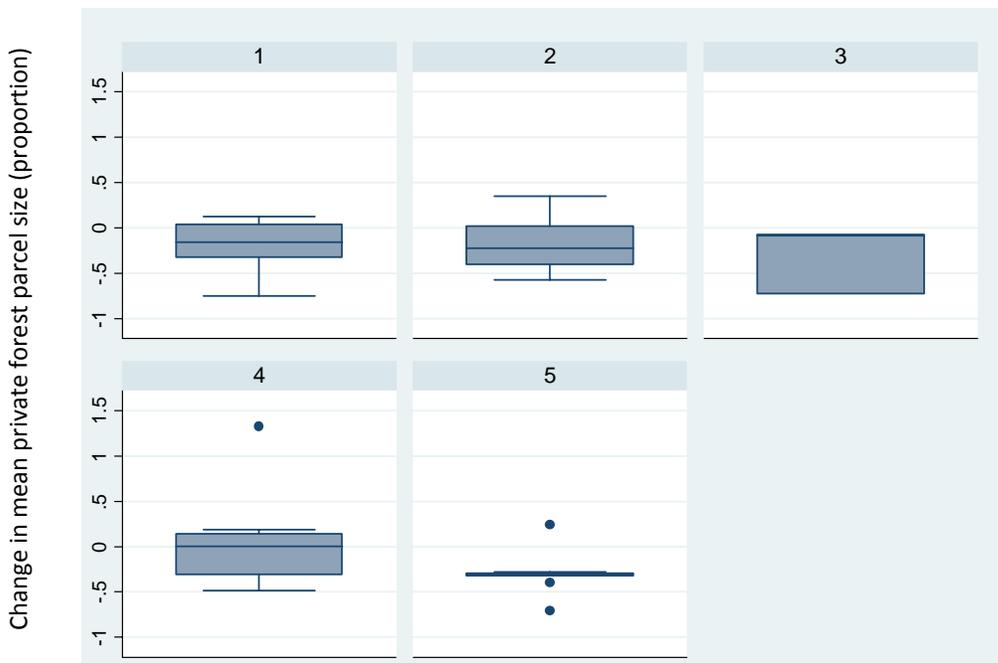


Figure 14. Box plots of change in mean, state-level size of private holdings between 1993 and 2006 (Birch 1996; Butler 2008) by preferential property tax program cluster.

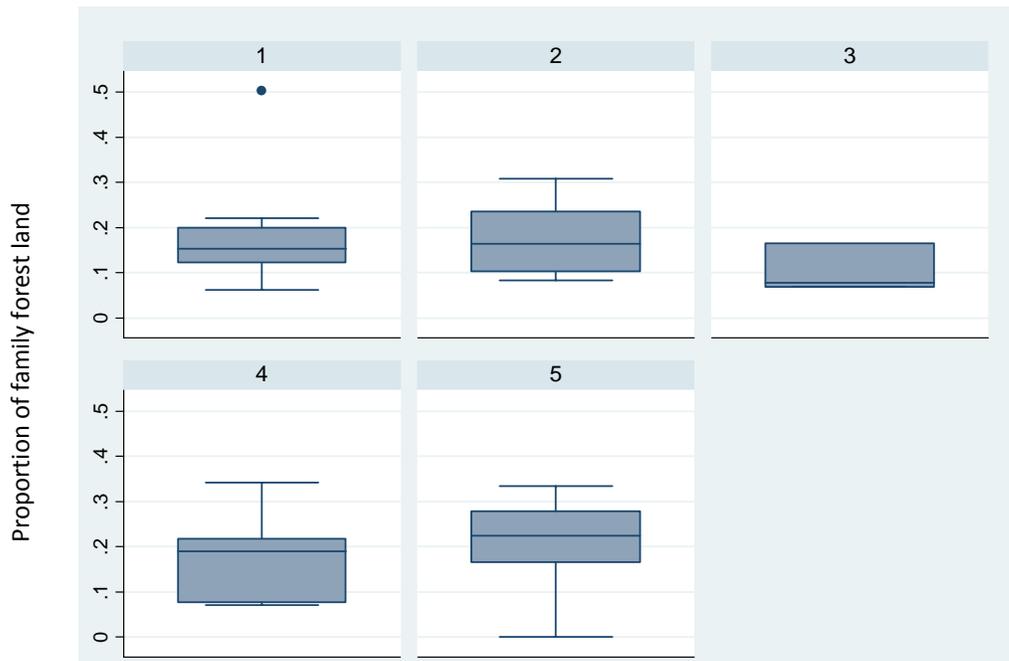


Figure 15. Box plots of differences in state-level percentage of family forest land owned by family forest owners who have a written forest management plan (Butler 2008) by preferential property tax program cluster.

Awareness, Knowledge & Usage

There are currently millions of acres of family forest land enrolled in preferential property tax programs across the country, but this is only a fraction of the total number of acres of family forest land in the U.S. The enrollment rates vary widely across the country (Figure 16). Of the 33 state administrators of preferential property tax programs who responded to our inquiry regarding enrollment, 48% estimated that at least half of the eligible forest owners are enrolled. Administrators of states indicating the greatest percent of eligible private forest land enrolled in preferential property tax programs were generally located in the western and southern U.S.

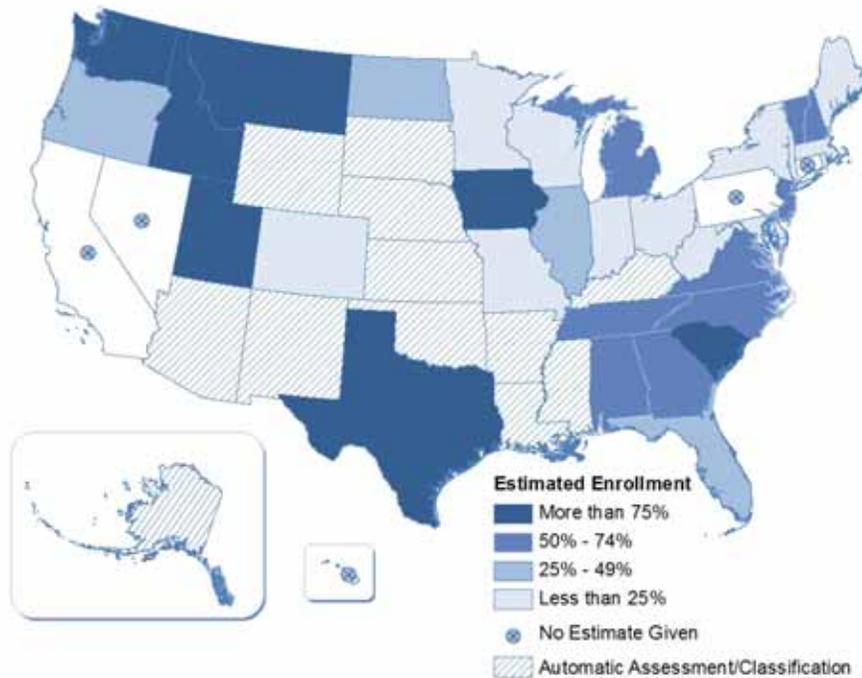


Figure 16. Percent of eligible forest owners enrolled in preferential property tax programs as estimated by program administrators.

Some forest owners are confused about the preferential property tax programs. This confusion was the greatest in the South where the program requirements were the least restrictive. In states with more stringent programs, owners were more likely to know what program they were enrolled in and the requirements of the program.

Besides the forestry tax programs, agriculture, homesteading, and senior exemption programs were mentioned as other ways to reduce property tax burdens. These provisions vary by state and not all owners will qualify for them. In general, the property tax policies that are strictly for agricultural land provide larger reductions in property tax burdens and have less stringent criteria regarding management plans, management requirements, and withdrawal penalties than programs designed for owners with just forest land. Depending on the state, this can include forest land that is grazed and/or forest land that is associated with a farm.

“My guess is that when I bought the land they simply asked me across the table ‘do you want to do this as current use for timber?’ and I said ‘yeah.’ I was enrolled without anything more formal than that. That’s what I think happened.”

