

FEDERAL TAX POLICY AND ITS RELATIONSHIP TO THE SUSTAINABILITY OF PRIVATE FOREST LANDS

A policy statement approved by resolution
of the National Association of State Foresters



INTRODUCTION

The National Association of State Foresters (NASF) is comprised of the forestry agency directors in all 50 states, the U.S. territories, and the District of Columbia. These agencies manage 76 million acres of state forests and protect and conserve over 450 million acres of local and private forestlands nationwide. These lands provide all Americans with a diverse and very important set of public benefits, including ample drinking water, clean air, appealing landscapes for recreation, carbon storage, wildlife habitat, and raw materials for wood and paper products.

A key NASF constituency are the 22 million individuals and families who own 299 million forested acres in the United States. For many of these forestland owners, the tax burden of owning and managing woodlands can, in the worst of cases, force them to sell their land to recoup costs. Undue tax burden coupled with development pressure and generational land transfer make family forestland owners the most at-risk group of forestland owners for land conversion and land fragmentation.

According to a recent survey, “improved tax policies” were identified by forestland owners as the best method for minimizing land conversion.¹ **To help family forestland owners retain ownership of their forests and to keep them working over the long run and for the greatest benefit, federal tax policy must be improved.**

To promote the retention and management of private forest land:

- **Simplify the federal tax code.** Families and individuals who own forestland must identify their forested property on their federal income taxes as one of four types: *investment* property; *personal use* property; *active business* property; or *passive business* property. How one treats income and expenses related to the property varies based on which identification is used. Just determining which Internal Revenue Service (IRS) rules and guidance apply can be daunting enough to discourage a timber sale.

In addition, landowners may not engage in active management because they aren’t aware of or don’t understand how management costs might be lowered through available tax treatments. It is also not uncommon for a landowner to receive inaccurate tax advice or to not be able to afford or find an expert advisor. Simplifying the federal tax code would make active management significantly more affordable for landowners.

- **Update Agricultural Handbook No. 731 - *Forest Landowners Guide to the Federal Income Tax*.** This 164-page document was published in 2013 and does not reflect changes brought about by the *Tax Cuts and Jobs Act of 2017*, plus other revisions to the federal tax code that may have affected forest landowners. NASF has written a letter in support of this project. The handbook’s revision has been authorized and will take several years to complete.

¹ Greene, J. et al. “Effects of Taxes and Financial Incentives on Family-owned Forest Land” in “Southern Forest Futures Project” pp 261 - 293. General Technical Report SRS-GTR-178. USDA Forest Service, 2013.

- **Maintain current provisions of the federal estate tax.** The 2017 Tax Act increased the dollar amount that is exempt from the federal estate tax from \$5.6 to \$11.2 million. In 2020, that amount increased to \$11.58 million. There are only a small number of families or individuals who might own sufficient forested acreage to have their forestland's value exceed the exempted amount; still, forests held in conjunction with higher value agricultural lands and/or other substantial assets could be impacted. For these instances, serious consideration should be given to eliminating the estate tax burden for inherited forestland where a professionally approved forest management plan is in place and is being implemented in good faith.

Several existing provisions of the federal estate tax are also beneficial to forestland owners and should be retained:

1. When land is inherited it is valued for estate purposes at the current market rate. A provision in the tax code allows this value to be reduced where the recipient has less than full decision-making control over the property. There may be multiple heirs to a single ownership who would have to agree on any disposition of property. This provision is important to maintain.
2. Another provision allows the executor of the estate to choose to value farm, forest, and/or ranch land at its current use value (known as the special use valuation or "SUV"). This allows the estate to look at the fair market value (the estimated value of the property if sold at existing market rates or "FMV") and the SUV and reduce the value by up to \$1.18 million. There are rules regarding qualifications and use of the property after the election.

This provision may not have widespread use, but it can be valuable for lands on the fringe of metropolitan areas where property values are increasing. Once this option is selected, heirs cannot sell the property (including the timber if it is part of the qualification) for 10 years without penalty. This rule likely discourages some participation, but it does help keep the land intact, and for this reason, should be maintained.

- **Retain capital gains treatment of timber revenue.** The net income of forestland identified as either an *investment* or *business* property (*passive* or *active business*) and owned for more than one year can be treated as a capital gain. Providing capital gains treatment for timber income recognizes the long-term nature of forest management and should be retained. Again, simplifying the rules for capital gains treatment would be beneficial to forestland owners and working forests.
- **Maintain annual forest management cost deduction.** Forest owners who incur costs growing and nurturing young forest stands to maturity can deduct those costs annually if the property is identified as an *active business* property. This deduction is critical for family forest owners who often don't see timber revenue for years – even decades –

between timber sales, but to maintain stand vitality and health, must pay to perform appropriate management measures in “off” years. This tax provision should be maintained.

Often landowners identify their property as an *investment* and lose the yearly deduction option because they assume their property doesn’t qualify as a *business*. Landowner education and simplified tax rules are needed so that more individuals claim *active business* status.

- **Maintain and enhance deduction and amortization for reforestation costs.** When reforestation after harvest landowners can deduct up to \$10,000 per stand at the time costs are incurred and amounts over that can be amortized over seven years. This tax provision encourages prompt reforestation – a key to forest sustainability – and should be maintained.

The benefits of this deduction could be enhanced for forestland owners by allowing the total cost of reforestation to be deducted during the year of planting. Additionally, clear guidance on what constitutes a qualifying timber property for this deduction is needed.

- **Fix the deduction for casualty losses of timber.** When landowners experience damages to their forestland and subsequent reductions in timber value as a result of wildfires or hurricanes they can deduct the smaller of: 1) the original value of their land when it was purchased plus any allowed adjustments (the adjusted basis); or 2) the reduction in fair market value due to the event. Almost without exception, the basis is the smaller amount and landowners have no means of recouping lost market value. The Forest Recovery Act, introduced in the 116th Congress, would alleviate this issue.
- **Stop treating cost-share payments as income.** Some payments received from federal cost-share programs like the Conservation Reserve Program and Environmental Quality Improvement Program are treated as income up to certain amounts. Federal conservation objectives achieved through these programs should be fully recognized as public benefits rather than an income source for landowners. Any and all federal conservation cost-share payments should not be considered income and a list of programs for which this provision applies should be continuously updated.
- **Set policy for landowner carbon payments.** A search of the literature and the IRS website did not produce any information on how landowners are taxed for receiving payments under a carbon sequestration agreement. The presumption is that these payments would be treated as ordinary income and expenses could be deducted for legal fees associated with the agreement, a baseline inventory, and other items necessary for earning the payment. Clearer guidance would be helpful.
- **Enhance the deduction for conservation easements.** If a landowner identifies their forest holding as an *active* or *passive business* property, they can deduct the value of a

donated conservation easement up to an amount that does not exceed 100% of their adjusted gross income. Where land is identified as *personal use* property, deductions are limited to 50% of adjusted gross income. Donated values above those limits can be deducted over a period of 15 years. Enhancing the financial benefit of these donations would encourage greater retention of working forests and should be considered.

CONCLUSION

Forestland owned by families and individuals make up a large percentage of all forestlands in the U.S. As such, they are responsible for providing a host of benefits to society at large. Federal tax policy should recognize these contributions by implementing rules and regulations that encourage active management and the retention of forests despite generational transfers and development pressures.

The federal tax code should be simpler. It should enhance forest management, not hinder it. It should make it easier for landowners to reduce their costs of owning and managing forests, and it should also give landowners full financial credit for their contributions to national conservation objectives.