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Optional Forest Yield Taxes



State legislators are asking, need timber go untaxed until harvest?

By Gary D. Kronrad and Clifford A. Hickman

Although the tax reform bill now before Congress could mean higher income taxes and lower profits for timberland owners, ad valorem property taxes can still be reduced by enrollment in special forest property tax programs offered by some states. Ad valorem taxes on forestland have been a concern for more than a century. Critics felt that an annual levy on fair market value of both land and timber encouraged forest exploitation. Fairchild (1935) referred to the problem as a "deferred-yield bias." The annual timber growth (income) is accumulated on the stump until final harvest, and each year's increment of income is re-

peatedly taxed year after year until final harvest. A long cash drain discourages intensive forest management and promotes premature cutting (Klempner 1980).

Under the yield tax, enacted by a number of states, land is taxed annually, but timber goes untaxed until harvest. A gross income tax equal to a percentage of stumpage value is then imposed. States with forest-yield taxes find that the programs have advantages and disadvantages (see box on page 30).

Marquis surveyed U.S. yield taxes in 1952 and found low enrollments. Over the years, the *Timber Tax Journal* has

followed the trends, as have Williams (1957) and Hickman (1982). In a recent study of optional-yield taxes, we looked at key legislative provisions, the effect of each tax on average annual property taxes, use of the programs, and problems encountered in administering them. State foresters recommended

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Ineligible property owners, in growing numbers, complain that more of the annual property-tax burden is shifted to them.

resident experts on their yield-tax laws, and the experts were interviewed by telephone.

Legislative Provisions

Nine states currently have 11 optional yield tax laws. Not included in this total are 4 repealed statutes applicable only to properties already enrolled. These are Louisiana's 1910 Reforestation Contract Severance Tax, Minnesota's 1927 Auxiliary Forest Tax, New York's 1926 Fisher Forest Tax Law, and Washington's Reforestation Act of 1931. Idaho and Michigan currently have two statutes each. Connecticut's 1913 law is the oldest, and Idaho's 1983 legislation, the most recent.

Six states (CA, LA, MS, NH, OR, and WA) impose mandatory yield taxes, under which all forest landowners pay a yield tax at harvest. States with mandatory laws were not surveyed.

Optional yield taxes have been adopted for a variety of reasons, but improved timber management has been a primary consideration in all states. Other motives include tax relief for forest owners, reforestation of cutover or burned areas, forest preservation, and economic stability. Purposes less frequently cited were conservation, tax equity, administrative efficiency, and multiple-use forestry.

Alabama is the only state not limiting enrollment. Other states restrict admissions. The most common limitation (8 states, 9 statutes) is a minimum acreage. This requirement varies from 1 acre under Michigan's second law to 50 acres in New York. Other common requirements are minimum stocking levels, maximum per acre values for land or timber, and maximum acreages. Less frequent restrictions limit enrollment to land requiring reforestation, land with a minimum productive capability, or land for which forestry is the highest and best use.

Three states require initial applications only, two require them periodically, and one requires them annually. As a condition of enrollment, 4 states

stipulate that landowners agree to keep their land in timber production for a specified number of years. Contracts extend from 5 years in Alabama to 50 years under Idaho's first law. In New York, a hybrid application procedure is employed. Participants must commit their land to timber production for 10 years, recertify this commitment annually, and pay a \$25 application fee. Similar fees are also collected by Massachusetts and under Idaho's first law.

Though all optional programs defer timber taxes until harvest, tax rates vary. In Connecticut, timber more than 10 years old and cut from tracts enrolled for 10 years or less is taxed at 2 percent of estimated value. At the opposite extreme, Idaho's first law mandates a 12.5 percent rate. In addition to tax deferral, many statutes stipulate that certain timber products can be cut without incurring a tax obligation. The most frequent exemption applies to trees cut by landowners for domestic use. Other exemptions apply to timber used in harvesting operations or removed in noncommercial cuttings.

The tax treatment of land differs substantially among states. In Hawaii, no enrolled land is taxed. Elsewhere, an annual modified property tax is imposed. The most common practice is to

base the land tax on a fixed, reduced, or use-value assessment. In two cases, a fixed per acre tax is mandated. The hybrid procedures employed in Alabama and Connecticut differ from the norm. Alabama's law exempts tracts of 160 acres or less and applies a fixed assessment to all other properties. Connecticut's law employs a fixed assessment in combination with a 10-mill tax-rate ceiling.