- An Alabama Forest Owner

“I will say that having my land in current use has kept me from selling it off and developing it.”

- A New Hampshire Forest Owner

“My dad signed up when the program first came into effect because it’s a huge property tax savings. Taxes are very, very reasonable in the Open Space program. If we had to pay full value property tax, there’s no way; that would be it. It would not be worth keeping the land. We’d have to sell it or develop it.”

- A Washington Forest Owner

Strengths & Opportunities

The greatest strength of the preferential property tax programs is the reduction in annual property tax burden. Of administrators providing an estimate of the reduction in property tax liability saved by forest owners enrolling in these programs, most, 83%, estimated annual tax burdens to be reduced by at least half (Figure 17).

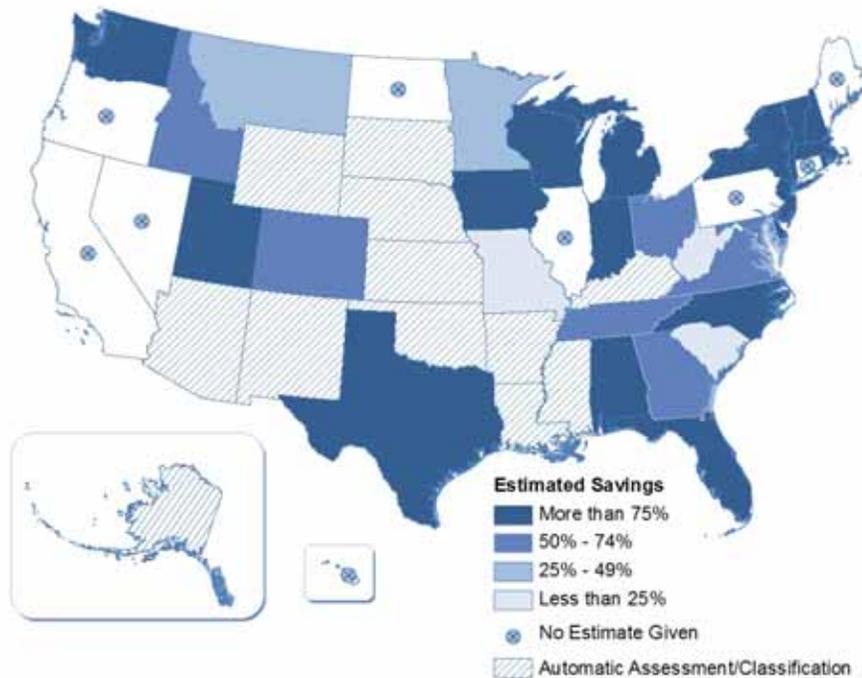


Figure 17. Reduction in annual property tax burdens for forest owners enrolled in preferential property tax programs as reported by program administrators.

Many enrollees have positive views of the preferential property tax programs, citing several benefits, including: significantly lowering property taxes, which is enabling some to keep their land; keeping open space and promoting sustainability; encouraging tree planting and growth; and improving forest management. The last two points are most relevant to the 19 state programs that require active forest management. Many of those enrolled in the programs enthusiastically recommended the program to owners not enrolled, assuming the non-enrollees meet the requirements and are not going to develop their land within the enrollment period. "It's a damn good program," one Wisconsin forest owner declared. And his woods are "a lot better than ever" because of the program, said another enrollee.

"I think the survival of forestry would be [programs] like the Managed Forest Law. You go past 40s that were slashed away before – they don't belong [to the program] – it looks terrible. A program like this, I think, really helps the whole forestry industry."

- A Wisconsin Forest Owner

Barriers & Weaknesses

In instances where programs have not been specifically designed with the needs of forest owners in mind, such as those aimed at protecting agricultural resources, forest owners may be at a disadvantage

as compared to farmers. Unlike most farmers, a forest owner raising timber typically does not realize annual revenue, yet programs of this nature may not make this distinction or vary the way forest land is assessed and taxed.

County assessors from South Carolina interviewed for this project expressed considerable frustration at the lack of requirements for their state's program, saying there were "too many dodgers" and "too many loopholes"; they felt that there was flagrant misuse of the program by forest owners with nothing more than large yards. To qualify for the preferential property tax program in South Carolina, forest owners can have as little as 5 acres of forest land and they are not required to have a forest management plan.

Only a third of the state administrators indicated that their program contains all of the attributes of an effective property tax policy (Figure 18). The most common shortcomings were a lack of consistent administration and a lack of stable funding, followed by a lack of complementarity with other programs and policies.

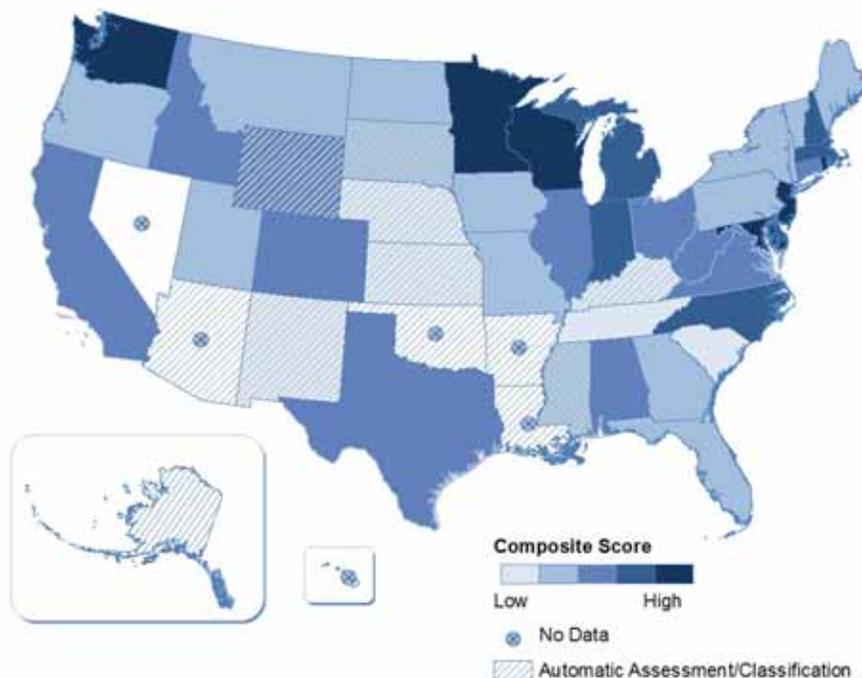


Figure 18. Composite scores of preferential property tax program policy effectiveness criteria as reported by program administrators.

The reasons for a lack of wider participation in the programs were varied, one explanation being that many owners simply do not qualify for the programs because their properties are too small. Data from the National Woodland Owner Survey suggests that, on average, 63% of family forest owners, who own approximately 14% of the family forest land, are ineligible to participate in any of the currently available preferential property tax programs due to their properties being too small (Figure 19 and Figure 20). The corollary is that although only just over a third of the family forest owners have properties of sufficient size to qualify for the programs, they own over three-fourths of the family forest land.

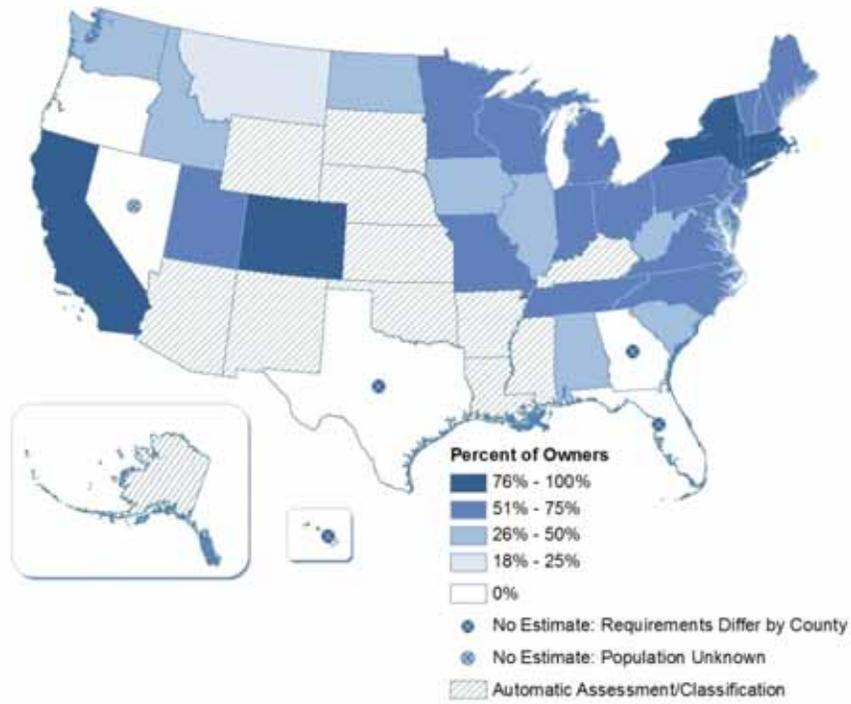


Figure 19. Percent of family forest owners in a state ineligible for any preferential property tax program due to holding size.

