Kentucky Woodland Owners Association

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KENTUCKY WOODLANDS NEWSLETTER

August 2012

Special Edition - Tax Assessment Issues

This special issue of the Kentucky Woodland Owners Association newsletter is focused on the woodland tax assessment issue that hinders to owning and managing woodlands in Kentucky.

Legal Action Looms on Woodland Tax Assessment Issue

by Don Girton, US Forest Service, (retired)

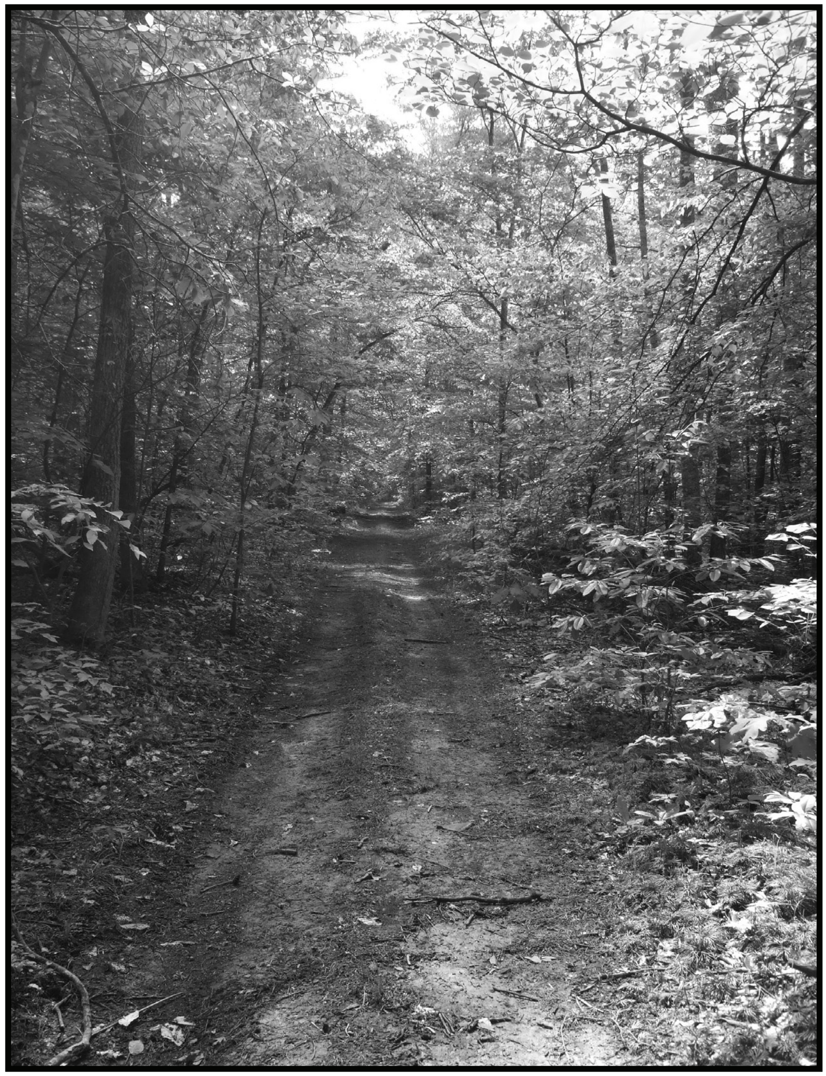
Efforts to change the guidelines the Kentucky Department of Revenue uses to assess woodlands for tax purposes appears to be stalled despite extensive efforts by the University of Kentucky Forestry Extension office to provide alternative methodology that is fair an equitable for long term timber production. Over the past year KWOA's woodland tax assessment committee and UK Forestry Extension staff have repeatedly met with Department of Revenue to present research findings and related information that recommends a change in Department guidance to county Property Valuation Administrators. Unfortunately the Department of Revenue shows no interest in the proposal.