Six states require landowners to have a formal management plan, and three stipulate that public access be allowed. To minimize the impact of tax deferral and modified assessment on local government revenues, participants must pay a penalty upon either voluntary or involuntary withdrawal from the program. In addition, three states partially offset revenue losses by making annual payments to local governments based on enrolled acreage. In Wisconsin, the payments are \$0.20/acre/year, in Missouri \$0.50/acre/year, and under Michigan's first law, \$0.70/acre/year. Other objectives are prompt restocking and control of grazing.

Status Quo

Tax savings possible under optional yield programs are shown in *table 1*. Payment figures for the without-yield

Table 1. Ad valorem tax savings obtained by timberland owners participating in optional yield tax programs, 1983.

State	Legislation		Ad valorem taxes		Savings
	Enacted	Amended	Without yield tax	With yield tax*	
	yr.		\$/ac./yr.		
Alabama	1923	1945			
tracts ≤ 160 ac.			1.00	0.00	1.00
tracts > 160 ac.			1.00	1.00	.00
Connecticut	1913	1973	10.00	.01	9.99
Hawaii	1963	1983	.00	.00	.00
Idaho (1)	1929	1974	1.50	.05	1.45
Idaho (2)	1983	1984	9.00	.45	8.55
Massachusetts	1914	1981	22.50	1.12	21.38
Michigan (1)	1925	1980	3.75	.30	3.45
Michigan (2)	1917	1977	3.75	.07	3.68
Missouri	1946	1981	.80	.16	.64
New York	1974	1979	8.00	2.00	6.00
Wisconsin	1927	1975	3.50	.74	2.76

*Excludes average annual equivalent cost of yield tax payments.

Penalties and interest charges would help ensure that enrollees do not use the program as a tax dodge or in land speculation.

tax case reflect the average annual tax imposed on land and timber combined, and payment figures for the with-yield tax case reflect land taxes only. Estimates are thus overstatements of likely savings and ought to be interpreted cautiously. In deciding whether or not to enroll in a yield-tax program, forest owners may not be concerned with future timber tax obligations—especially if they are several years away from making a harvest.

Without the optional yield tax, forest owners in Hawaii pay the lowest average annual tax while their counterparts in Massachusetts pay the highest. Values range from nothing to \$22.50/acre/year. With the optional yield tax, forest owners in Hawaii continue to pay the smallest amount annually. Along with owners of 160 acres or less in Alabama, they pay nothing. Their acreage is exempt. At the opposite extreme, owners in New York pay an average annual land tax of \$2 per acre. Financial incentives to enroll are greatest in Massachusetts and Connecticut and under Idaho's second law. In contrast, no financial incentive to enroll exists in Hawaii or for tracts greater than 160 acres in Alabama. In both states, the annual taxes with or without the yield-tax program are roughly the same.

Low enrollments, prevalent in the

1950s, continue today (table 2). Participation varies from no landowners in Hawaii to 3,200 in Wisconsin. In no state have over 6.5 percent of eligible landowners elected to take advantage of an optional yield tax. Participation rates per eligible acre are somewhat higher. The acreage enrolled varies from 0 in Hawaii to over 2 million acres under Michigan's first law. In Wisconsin, owners have enrolled 26 percent of the state's qualifying forest acreage.

Overall usage remains stable. In Massachusetts, participation is increasing by approximately 7 percent per year, and Michigan's first law is showing a 5 percent increase per year. Missouri reports a decline of 4-5 percent annually. In New York, participation is rising at an unknown rate, and in Wisconsin, at approximately 10 percent per year. Reasons for low participation are many, and differ somewhat among states (see box on page 30).

The most common difficulty—cited for Connecticut, Idaho's first law, Michigan's two laws, and New York—is the inability to ensure that yield-tax revenues are consistently collected. Some states reported that public benefits, such as improved management practices and greater public access, are not being realized; local records are inadequately maintained; and withdrawal penalties are not consistently imposed.

Deficiencies in enabling statutes have been one source of difficulty. Some laws fail to require a management plan, and others admit properties too small to form economic management units. Hostility on the part of local tax officials has hindered some programs, and inadequate staffing troubles public administrators.

In Michigan and New York, some local governments are experiencing revenue shortfalls because of special tax treatment extended to forest owners. Shortfalls make it difficult to provide traditional services. Ineligible property owners, in growing numbers, complain that more of the annual property tax burden is shifted to them. These complaints, particularly if accompanied by the general perception that existing special forest taxes are not providing intended public benefits, may lead to pressures for program repeal.