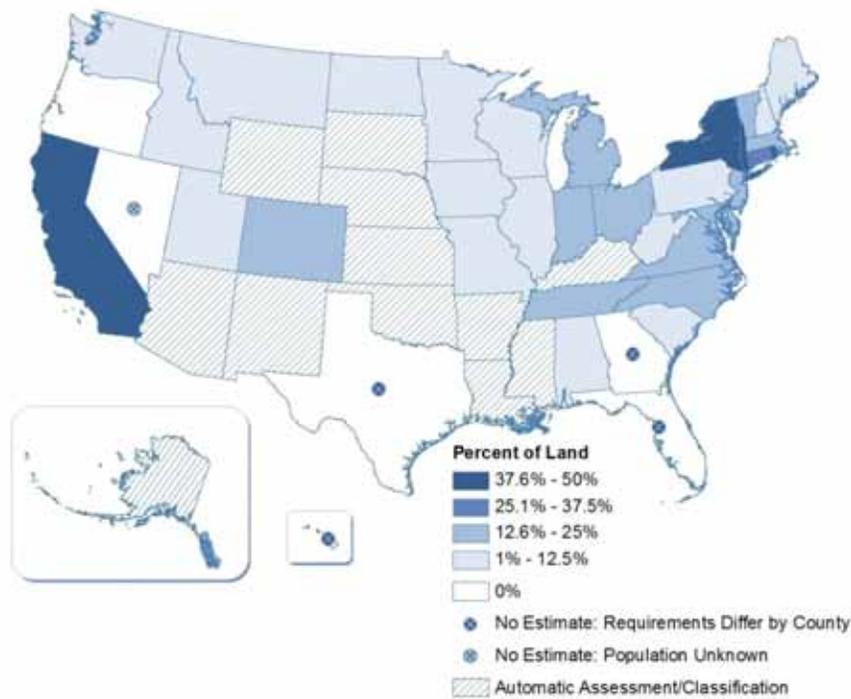


Figure 20. Percentage of family forest land in a state ineligible for any preferential property tax program due to holding size.

Other reasons for a lack of participation in these programs include goals of the programs not being compatible with some owners' plans for their land. These plans may include selling and/or developing their land in the near future or, for programs that require active management, not wanting to harvest trees. And for some, the property tax reductions were deemed too small for the restrictions placed upon them.

There were also information gaps. Some participants in the focus groups had never heard about the programs before. In some states, awareness of a program was high when it was first introduced, often decades ago, but newer owners may not be aware of it. When the programs were discussed, some forest owners became interested, although others remained wary. Information about the details of the programs was often debated, especially the withdrawal penalties, what happens after the land is sold or passed onto heirs, and the requirements, or lack thereof, for allowing the public to access their land.

Privacy is a major ownership objective of many owners and this includes the freedom to do with their land what they so desire. As a result, many owners are hesitant to enroll in a program due to the fear of more government intrusion and the resulting loss of control. Public access in particular is a "deal-breaker" for a number of owners, tying in with their desires for privacy and their complaints about trespassing and vandalism discussed earlier.

In states requiring strict adherence to management plans, some owners are unhappy with being bound to management plan prescriptions. Some of the problems arise because the foresters writing the plans, those enforcing the law, and the forest owners themselves disagree on the management objectives and the most appropriate practices. In other cases, forest owners reported being forced to cut trees they did not want to cut. In still other instances, forest owners reported being forced to harvest timber during times when stumpage prices were low.

In most states, the preferential property tax program is administered at the local level. Tax program administration can vary considerably from one county to another. And the interpretation of program eligibility and forest owner requirements can vary significantly, which some owners view as arbitrary and unfair.

Information Sources

Awareness of preferential property tax programs was generally high among the family forest owners in the focus groups. However, many

"We have 72 acres [and] we don't have it in Forest or in Open Spaces, basically because I didn't want to get stuck with the seven years' interest and penalties. We wanted to have more flexibility if something came along."

- A Washington Forest Owner

"I had heard that you put land in this program and you had to allow other people to come on to your land to hunt or whatever. And your taxes would be lower. That's pretty much it. That didn't sound too appealing. I don't want anybody just to be able to go on my land. Lower taxes sound appealing. I didn't know anything about the stipulations for cutting."

- A Wisconsin Forest Owner

"In this program what happens when a person dies or they need to sell the land? Is the contract null and void? Or your estate has to pay the back taxes on it?"

- A Wisconsin Forest Owner

"If I did put it in managed forest, I can't just go in there and cut three trees down and use for firewood unless they're dead or downed already. There're too many rules and regulations that I have to follow – it's not my own land anymore."

- A Wisconsin Forest Owner

"My land is in Designated Forestland. I've got more than 20 acres. That's a wonderful program to be in. You sign up, you're in and most people are going to be in that program for life; they aren't looking to develop their property. There's no hassle. It's the same in every county. But the Open Space Timber varies county by county. Every assessor is different; some assessors are just nasty."

- A Washington Forest Owner

forest owners were not familiar with all of the provisions, requirements, and penalties associated with enrollment.

Talking with neighbors, friends, and relatives was the primary means by which most forest owners heard about these programs. Professionals, including assessors and, for those who actively manage their land, foresters and loggers were common contact points for information. Community meetings were mentioned as another venue for receiving information. Forest owners also discussed receiving information when they purchased their land (e.g., during closing), as well as annual notices distributed with property tax bills.

Following initial realization of a program's existence, many owners will move on to talk with a local or state property tax administrator. Owners have mixed experiences with the local assessors. Some assessors' offices are actively distributing information about the programs while others are telling them "if you can't afford the taxes, sell it." Assessors are viewed in some cases as discouraging enrollment due to negative impacts on local revenue collection.

In some locations, there are government employees who are specifically hired to provide assistance to people interested in the programs, while in other areas, the job falls to local tax assessors. In some areas, information on preferential property tax programs is included with property tax statements and in other areas this is not allowed. Information on the programs is sometimes gained when the land is purchased, either from the attorney during closing or conversations between the previous and new owners.

Implications for Forest Conservation

High property taxes may be forcing some forest owners to sell land and cut timber when they would rather not. These decisions are often compounded with other factors, such as a loss of a job or living on a fixed income (e.g., older owners). A number of owners enrolled in preferential property tax programs stated that these programs have enabled them to hold on to their land. Some fear they will be forced to sell their land in the future. And a number of owners had stories of relatives, friends, or friends of friends who were forced to sell due to high property taxes.

Most state administrators believe their programs are effective at achieving the intended goals – reducing family forest tax owner burden. Approximately half of them believe their preferential property tax program is effective in retaining forest land in areas highly susceptible to development.

"Go over to your friend's house and complain about it and they go 'oh, you go to the assessor.'"

- A South Carolina Forest Owner

"When I went to the town hall to pay my tax bill the lady that took my money asked me if I was aware of [the current use program]. That was nice. She just said 'are you aware it exists?' I said 'nope.' She said 'here's some information. You can go here on the computer and check it out.'"

- A New Hampshire Forest Owner

"When I bought ours, the people who had it before us had current use on it. When I bought it they said 'in the closing it shows this is what your taxes are going to be. But if you'll go down and sign up [for current use], you'll keep the same taxes as they did.' It went from approximately \$1,200 down to like \$38."