Currently three Association members have appeals pending on 5 woodland tracts before the Kentucky Board of Tax Appeals. These cases are held in abeyance pending our efforts to seek resolution with the Department of Revenue. The Association has been seeking resolution to inequitable assessments for over ten years. Efforts were launched in the 2001 legislative session when a House Concurrent Resolution directed the Legislative Research Commission to study forest tax policy. Its January 2003 report (Research report No. 307) references a UK study that found property tax burden was much greater on forestland than on agricultural croplands when measured in proportion to earnings. Forestland paid 60% to 115% of earnings in taxes, while cropland could expect to pay between 5% and 9%. It now appears legal action, through the Kentucky Board of Tax Appeals and possibly to the Circuit Court and above, may be our only recourse. The Association board has authorized some funding to cover legal costs, and the appellants are committed to helping. Members are strongly encouraged to donate to the "Woodland Assessment Legal Fund". For additional information and updates, contact committee chair Dr. Jim Corum at 606.337.8115.

Assessing Woodlands in KY for Tax Purposes - An Overview of the Legal Framework

by Doug Curtis, Attorney

Agricultural land in Kentucky is subject to a constitutional mandate that it must be assessed for taxation at its value for agricultural use alone. A brief survey of applicable constitutional provisions, enabling statutes, and appellate court decisions, is offered to provide an understanding of this constitutional mandate.



Kentucky has some of the most diverse and potentially productive woodlands in the world. However, woodland property taxes that are not fairly assessed hinder the management and retention of woodlands.

Section 172 of the Kentucky Constitution, ratified in 1891, requires that property "shall be assessed for taxation at its fair cash value, estimated at the price it would bring at a fair voluntary sale." Ratified in 1969, Section 172A carves out an exception for agricultural land to the general rule of all assessments of fair cash value requiring that it be assessed "according to the land's value for agricultural….use."

KY. REV. STAT. ANN. & 132.010(9)(a) – Defines agricultural land as "any tract of land, including all income-producing improvements, of at least ten (10) contiguous acres….used for the production of crops, including timber."

In the guiding case of Dolan v. Land, 667 S. W.2d684 (Ky., 1984), the Supreme Court of Kentucky found that Fayette County's approach to assessing agricultural land was constitutionally defective because it relied on general averages and "failed to consider the particular individual characteristics of specific farm property."

"The method used by the PVA could be valid as to individual properties only if it were adjusted to take into account the specific characteristic of each farm. The PVA made no effort to identify the different types of land or soil comprised in each individual farm so as to produce a more accurate assessment of the true value. No such individual adjustments were ever made." "It did not result in an equal tax burden."

Most PVAs still make the same mistake and additionally use an assessment model (cash rent) that will not, cannot, produce the accurate assessment that is needed for woodland. As currently applied by most PVAs, it produces a significant over assessment.

Assessing agricultural land, at its agricultural use value alone is a constitutional requirement in Kentucky, and a challenging task. So much more so when the subject property is used to grow timber. The difficulties inherent in assessing land used to grow timber is for purposes of taxation, the direct result of the constitutional mandate requiring that it be assessed at its value for agricultural use alone. A careful consideration of the specific characteristics of each farm must be the basis of any constitutionally valid approach.

Unfair Property Taxes Negatively Impact Financial Outcomes

by Tim Freibert, KWOA Board Member

The property tax issue is the most important problem facing woodland owners. Inaccurate property tax ultimately impact financial outcomes. The more expenses incurred in bringing timber crops to maturity reduces the profit realized from any timber sale. The property tax paid each year is a significant carrying cost because of the time value of money factor created by the lengthy interval between harvests.

Property taxes that are too high, as is the case now, are devastating as they cause a net loss from a harvest. This situation results in a very bad long-term investment.

Timber is one of the most valuable products that our woodlands provides from an economic prespective. Because of the long rotations required to reach maturity, unfair annual taxes errode the potential profit of timber management.

Woodland Investment Analysis

by Jack Rentz, KWOA Board Member

The timing of real estate taxes that are paid every year on timberland does not coincide with the cash from the harvest of timber. Since the crop cycle for hardwood timber is 60-80 years, and since real estate taxes are typically the largest recurring expense of the owner, these annual tax payment have a large adverse impact on the financial viability of timberland as an investment. This position has been confirmed by studies by the University of Kentucky. KWOA recognizes this inequity, and over the years has initiated numerous discussions with the Commonwealth of Kentucky and county property valuation administrators in repeated attempts to reduce timber taxes in order to recognize the long term nature of the investment. So far, these discussions have not been fruitful.