Proper Design

Optional yield taxes cannot be effective unless forest owners elect to use them. Enrollment figures, at first glance, would indicate that the programs have failed. The exceptions are Massachusetts, Michigan, Missouri, and Wisconsin, where programs function with some degree of success. The experience of these states supports the position that optional yield taxes can be effective if properly designed. How can optional yield-tax programs be improved? The attributes of successful programs and comments of the resident experts suggest the following measures:

—An optional yield tax should be implemented only in those states in which forest landowners need some form of tax relief to profitably engage in forest management. The tax should be adopted over other alternatives only when shown to be the most efficient, equitable, and politically acceptable method of relief.

—Except for collection of taxes due, an optional yield tax should be administered by the agency most knowledgeable about forestry, usually the state

Table 2. Utilization of optional yield tax programs, 1983.

State	Landowners			Timberland		
	Eligible*	Enrolled	Ratio	Eligible*	Enrolled	Ratio
	no.		%	ac. (millions)	ac. (thousands)	%
Alabama	202,000	1	0.0005	20.3	2.0	0.01
Connecticut	20,000	179	.90	1.4	29.8	2.17
Hawaii	30	0	.00	1.0	0	.00
Idaho (1)	41,000	50	.12	3.0	130.0	4.33
Idaho (2)	25,000	**	**	3.0	**	**
Massachusetts	41,100	2,000	4.87	2.2	146.8	6.56
Michigan (1)	**	500	**	**	2,003.0	**
Michigan (2)	**	**	**	**	.8	**
Missouri	**	1,010	**	8.0	310.1	3.88
New York	100,000	285	.28	5.5	102.7	1.87
Wisconsin	50,000	3,200	6.40	5.0	1,300.0	26.00

*Figures represent best estimates in most cases.

**No data available.

Hostility on the part of local tax officials has hindered some programs.

forestry agency. Taxes should be collected by local tax collectors.

—Yield- and annual property-tax obligations should be structured so that the average forest owner does not receive an excess subsidy. After adjustments for differences in risk, participants should earn their alternative rate of return and no more.

—Landowners who have recently cut timber should not be allowed to enroll in an optional yield-tax program unless they are willing to pay a tax based on the volume of timber removed. Without this provision, landowners might be tempted to cut all merchantable timber before application.

—State revenue-sharing should be instituted to ensure that local taxing jurisdictions do not suffer severe shortfalls because of the yield-tax program. Since optional yield taxes are designed to provide public benefits, their costs can fairly be borne by all taxpayers.

—Landowners should pay an application fee at enrollment. Fees should at least partially cover the administrative costs of classifying a property.

—An optional yield-tax law should contain a good definition of eligible forestland. Definitions should be structured to accomplish the objectives of the law. For example, if the legislative purpose is to increase timber production in the state, only commercial forestland should be eligible. A vague definition of eligible forestland can lead to inequities and inefficiencies.

—Landowners should be required to submit initial and periodically updated management plans. This requirement will help ensure that enrolled properties are managed to accomplish the program objectives.

—When a property is removed from an optional yield-tax program, except by means of an eminent domain proceeding, the landowner should pay a penalty. Penalties and interest charges would help ensure that enrollees do not use the program as a tax dodge or in land speculation.

—Optional yield-tax programs, once enacted, need to be widely publicized. Prospective participants need to be made aware of the program's existence. ■

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Are Forest Yield Taxes a Good Option?

Advantages:

- Administration is easy and inexpensive.
- Cash-flow problems are minimized, enabling longer rotations.
- Risks of fire, blight, insects, and price fluctuations are shared by all landowners in a state.

Disadvantages:

- Local revenues are less predictable.
- Incentives to restock cutover lands are reduced.
- A bias is created against better sites and fast-growing species.



Photos of the Wisconsin State Senate (p. 27) and Assembly (above) are courtesy of G.D. Konrad.

Why Don't More Landowners Enroll?

Resident tax experts listed the following deterrents to yield-tax programs, which haven't changed much since the fifties:

- Absence of an obvious tax advantage.
- Lack of awareness of relevant tax options.
- Reluctance to relinquish control over management decisions.
- Unwillingness to allow free public access.
- Reluctance to restrict future land-use alternatives.
- Red tape of application procedures.
- Restrictive eligibility criteria.
- Severe declassification penalties.
- Poor program administration.