- An Alabama Forest Owner

"The property that we have in the family partnership was family land forever and ever. Taxes have just skyrocketed because the value of the land. 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."

- An Alabama Forest Owner

Income & Harvest³ Taxes

Unlike property tax policies which are established at the state level and are typically administered at the local level, income taxes are imposed at the federal level and 41 states levy an additional income tax. When states do impose an income tax, the burden is more modest than that under the federal income tax.

Existing Policy Landscape

Federal Income Tax

The federal income tax has a greater impact than state income taxes because of the higher rates levied. The federal tax code does include several provisions that can be beneficial to forest owners. Some are general business provisions, while others are specifically for owners of forests or other working lands. Most state income taxes use federal adjusted gross income or federal taxable income as their starting point, so beneficial provisions at the federal level flow through to the state level.

Since the federal income tax was instituted in 1913, provisions have been added that some family forest owners may find beneficial. Some are general business provisions:

- Long-term capital gains treatment of timber income;
- Depletion deductions;
- Annual deductions of “ordinary and necessary” management costs;
- Section 179 deductions;
- Loss deductions.

Treating income as a capital gain, as can be done with any investment that is held for over a year, provides a substantially lower rate than treating it as ordinary income, a reduction in the tax rate by upwards of 50% depending on one’s tax bracket. A basis, value at time of acquisition, needs to be calculated to take full advantage of the capital gains treatment. Depletion deductions allow for adjustments in the value of property when timber is sold. Management plans, boundary marking, road maintenance, and similar costs may be considered “ordinary and necessary” management costs and can be used as an income tax deduction. The purchase price of equipment related to the management of a forested property can be deducted using a “section 179 deduction” for those operating their properties as a business. If losses are incurred due to fire, wind, or other events, a loss deduction may be applied.

Other provisions are specifically for owners of forests or other working lands:

- Reforestation tax incentives;
- Ability to exclude qualifying public cost-share payments from gross income; and
- Charitable deductions for a qualifying donation of interest in land.

Incentives for donations of conservation easements exist within the federal income tax code. In 2010, federal law allowed for a charitable contribution deduction of up to 30% of an owner’s annual income for the qualified donation or “bargain sale” of a conservation easement, with unused amounts of the

³ Harvest taxes are often collected in lieu of or in association with property taxes, but since they occur when an owner harvests trees, they act more like an income tax and are therefore discussed in this section.

deduction carried forward for up to 5 years. From 2006 through 2009, the maximum deduction was 50% for most taxpayers, 100% for those who derived more than half of their income from farming (defined to include forest owners), with a 15 year carry-forward period.

State Income Taxes

Although the federal income tax has a greater economic impact than any state income tax, state-level taxes add an additional layer of burden to forest owners in 41 states. In 2007, the most recent year for which comparable data was available, the top federal income tax rate was 35%, while the top state rates ranged from 3% to 10% (Reinhardt 2009).

Similar to provisions of the federal code, seven states provide for special treatment of capital gains income, which is accomplished by either excluding a portion of capital gains income from taxation or allowing for a credit or deduction (Table 6).

Table 6. States with preferential capital gains treatment

State	Type	Extent
Arkansas	Exclusion	30% of long-term gains
Montana	Credit	2% of net capital gains
New Mexico	Deduction	up to 50% of federally taxable gains
North Dakota	Exclusion	30% of long-term gains
South Carolina	Exclusion	44% of long-term gains
Vermont	Exclusion	40% of long-term gains
Wisconsin	Exclusion	60% of long-term gains

In addition to providing preferential treatment for capital gains, five states also offer income tax incentives related to forest management (Table 7); including for management plan preparation, reforestation practices, and maintaining riparian buffers during harvest. In recent years, an increasing number of states have also enacted legislation providing income tax credits for forest owners who donate a conservation easement on their property (Table 8).

Table 7. State income tax credits and deductions related to forest management.

Type	State	Program name/identifier
Credit		
	Maine	Income tax credit for a forest management plan
	Mississippi	Mississippi Reforestation Tax Credit
	Oregon	Underproductive Forestland Conversion Tax Credit
	Virginia	Virginia Riparian Forest Buffer Tax Credit
Deduction		
	Maryland	Maryland Income Tax Modification Program

Table 8. State-level income tax incentives related to land conservation.

State	Program name/identifier
Arkansas	Arkansas Wetland and Riparian Zone Tax Credit
California	California Natural Heritage Preservation Tax Credit
Colorado	Conservation Easement Tax Credit
Georgia	Georgia Conservation Tax Credit Program
Delaware	Land and Historic Resources Tax Credit
Iowa	Iowa Tax Credit for Charitable Cons. Contrib. of Land
Maryland	Preservation and Conservation Easement Credit
Mississippi	Conservation Tax Credit
New Mexico	Land Conservation Tax Credit
New York	Conservation Easement Tax Credit
North Carolina	North Carolina Conservation Tax Credit Program
South Carolina	South Carolina Conservation Tax Credit
Virginia	Land Preservation Tax Credit

Harvest Taxes

Ten states impose one or more harvesting taxes on forest owners selling stumpage (Table 9). In six of these states, all owners must pay a harvest tax, while in three, only owners enrolled in the preferential property tax programs pay the tax. Idaho imposes its harvest tax on all forest owners except enrollees in one of the state's two preferential property tax programs. Oregon imposes a second harvest tax on enrollees of its Small Tract Forestland Program. Harvest taxes may be collected by the local unit of government or through a state's forestry agency or department of revenue. However, at least some portion of the tax collected is typically routed back to the county or municipality from which the harvests occur, in order for the local governments to recoup the money lost in annual property tax reductions.

The methods for determining the taxes owed vary by state, but in general range from a percentage of the sale value to an amount levied based on the volume of products harvested. Many states have a volume threshold under which a forest owner, typically harvesting for personal use, does not have to pay the harvest tax.

Table 9. States imposing harvest taxes on forest owners.

State	Who pays ¹	Basis for calculating tax	2009 rates
California	All landowners	Value	2.9%
Georgia	All landowners	Value	Set by county
Idaho	All except PPTP - Productivity Program	Value	3%
Illinois	All landowners	Value	4%
Missouri	PPTP enrollees	Value	6%
New Hampshire	All landowners	Value	10%
New York	PPTP enrollees	Value	6%
Oregon (a)	All landowners	Volume	\$3.89/MBF
Oregon (b)	Only landowners in PPTP - Small Tract Forestland Program	Volume	East: \$3.50/MBF West: \$4.48/MBF
Washington	All landowners	Value	5%
Wisconsin	PPTP enrollees	Volume	Depends on region, product, and species

1: PPTP – preferential property tax program

Awareness, Knowledge & Usage

Discussions about income taxes among the focus group participants were limited and consistent – these taxes were not a major concern. Most of the owners had few and infrequent income generating events (e.g., timber harvests). When they did, they realized income; otherwise they would not have been paying taxes and it was, therefore, “easier” to accept the tax. As a consequence, few owners reported their behavior was influenced by income or harvest taxes. This finding may have been different if more people who harvest timber on a regular basis participated in the focus groups.

Awareness of beneficial income tax provisions was quite limited among the focus group participants, but each region had a small number of owners who knew about income tax provisions affecting the ownership and management of their forest land. These individuals tended to own large properties and conducted timber harvests on a relatively frequent basis. The owners who were knowledgeable of income tax provisions described in considerable detail how they used beneficial tax provisions in the management of their forest land.

“The problem is not having enough income to pay taxes on.”
- A New Hampshire Landowner

“With growing trees, taxes are a moving target. You plant your trees, you figure taxes are at this rate when you plant them. Then later, the whole picture changes. All of a sudden there may be a loss or less of a gain. The way that taxes are a moving target is a real impediment to growing trees over the long run.”
- A Washington Forest Owner

“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.”
- An Alabama Forest Owner

Barriers & Weaknesses

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

Some owners are opposed to harvesting timber and hence income tax provisions are not applicable to them.