More recently, three long time KWOA members, all with significant timberland holdings in Kentucky, have appealed the assessment of their timber properties with their local PVA's, and these appeals are now scheduled to be heard by the Kentucky Board of Tax Appeals. We feel that favorable decisions in

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these tax appeal cases will result in property tax relief for all responsible family woodland owners, not just those who are appealing. We recognize the fact that these appeals and possible resulting litigation may require a significant outlay of cash for legal and related expenses; therefore; we are asking others who have an interest in lower taxes for timberland owners to help defray the expenses of prosecuting these pending appeals.

Woodland Tax Initiative – Update July 2012

by UK Forestry

Long-term woodland ownership by non-industrial family ownerships is very sensitive to administrative and other annual recurring costs. Administrative costs include for example taxes and insurance. Other recurring costs include infrastructure maintenance, protecting boundaries and other similar activities. Small changes in these types of costs can affect the ability of woodland owners to maintain the property in woods and to improve these woodlands. In recognition of these facts, the University of Kentucky Department of Forestry's (UK Forestry) research and extension faculty and staff were requested to assess the tax situation in Kentucky by the Kentucky Woodland Owners Association. Two US Forest Service funded projects supported by the Kentucky Division of Forestry were initiated to assess the property tax situation for Kentucky's family owned non-commercial woodlands. Results of the first project indicated that:

1) there was a wide range of taxation rates associated with woodland property value assessments across the commonwealth,
2) 75 percent of the PVAs used Department of Revenue guidance, or a modification of the guidance for developing assessments,
3) the accuracy of the woodland assessments relative to established norms for woodland valuation varied widely, with a few counties valued as less but many counties assessed at values above the established norms.

The second project built upon the results of the first research project. This second project resulted in the development of appropriate methodologies for valuing family woodland ownership that are involved in long-term sustainable management and are based on widely accepted norms for valuation of these types of woodlands.

The results of the two projects were presented to and discussed with the Kentucky Department of Revenue in 2011. The Department of Revenue requested that UK Forestry develop a proposal that provided for the use of UK Forestry's methodology for valuation of non-industrial family woodlands. Research and extension faculty developed a proposal that was submitted to the Department in early 2011 and indicated that the Department of Revenue should develop a set of appropriate guidelines for family owned non-commercial woodlands that could be used by PVAs to equitably assess the value of these woodlands (in contrast to the current cash rent model recommended by the Department of Revenue). The appropriate methodology involves the use of a growth model outlined by UK Forestry. UK Forestry believes that the development of appropriate guidance would be widely accepted by PVAs; research indicates that approximately 75 percent of the PVAs used Department of Revenue guidance recommendations, or a form of them, to guide their assessment process. The guidance recommendations were developed with sensitivity to: the wide range of resources and information available to individual county PVAs, the need for assessment procedures to be implemented easily by PVAs, constitutional constraints, and the concern over significant changes in county tax revenues. Further, the guidance would provide a fair and equitable assessment of woodlands that would allow woodland owners to manage their woodlands in a manner that provides for sustainability of the woodland and timber resource.

Note: The proposal did not indicate a tax incentive for woodland ownership (although many states have this and it could be rationally proposed for Kentucky). Rather, the proposal indicated that appropriate methodology be used to determine woodland values thus providing the appropriate basis for taxation.