Although a number of owners knew about capital gains treatment, not everyone took advantage of it. This was true for calculating basis and depreciation as well. Owners often limit their ability to use beneficial income tax provisions by not establishing their timber basis or not keeping adequate records. One Wisconsin forest owner said, "It was not enough to make a whole heck of a lot of difference."

Most forestry professionals know something about the income tax provisions affecting forest land ownership and management, but some are hesitant to provide advice and simply tell owners to consult with an accountant. And others provide information that seems to contradict what an owner would get from a knowledgeable accountant; one professional stated: "I recommend to my clients paying tax as ordinary income on timber instead of calculating their historical basis and taking a depletion deduction." Misinformation is common among both owners and the foresters and accountants they turn to for advice.

Strengths & Opportunities

The current federal income tax policy is largely favorable to family forest owners, as are a number of state policies. Knowledgeable owners in the focus groups were happy to describe how they have used beneficial tax provisions, and other owners were interested to hear their stories.

Opportunities exist for providing more and better information to owners who generate income from their land and the accountants and other professionals who provide services to them. This can build upon the work currently available through extension, state and federal forestry agencies, and reliable internet sites.

Information Sources

Forest owners turn to financial professionals, such as accountants, tax preparers (not necessarily accountants) and the Internal Revenue Service, when they have questions related to income taxes. There were scattered mentions by focus group participants of financial professionals who had expertise with forestry issues. One owner cautioned others that a lot of accountants are financial generalists and do not know "what the value of the woods is."

Implications for Forest Conservation

Most family forest owners seem to consider income taxes less of a burden than property taxes. 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. Indeed, some said they would never harvest trees because it "destroys the atmosphere of what you've got, what you're working for." More pragmatic owners were of the opinion that "I really didn't want to cut the timber, but I wasn't going to let it rot."

"At the DNR you can get a pamphlet on forest taxation or the Forest Service has a publication called Federal Income Tax for Timberlands. 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."

- A Washington Forest Owner

"I'm just going to postpone cutting my timber because I don't want to pay the timber tax."

- A New Hampshire Forest Owner

Some owners feel the taxes on harvested trees are unfair and have decided to postpone cutting. Others spread out the income over multiple years to reduce their burdens.

“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.”

- A Wisconsin Forest Owner

Estate & Inheritance Taxes

When assets, including land, are transferred from one family member to another, taxes may be owed depending on: the total value of all assets being transferred and the applicable federal and state policies in effect that year. Estate taxes are levied on the estate of the deceased individual. An inheritance tax makes the inheritor liable for the taxes due on the estate assets received. The exception to this is when assets are transferred to one’s spouse. In general, estate/inheritance taxes are not due. In a typical year, the impact of the federal estate tax is much greater than that of state-level estate or inheritance taxes, but 2010 was far from a typical year when, for the first time since 1916, there was no federal estate tax (Jacobson et al. 2007).

Existing Policy Landscape

Federal Estate Tax

Federal estate tax exemptions have been a “moving target,” ranging from \$675,000 in 2000 to \$3.5 million in 2009 (Figure 21). In 2010, there was no federal estate tax. In 2011 and 2012, the exemption rate will be \$5 million and the taxation rate will be 35%. The fate of the estate tax beyond 2012 is uncertain. Federal law has provided for special use valuation of forest land and/or timber, and can be used to reduce the value of an estate. This provision values land as it is currently being used rather than at its “highest and best use,” which usually is for residential, commercial, or industrial development. However, special use value reduction of land is limited to \$1 million, and there is a substantial set of stipulations and requirements that apply. Land that is subject to a conservation easement is also eligible for a reduction in valuation and tax; the 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.

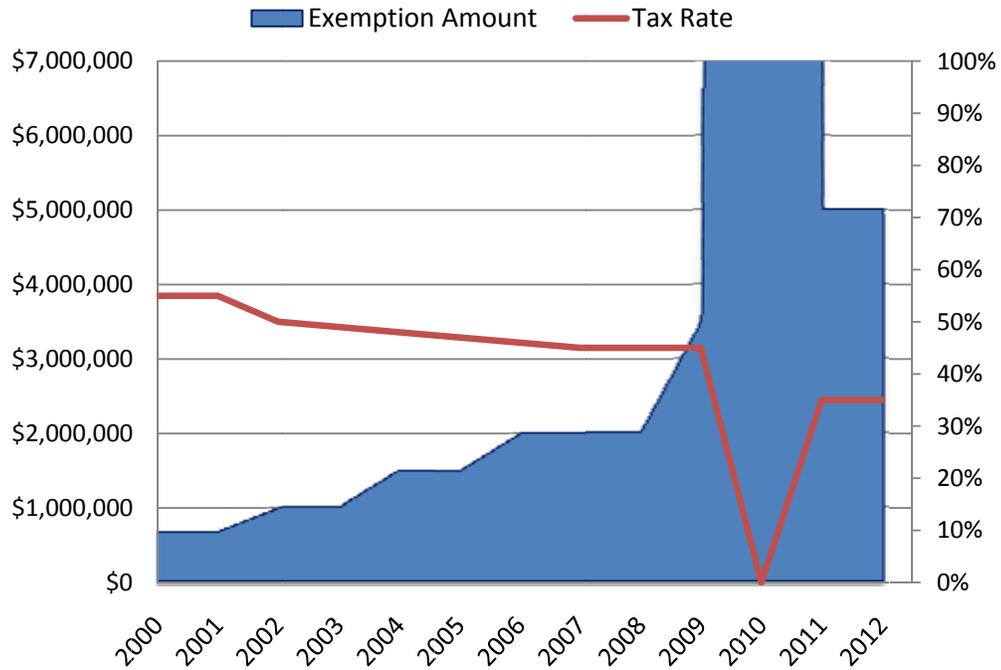


Figure 21. Tax rates and exemption amounts for the federal estate tax.

State Estate & Inheritance Taxes

Prior to 2001 all states collected at least the maximum federal credit for state estate taxes, which imposed no additional burden on the estate. Some states had stand-alone policies as well. In 2001, federal tax legislation swapped the credit with a deduction, veritably doing away with all state-level taxes tied to the federal credit.

In response to changes in the federal estate tax, states have adjusted their estate and inheritance tax policies. By 2009, 20 states had imposed their own state-level estate or inheritance tax (Figure 22). Exemption amounts range from \$3,500 to \$3.5 million and tax rates range from 1% to 19%. Like the federal estate tax, five states, Indiana, Nebraska, Pennsylvania, Oregon, and Washington, have provisions for special use valuation of forest property. In Oregon, the value of working forest land is excluded from the estate tax.

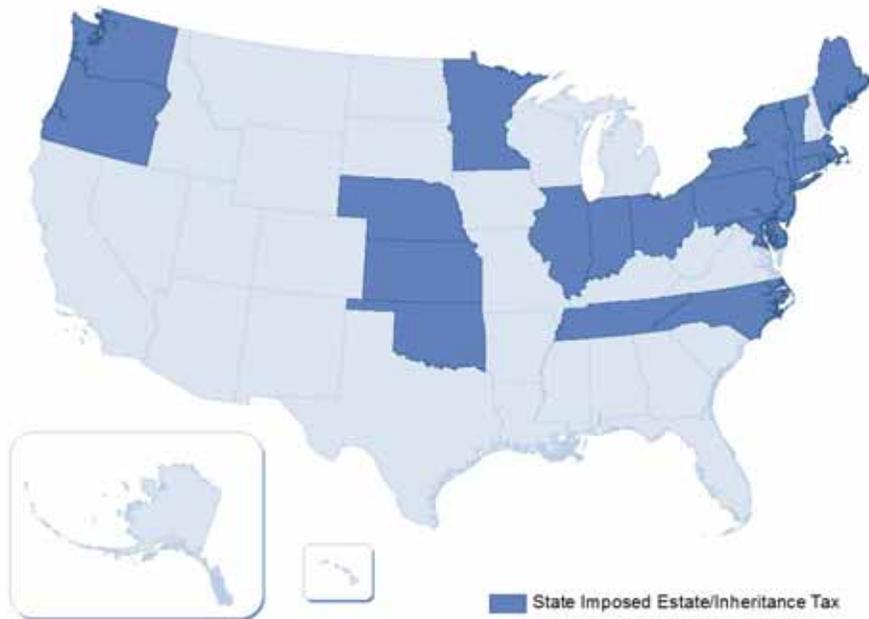


Figure 22. States with estate or inheritance taxes.

Awareness, Knowledge & Usage

Unlike property taxes, and to a lesser extent income taxes, most forest owners do not have direct experience paying estate taxes. Although estate taxes did not rise as a top concern among forest owners in the current study, challenges in transferring land to heirs did. Most of the focus group participants, however, do not view estate or inheritance taxes as relevant to their situation.

Inheritors in the focus groups generally said they themselves did not have major problems with the estate taxes; granted, these are people who were able to keep their property. Land was worth less and taxes were lower when most of them inherited it. Among the inheritors, various transfer strategies were used: parents gifted or deeded the land, children purchased the land from parents, children used inherited money to pay off the estate taxes, and a few had inherited their land as part of a trust or family partnership. One Alabama owner talked about the “nightmare” that occurred when she and her siblings divided the land.

Some of these forest owners expressed concern about their heirs being able to afford to pay estate taxes or having other problems, such as high property taxes, when they inherit it. Many forest owners are keenly aware of the uncertainty in the present policy landscape;

“I don't think we're worried about estate taxes. We're worried about “being-able-to-keep-it” taxes because of the price of living and owning the land. Estate taxes are nothing compared to [that].”

- A Wisconsin Forest Owner

“Estate taxes shouldn't exist. We've already paid taxes. My dad paid taxes when he earned the money, he paid taxes when he bought the land, he's paid taxes on it every year. When it's inherited there should not be a lump sum.”

- An Alabama Forest Owner

“Everything that [my father] had ever saved I had to pay [to cover estate taxes]. If he hadn't had \$200,000 – that's what the estate tax was when he died – I would have had to sell my house.”

- A Washington Forest Owner

this appears to prevent some from embarking on succession planning. Forest owners who want their land to stay in the family have an understanding of the need to “do something,” but many are unsure exactly what to do. The “solutions” discussed by the focus group participants included:

- Dividing up the property among children through gifts or sales;
- Family trusts;
- Family partnerships and limited liability company (LLCs);
- Conservation easements;
- Donating the land to a governmental or non-governmental conservation group;
- Deeding the land to heirs in their will;
- Adding all children’s names to the deed; and
- Life insurance.

Giftgiving was seen as a good option for some to transfer assets while they are still alive. There was some confusion over allowable amounts and some owners had no desire to cede control before their death.

Whether or not the land remains intact depends largely on one of two things: The owners’ ability and willingness to proactively make legal provisions for it to remain intact; or, if the land is being inherited, the owners’ children’s ability and willingness to keep it intact. Some forest owners feel empowered to make the decision and move forward with steps to ensure their land remains undeveloped. Some forest owners are confident that at least one child or other heir will keep the land; a few have specifically asked their children not to sell. Others, however, know or are worried that their children do not want the land, primarily because they live far away and have no interest in returning to the community where they grew up.

The overall level of concern about estate taxes was low, but several forest owners in the focus groups had taken action to mitigate the effects of this tax. Most of the forest owners had not considered estate taxes or viewed them as irrelevant to their situation. When knowledgeable owners offered advice on avoiding the tax, some focus group participants were eager to learn but others immediately lost interest.

Awareness that there are no estate taxes in 2010 was mixed. Some owners recognized that there is uncertainty about whether or not the taxes would be reinstated in 2011. Jokes about dying this year (or being helped to do so) were made in several groups. Plans made to deal with possible taxes may well have to be remade when the laws change. The value of the estates that might be taxed was discussed and this contributed to forest owners’ confusion about whether or not they might be affected.

“My father passed away and left the land jointly to six children and it was a nightmare. We didn't own 10 acres of the parcel; we owned one-sixth of a hundred. Just trying to divide [it when] you've got six kids – one of them wants to keep it, one of them wants to sell it.”
- An Alabama Forest Owner

“I think your state and federal exemption for estate tax may be a million dollars for the federal government now. Unless you were very wealthy you wouldn't have to contend with them. If you were very wealthy it wouldn't bother you. Estate tax shouldn't really be involved here too much.”
- A Wisconsin Forest Owner

“I take the advice of my attorney and my CPA. But when you sit down and start talking about it, honest to God, I can't even tell you what the hell to do because it's so damn confusing. All I know for sure is that, depending on what you need for income, we're in a line of gifting because we intend to keep things intact. That's definitely going to have to happen.”
- A Washington Forest Owner

“I told my children to pull the plug in 2010 if I was on a respirator. The law changes this year nationally.”
- A South Carolina Forest Owner

There were a handful of owners in the focus groups, primarily ones with larger properties, who were actively planning the future of their land, in part to mitigate estate tax issues. Advance planning was said to be key, but the complexity of the subject was shown in the frustration even some knowledgeable owners feel, despite having studied and received professional advice. “There are a lot of ways around estate taxes,” one Wisconsin forest owner said. Difficulties dealing with estate issues for forest owners include avoiding conflicts within the family and treating their children equitably.

Strengths & Opportunities

One expert interviewed called the estate tax the “Stupid Tax.” He was implying that it can be planned for and those who fail to get out of its way are ignorant or in denial. The tools exist for estate taxes to be largely mitigated or even completely avoided. Witnessing a neighbor, friend, or coworker adversely impacted by the tax, and wanting to keep their heirs from having to face the same fate, seems to be an impetus for action.

The estate tax may have the unintended consequence of increased succession planning. This has the potential to help owners meet their goals and, in general, help family forests stay family forests.

Barriers & Weaknesses

Estate planning is far from simple or straight-forward. Owners fail to plan for several reasons: they don’t want to face their own mortality; many don’t know the full value of their land (and other assets); they don’t know how to deal with the desires of heirs; they don’t like the feeling of their kids “measuring for drapes”; or they simply don’t like paying for professional assistance. Other obstacles are related to: parents’ reluctance to talk with their children about topics that could stir inter-generational or sibling conflicts; parents’ belief in a hands-off approach to their children’s lives and not dictating their choices; development, which some see as an unstoppable trend; and rising property taxes, which can pressure heirs to sell.

Special use valuation provisions for forest land exist at the national level and in a few states. The provisions of some of these programs are of limited use to many owners: the programs are too stringent and limit forest owners’ future options.

Information Sources

Focus group participants said estate planners were the most common type of professional consulted regarding estate issues. Other types of lawyers and financial advisors were also mentioned. Respondents stated these services could be very expensive and the advice received can vary from professional to professional. It was also noted that finding an estate planner who knows land issues well can be difficult. More knowledgeable owners took on the role of advice-givers in the focus groups, suggesting ways others can reduce taxes owed.

“Just got to do prior planning. There’s ways around it before it happens like giving it to the people years ahead of time, putting it in their name, doing the survivorship deeds so it doesn’t roll over into your estate.”

- An Alabama Forest Owner

“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.”

- A South Carolina Forest Owner

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

- A South Carolina Forest Owner

“Small forest land 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 what the hell they’re doing and get it done right. I’ve made many mistakes because I was trying to save a buck. I ended up costing myself a hell of a lot more.”

- A Washington Forest Owner

Implications for Forest Conservation

The effect of estate and inheritance taxes on the future of family forest land is heavily dependent on the future of federal policy. Exemption amount is a primary trigger for determining who will be affected by the taxes. Tax rates determine the degree to which they will be affected. Regardless, estate planning can be used to ease the transfer of lands, in addition to helping mitigate the effects of estate and inheritance taxes.

The question of whether or not estate and inheritance taxes push owners to sell their land is difficult to answer from this and most previous research, but anecdotal accounts of the impacts of the taxes abound. Few of the current forest owners interviewed have directly been affected by estate or inheritance taxes, although some had other problems when they inherited it. Anxieties exist about heirs being pushed to sell because of property and/or estate/inheritance taxes. “Some people worry about the tax bill and will that put pressure on the kids to sell,” one South Carolina forest owner said. Stories were told of people focus group participants knew personally who sold because of estate taxes.