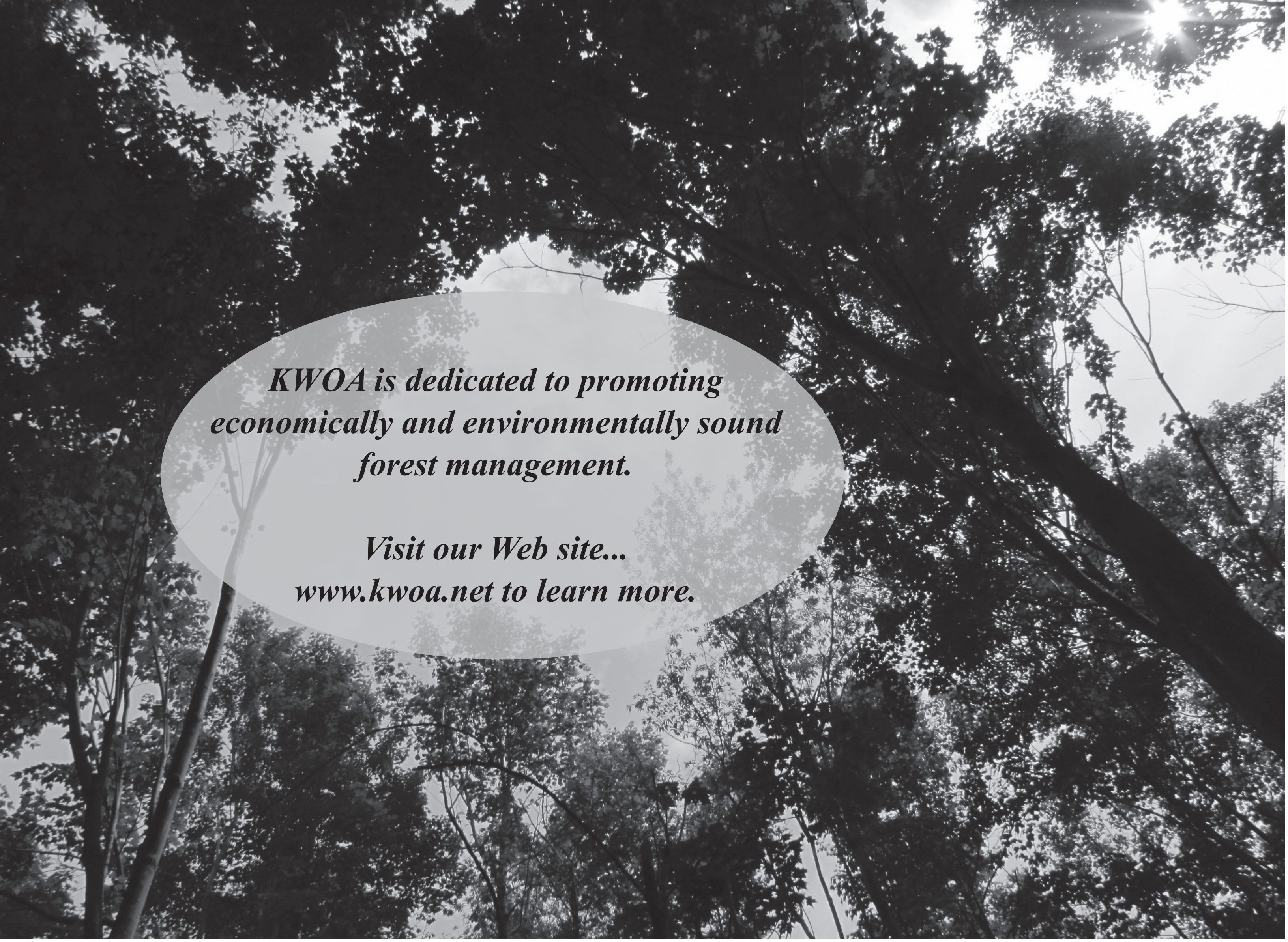
Further, UK Forestry also recognizes that sustainable management is very important to Kentucky's economy as a whole and critically important to the 110 counties containing forest industries that annually contribute a minimum of $4.8 billion to Kentucky's economy. UK Forestry's partners (including major forest industries) also support sustainable management and provisions, such as proper and equitable taxation, that allow family woodland owners to continue to manage their lands in a manner consistent with providing sustainable supplies of timber.