“I know a man who lost as much as half a thousand acres that he inherited due to an inheritance tax. When his daddy died he lost about half of all that timberland they had. He had to sell just to pay the inheritance tax.”

- An Alabama Forest Owner

CONCLUSIONS

The factors that determine forest owners’ decisions are complex, multi-faceted, and dynamic (Kittredge 2004). Forest land is sold or transferred and trees are cut for myriad and often interrelated reasons, such as a death, a desire for a lifestyle change, financial needs, or simply taking advantage of what appears to be an attractive offer. By providing a diversity of tools and options geared towards forest owners’ needs and desires, the likelihood of forests staying forests and being well managed increases – something both forest owners and the general public desire. Tax policies, conservation easements, outreach, cost-share programs, and other policy tools can be refined so they work better, alone or together, to further these goals.

The general findings of this study are congruent with the findings from previous studies, such as Greene et al. (2005) – beneficial tax policies are not enough to stave off development indefinitely. Instead, taxes are one of a number of factors that may influence a forest owner’s decision about her/his land. Unfortunately, the ultimate question of what is the impact of taxes on family forest owners is still largely unanswered. Retrospective studies could be conducted to study why forest owners made specific decisions and if property taxes were influential. Alternatively, fine-scale analyses could compare areas of increasing tax pressures to those with stable taxes. Additional scoping of the extent of those impacted by specific taxes could also be conducted. For example, there is only one study that has assessed the potential impact of estate taxes on family forest owners (Greene et al. 2006), which would greatly benefit from an updating of source data and expansion to include a wider sample of forest owners.

Of the three types of taxes studied, property, income, and estate/inheritance, property taxes were of greatest concern to the forest owners in the focus groups. Property taxes are paid on an annual basis, so forest owners see these taxes most often, and the taxes are due even if no revenue is generated.

Income taxes were less of a concern because most owners generated revenue from their land infrequently and when income taxes were due, revenue had been generated and was generally available to pay the taxes. Estate taxes did not emerge as a concern for many family forest owners, most likely because they believe their estates are unlikely to be of great enough value to be subject to estate or inheritance taxes, they do not know the full value of their assets, they do not want to confront their own mortality, and/or they dislike the estate planning process which can be long, expensive, and emotionally trying. Since property taxes appear to be of greatest concern to family forest owners, and thus conceivably have the greatest impact on their behavior, this puts policy emphasis at the state, rather than federal, level. Apart from influencing federal income and estate tax policies, the greatest ground to be gained in terms of tax policy and forest owner decision-making is at the state level.

As with many complex issues, there is a fog of low awareness, confusion, and misinformation that enshroud tax policies. Most, if not all, existing programs and policies are not reaching their full potential because the information is not readily available, the timing of the information is not right, and/or the information is too complex for a forest owner to quickly and easily grasp. The materials will be more effective and efficient if they are targeted to specific types of forest owners (Butler et al. 2007). To ensure forest owners are getting the right information, when they need it, the communications should be both consistent and persistent; consistent so that they get the same information regardless of who they ask and persistent so they are aware of the information when they need it. In addition to the forest owners, more efforts could be made to provide ready access to the information to the accountants, lawyers, foresters, and other professionals with whom the forest owners interact.

The specific communication channels should also be considered. Most owners desire information from multiple sources and in multiple formats. While traditional printed materials are likely to continue to be important, the fluid nature of tax policies and increasing rate of internet usage among family forest owners makes the internet a good option for information that is easily updated and always available. In addition to new and redesigned materials, providing more opportunities for forest owners to talk directly to other forest owners may have many benefits (and prove more economical than other options). It was interesting to observe how much participants seemed to learn from one another during the focus groups, and how frequently they remained after the groups had ended, sometimes talking with one another for an additional hour or more. As one colleague put it, “we need to be encouraging more potluck dinners and fewer forest management plans.”

Property Taxes

At their core, property tax policies should be flexible, appropriate, and simple. As threats to maintaining forests vary across the landscape, tax policies should be flexible enough to address these differences. Forest owners in exurban areas face different challenges than forest owners in rural areas. Tax policies should also be appropriate for owners’ needs and desires; requiring forest management is not reasonable for all forest owners. And the policies should be simple enough for forest owners to easily understand and evaluate.

Some forest owners are indeed pleased with existing preferential property tax programs. A number of focus group participants indicated that preferential property tax programs were allowing them to hold on to their forest land. It is important to learn from the successes (and shortcomings) of these programs.

Many preferential property tax programs were developed in decades past when the challenges facing the forests and forest owners were different. A conscious decision needs to be made as to whether the goal of a program is to promote forest management or to keep forests as forests. If the goal is the former, it makes sense that on-the-ground management should be required. This should include the creation of a meaningful management plan and some level of oversight that ensures the plans are being properly implemented. Adherence to the plans should be mitigated by changes in forest owners' personal circumstances as well as natural succession and disturbance processes. If generation of revenue for the forest owner is important, market conditions should also be considered.

If the primary goal of a program is to keep forests as forests, then the policy should primarily focus on discouraging conversion of forest to other uses. Promotion of timber production or public access should be secondary.

The goals of current programs, especially those with a strong forest management component, are not in sync with some owners' objectives. In certain areas, timber production is not economically feasible due to a lack of markets, small parcel sizes, prohibitive costs to transport products, and other barriers. Programs that are in-line with owners' objectives will be more appealing, but this should be balanced with the goals of the program and the ultimate benefits provided to society.

Given the diversity in reasons for owning forest land, economic circumstances, and differences in pressures to develop land, it follows that there should be a diversity of programs offered to forest owners. A diversity of programs or program options would allow targeting of specific types of forest owners and tailoring of approaches for specific geographic areas. For example, a program focusing on amenity values and open space retention may be more effective in rapidly developing areas while a more traditional forest management program may be better suited to rural regions within a state. In addition, minimum acreage and other requirements should be set appropriately to ensure the target audience can qualify for the program.

New Hampshire's Forest Land tax program is an example of a flexible preferential property tax program that meets the needs of different types of owners. The basic program provides property tax reductions for keeping land undeveloped. Should a forest owner desire to manage her/his land according to a plan written by a licensed forester s/he is eligible for a greater reduction in taxes. In addition, should a forest owner be willing to allow non-motorized recreation by the general public on the property, s/he may be eligible for an additional "recreational adjustment" in assessment and taxation.

Wisconsin's Managed Forest Law is an example of a preferential property tax program that incentivizes forest management. A forest owner's annual property tax is substantially reduced if s/he gets a forest management plan and adheres to it. While this program is not appropriate for all forest owners, it does encourage sustainable forest management by those who are so inclined and appears to offer rewards that are commensurate with restrictions.

Some critics of preferential property tax programs have argued that the programs act as a "safe haven" for developers. This may be an unavoidable, but not necessarily disastrous, result. As long as a program has a withdrawal penalty that at minimum allows the taxing jurisdiction to recoup all deferred taxes plus interest, the jurisdiction will be no worse off than had it collected a greater amount in taxes during the time the land was not enrolled. Under this scenario, the taxing district would see increased revenue at the time it would see an increased demand in services.

Income Taxes

Financial incentives, such as some income tax policies, will have the greatest impact and influence on those forest owners who are most interested in financial gains from their forests. In this study, the perceptions and opinions of family forest owners located in areas experiencing significant development pressures were explored in-depth. It is unknown whether different perceptions and opinions would have emerged if the focus groups were conducted in more rural areas or with more income oriented owners.

Federal and state income taxes on forest-related revenue are non-issues for owners who do not produce income from their land. Owners who do manage their forest land to regularly produce income from timber usually have a reasonable grasp of the favorable tax provisions available to them. Many of these owners elect to use the provisions, but some do not. Some owners feel the requirements to take advantage of a provision outweigh the prospective benefit (Greene et al. 2005) or mistrust government programs (Zhang and Flick 2001; Daniels et al. 2010). Owners who do not produce income from their forest land, or who do so only infrequently, generally are less aware of favorable income tax provisions, as are many of their tax preparers.

One reason for low awareness is the complexity of the tax code. Preferential tax treatment relevant to family forest owners could be simplified, and more straight-forward informational materials distributed – to both forest owners and their accountants. One simplification proposed by an Internal Revenue Service forester is to simplify the method for calculating basis. Instead of requiring an inventory when forest land is acquired or a retrospective inventory at the time of a timber sale, a “safe harbor” schedule could be created based on general forest types, regional timber values, and length of tenure. The inclusion of forest owner specific provisions in a commercial tax package could also prove useful. It may be beneficial to develop materials targeted to specific owner groups, such as “Managing your forest for value: Money does grow on trees” for owners who hold their forest as an emergency fund or retirement account.

Income earned from forest land is treated the same as any other long-term capital gain held for at least one year. A sliding scale capital gains tax rate that decreases the longer an asset is held would encourage holding forest land and timber for longer periods of time.

To assist more people in acquiring forest land, a first time forest owner’s tax credit could be created for forest land purchases that meet certain criteria. The program could be similar to the first time home buyer’s credit or the beginning farmer loan program. Stipulations would need to be created so that the program does not inadvertently contribute to forest parcelization or engender other negative effects. Although it is unlikely the forestry lobby is strong enough to instigate such a policy, collaborating with other interest groups, such as farmers and ranchers, may prove beneficial to all parties involved.

Estate & Inheritance Taxes

In general, broader issues related to the intergenerational transfer of land were of greater concern to family forest owners in the focus groups than were issues related specifically to estate or inheritance taxes. Most forest owners indicated a desire that their forest land stay forested, but many obstacles to this outcome were expressed.

Though some of the forest owners in the focus groups with larger forest holdings were engaged in estate planning, most of the forest owners expressed frustration with the complexity of the process and a hesitancy to pay for a professional estate planner. Forest owner unwillingness (e.g., “don’t want to consider mortality”) or inability (e.g., hiring professionals can cost upwards of \$10,000) to conduct estate planning were principal obstacles to preserving and sustainably managing family forest land - estate and inheritance taxes were potential confounding factors.

Some forest owners in the focus groups were confident that at least one child or other heir will keep the forest land undeveloped; a few have specifically asked their children not to sell. Others, however, knew or were worried that their children do not want to inherit their land, primarily because they live far away and have no interest in returning to the communities where many of them grew up.

Regardless of level of concern, estate and inheritance taxes have the potential to have a considerable impact on family forest owners who are planning to pass their land onto their heirs. The fact that many owners are relatively advanced in age suggests that these issues will increase in the near future. The National Woodland Owner Survey estimates that 34% of the family forest owners are 65 years of age or older (Butler 2008). The extent of the impact depends upon the exclusion amounts and tax rates. The higher the exemption amount and the lower the tax rate, the fewer the number of owners who will be impacted and the less the impact will be.

Through sound estate planning, family forest owners can better ensure that their forest land is used as they so desire, that their heirs are treated equitably, and that the impacts of estate and inheritance taxes are minimized. To increase the likelihood of such outcomes, better and more simplified information on estate planning is needed. In light of the fact that the process can take years to accomplish, it is likely to be more palatable if the process is broken into discrete, digestible bites that owners and their families can deal with at their own pace. The sobering reality is that each family has a unique mix of objectives, values, and financial needs. Estate planning for forest owners cannot be a “cookie cutter” approach. Instead, it may be more effective to encourage forest owners to have conversations with estate planning professionals with experience in land transfers.

Access to affordable, high quality estate planners could help many owners navigate this sensitive and complex topic. Subsidies, including cost-share and tax credits, for the creation and updating of estate plans, especially those that incorporate appraisals of forest land, might go a long way towards helping forest owners keep their land in the family, thus increasing the likelihood it remains forested. These cost-share programs may have a greater impact on “keeping forests as forests” and provide more public benefits than current cost-share practices such as management plan development. Estate planning may even prove to be an effective way to get more people involved in traditional forestry activities.

There is also a need to better educate service providers (i.e., estate planners) on the intricacies related to land transfers and strategies to keep the land largely intact while satisfying heirs’ differing objectives. Liquidation and distribution of assets among heirs may be the typical *modus operandi* for many estate planners, but the use of longer-lasting legal mechanisms and entities such as conservation easements, trusts, and limited liability companies might more effectively meet the objectives of many forest owners.

Like preferential property tax programs, assessing the value of forest land and other open space within estates at current use, rather than fair market value, would reduce the need and incentive for the next generation of owners to sell and/or develop the land. Special use valuation is available under the

federal estate tax, as well as in a handful of states, but the amount by which it can be used to reduce the taxable value of an estate is capped, and there are stringent requirements to qualify for and remain under the provision.

Currently, under federal law, as well as in a number of states, assets may transfer from a deceased spouse to the surviving spouse with no estate taxes being owed; this is known as the right of survivorship. If this provision were extended to land being passed to any family member, it could act as an easy way to defer tax payments and as an incentive to keep the land in the family. If the land were sold or developed, then the full estate taxes, plus interest, could be due.

Conservation Easements

Conservation easements are the only tool currently recognized that can fully ensure the long-term protection of private forest land. However, conservation easements are not appropriate, appealing, or even an option for all forest owners. Some owners do not want to be restricted in what they can do with their land, some owners don't want future owners to be restricted, and some mistrust the organizations holding the easements (American Forest Foundation 2010).

Tax policies can be used to incentivize conservation easements for those forest owners for whom it is an appropriate and feasible option. The development of a fair and consistent method of taxing land with a conservation easement may also help forest owners make more informed decisions about whether an easement is right for them. Exemptions, or special treatment, of easements within estate and inheritance tax laws may provide both an incentive for easing land and for keeping the land in the family.

Eased forest lands could be either exempt from property taxes or taxed preferentially. Treatment of lands with conservation easements under existing property tax systems is inconsistent and generally under the purview of local taxing agencies. At a minimum, these lands should be taxed at current use, since they are legally restricted from being developed. Some states, such as Florida, have laws mandating this treatment, while others, such as New York, provide income tax credits for a portion of property taxes paid on land subject to a conservation easement. Policies such as these are far from being ubiquitous across the U.S.

Continuing to provide income tax deductions for donated easements, and further enhancing these deductions, would be an incentive for more easements and providing credits, instead of deductions, would be an additional incentive. Income tax deductions are adequate for owners with sufficient annual incomes, but according to the National Woodland Owner Survey, 46% of family forest owners have an annual income of less than \$50,000 (Butler 2008), and thus are unable to take full advantage of existing provisions. A number of states provide income tax credits for the value of donated development rights; a federal credit would provide an additional incentive. Allowing owners to transfer their tax credits in exchange for cash, as is the case in some states, may also increase the attractiveness of such a provision.

Payments for Ecosystem Services

Payments for ecosystem services derived from forests, such as water protection and carbon sequestration, are still largely in the early stages of development, but tax law could be used to incentivize these markets that, by definition, provide public benefits. Expenses associated with the production and provision of these services, such as specialized inventories or specific stand treatments,

could be made deductible, the same as timber-related expenses, or even eligible for a credit against taxes due. Income derived from the provision of these services could receive favorable tax treatment or even be exempted from taxation altogether. The future impact of existing tax policies on those whose lands provide ecosystem services is uncertain. Likewise, the possibility of using tax policies to incentivize the provision of ecosystem services is largely unexplored. By developing a greater understanding of this topic now, potentially beneficial, deleterious, and unintended consequences may be identified and, as appropriate, incorporated or avoided in the development of relevant tax policy.

It is likely some of the findings from this report can be implemented relatively easily, while others will require broad coalitions to achieve. Hopefully, the report has provided insights into the benefits and challenges inherent in different approaches. The ultimate decisions, however, on which changes to pursue will be determined by forestry and conservation organizations, and ultimately the policy-makers, the general public, and the people most affected – family forest owners.

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The included CD contains the following materials:

- Appendix I. Project and tax policy summary sheets
- Appendix II. Annotated bibliography of selected studies
- Appendix III. Policy verification questionnaire
- Appendix IV. Family forest owner focus group report
- Appendix V. Family forest owner focus group topic guide
- Appendix VI. Family forest owner focus group screener questionnaire