The Department of Revenue reviewed the proposal and requested that UK Forestry review the constitutionality of the methods included in the proposal. This finding submitted to the Department of Revenue in March of 2012 indicated that the methods, provisions, and approach to woodland assessment recommended by UK Forestry were not in conflict with the Kentucky Constitution as it involved the use of a growth method that was in use in Kentucky prior to 1995 and was and continues to be constitutional. (The Department of Revenue with advisement by PVAs changed the methodology for all assessments in 1999 to a cash rent system.) This system works well for traditional agriculture crops including row crops, pasture, etc. as there are annual cash rent values that can be used for setting assessments at the county level and agriculture provides recurring annual income streams. However, cash rent values are not available for woodlands, and regular income streams are not a part of family woodland ownerships in Kentucky). The Department of Revenue reviewed both the initial UK

Not only do Kentucky's woodlands supply the raw materials for a multi-billion dollar wood industry, they also provide numerous other benefits such as wildlife habitat, outdoor recreation, and air and water filtration.

Forestry proposal and the constitutionality finding, however determined that their current methodology used by many PVAs was a valid approach for "mass appraisal" purposes. Further, the Department of Revenue indicated that family woodland owners should consider the use of a tax credit for holding commercial timberland on a long-term basis. The Department of Revenue also indicated that this would be, in their belief, a more feasible approach to the issue.

In May 2012, UK Forestry reviewed this recommendation and indicated to the Department of Revenue that UK Forestry could not support the use of a tax credit for holding commercial timberland for the typical non-commercial family owned woodlands in Kentucky. UK Forestry also requested clarification of the rational for the Department of Revenue's decision to recommend a tax credit for commercial timberland. Further, UK Forestry asked the Department of Revenue to reconsider the development of guidance that incorporated the use of a growth model for county valuation of this type of ownership; UK Forestry offered to provide assistance to the Department of Revenue and PVAs if helpful to institute the recommended guidance. At this point in time (August 2012) there has been no further response by the Department of Revenue to the proposals by UK Forestry.



The Way Forward ...

by Jim Corum, KWOA Tax Committee

Our prospects for success in court are excellent but we still have hope the UK Department of Forestry can convince the Department of Revenue to use the correct system for the assessment of value for managed forest land for property tax purposes. If UK is successful, the system will be corrected, and no court action will be needed.

We must, however, prepare for battle. If we are forced to court, we will need legal help with the need for money to carry the day.

The KWOA Board of Directors has pledged $4,000 for legal expenses if needed; however, we will need a minimum of $15,000 or possibly more if we have to go all the way to the Supreme Court.

I, and my wife, are going to pledge $1,000 toward legal expenses, and I strongly encourage each of you to help us all to be able to pay an accurate, fair property tax - any contribution will help.

I estimate an appropriate tax assessment will result in a savings of one dollar per acre each year, on average.

Pledge Now to Save Our Woodlands or e-mail Pledge Intention to editor@kwoa.net

Please cut out and return this pledge or e-mail by September 15, 2012

____ Yes, I want to help

I pledge to send $_________ DO NOT SEND MONEY NOW

Contact me if we have to go to court at:

Name______________________________

Address______________________________

Phone______________________________

E-mail______________________________

Send Pledge to:
Jim Corum
156 Corum Hollow Rd.
Stoney Fork, KY 40988
Phone: 606-337-8115

Tax Deductibility of Payments to Support Litigation

by Kenton Ball, Attorney

In reporting your income and expense from tree farming operations (generally on Schedule F "Profit or Loss from Farming"), your ordinary and necessary expenses incurred in those farming operation are generally deductible pursuant to IRC § 162 as trade or business expenses. Your dues payments to KWOA are clearly deductible under IRC § 162. Any payments made to KWOA specifically to support its litigation initiative to eliminate excessive property taxes (which themselves are deductible per IRC § 164) would be similarly deductible per IRC § 162 as farm-related attorney's fees.

From small acorns mighty oaks grow. Your support of the KWOA efforts to correct the current woodland tax assessment will help to ensure woodlands for future generations.

Because KWOA is not a charitable organization exempt from income taxation under IRC § 501(c)(3), it is doubtful that any payment to KWOA could be properly characterized as a charitable contribution. Furthermore, charitable contributions are deductible only on Schedule A (Itemized Deductions); they cannot be deducted on Schedule F (Profit or Loss from Farming).

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Next Board Meeting: August 16, KFIA

Members are encouraged to attend.

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