Nonindustrial private forest owner use of federal income tax provisions

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Abstract

Seven provisions of the federal income tax provide incentives for nonindustrial private forest (NIPF) owners to follow sound management and reforestation practices. Four provisions – long-term capital gain treatment of qualifying income, annual deduction of management costs, depreciation and the section 179 deduction, and deductions for casualty losses or other involuntary conversions – are available to taxpayers in general. The remaining provisions – the reforestation tax credit, amortization of reforestation expenses, and the ability to exclude qualifying reforestation cost-share payments from gross income – are specifically for forest owners. NIPF owners in South Carolina were surveyed by mail to determine whether they were aware of these tax provisions, whether they had made use of them, and their reasons for using or not using each one. Information also was collected on the owners' demographic characteristics, to test for differences between users and non-users of the provisions. Owner awareness and use was highest for long-term capital gain treatment of income and annual deduction of management costs. Some 78 percent of owners were aware of the two provisions, and 85 percent of owners who were aware of the provisions used them. Owner awareness was lowest for the ability to exclude qualifying reforestation cost-share payments, at 42 percent; owner use was lowest for loss deductions, at 23 percent. Membership in a forest owner organization, having a written forest management plan, and a high level of household income were associated with owner knowledge of beneficial tax provisions. No demographic characteristics were associated across-the-board with owner use of provisions.

Nonindustrial private forest (NIPF) owners hold nearly 60 percent of the nation's forestland and nearly half of its growing stock (Smith et al. 2001). NIPF owners are a diverse group with widely varied objectives for forest ownership and management (Birch 1996, Melfi et al. 1997). Many NIPF owners manage their forest primarily to produce timber (Birch 1996) and, thus, are concerned with issues such as reforestation incentives and tax treatment of timber revenues. Their actual knowledge of the tax aspects of timber management varies greatly, however, with some owners not even aware that federal income tax provisions apply to timber (Thrift et al. 1997).

The federal income tax has a profound effect on the profitability of timber management. Land expectation value, the value of forestland in permanent timber production, is significantly affected by the tax rate applied to timber income (Guertin and Rideout 1987, Haney et al. 2001). Particularly for less productive sites, forest management practices quickly become economically infeasible if the tax rate is increased. Conversely, the reforestation tax incentives – the reforestation investment tax credit and amortization of reforestation expenses – dramatically improve returns to the forest owner (Royer and Moulton 1987).

Most of the literature on federal taxation of timber income concerns the tax law itself. It consists of tax guides for forest owners (e.g., Jones and Jacobson 2000, Haney et al. 2001), popularized descriptions of how particular income tax provisions affect forest owners (e.g., Bishop 2001, Hoover 2002), analyses of

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the economic effect of the federal income tax on forest management systems (e.g., Richardson et al. 1991, Siegel 1991), analyses of the economic effect of existing or proposed income tax provisions on “typical” forest owners (e.g., Klemperer 1989, Bailey et al. 1999), or background papers directed toward policy-makers (e.g., Sampson and DeCoster 1997, Dialog Group on Forested Lands and Taxation 2001).

Only a few researchers have investigated whether NIPF owners are aware of or use the incentives and other beneficial income tax provisions that are available to them. Royer (1987) compared use of two types of reforestation incentives – cost-share payments and the reforestation tax incentives – by forest owners in North Carolina who sold timber between 1981 and 1984. Of the owners who actively reforested, 80 percent received cost-share payments, 60 percent used the reforestation tax incentives, and 55 percent used both (Royer 1987). Royer and Moulton (1987) surveyed use of the same incentives by forest owners in the South who sold timber in 1983. Again, of the owners who actively reforested, 48 percent received cost-share payments, 59 percent used the reforestation tax incentives, and 36 percent used both. Owner knowledge of either type of incentive increased the likelihood of reforestation by 19 percent and owner knowledge of both types increased the likelihood of reforestation by 38 percent (Royer and Moulton 1987).

The motivations that tax incentives provide was one of the topics Bliss and Martin (1990) discussed in intensive interviews with selected NIPF owners in Wisconsin. They found that the chief effect of a tax incentive was to enable owners who used management practices to treat more acres rather than to induce additional owners to manage (Bliss and Martin 1990). Vericker (1999) surveyed Florida forest owners’ awareness of tax provisions along with other information related to forest management to identify areas of need for extension and pubic assistance programs.

This paper reports the results of a study conducted cooperatively by the Clemson University, Department of Forest Resources and the USDA Forest Service, Southern Research Station. In the study, NIPF owners in South Carolina were surveyed by mail to determine whether they were aware of seven federal income tax provisions that provide incentives for forest owners to follow sound management and reforestation practices, whether they had made use of the provisions, and their reasons for using or not using each one. The seven provisions examined were:

- Treatment of qualifying income as a long-term capital gain;
- Annual deduction of management expenses;
- Depreciation and the section 179 deduction;
- Deductions for casualty losses or other involuntary conversions;
- The reforestation tax credit;
- Amortization of reforestation expenses; and
- The ability to exclude qualifying reforestation cost-share payments from gross income.

The first four provisions are available to taxpayers in general, while the last three are specifically for forest owners.

Federal income tax provisions

Treatment of qualifying income as a long-term capital gain

The first of the four provisions available to taxpayers in general is long-term capital gain treatment of income from the sale or disposal of a qualifying asset that the owner has held for more than 12 months. Timber sold outright, in a lump-sum sale, qualifies for capital gain treatment if the owner held it as an investment (a section 1221 sale) or if the owner can demonstrate that they held it primarily for use in their business rather than for sale to customers (a section 1231 sale). Owners who hold their forest as part of a trade or business can only ensure capital gain treatment of timber income by disposing of the timber under the provisions of section 631 of the Internal Revenue Code, either pay-as-cut with an economic interest retained (a section 631(b) disposal) or by cutting the timber themselves and selling logs, pulpwood, or other products (a section 631(a) transaction; Haney et al. 2001).

Long-term capital gains are taxed at lower rates than ordinary income. For 2000, the tax year for which this study was conducted, ordinary income in the bottom bracket was taxed at 15 percent, compared to 10 percent for a long-term capital gain; ordinary income in higher brackets was taxed at rates ranging from 28 to 39.6 percent, compared to 20 percent for a long-term capital gain (CCH Editorial Staff 2000). Capital gains enjoy additional advantages over ordinary income. Large losses in capital investments can be applied against any amount of capital gain, while there is a $3,000 annual limit on applying such losses against ordinary income. Capital gains do not count toward the amount of income retired persons can earn before their Social Security benefits are reduced. Additionally, for owners who qualify as “material participants” in the management of their forest, ordinary income from timber is subject to self-employment tax but a capital gain is not (Haney et al. 2001; Endnote 1).

Annual deduction of management expenses

The second provision available to taxpayers in general is the ability to deduct certain management expenses from gross income annually, as they occur. Qualifying expenses include the costs of the day-to-day activities required to manage forest property – for example, silvicultural practices (other than for reforestation), control of insects and diseases, and maintenance of roads and firebreaks – as long as the costs are “ordinary and necessary” for forest management in the area and are related to the income potential of the forest. It is not necessary that the forest produce income during a year for the owner to deduct management expenses; the increase in size and value of the timber itself over time meets the “for profit” requirements (Haney et al. 2001).

The extent to which an expense is deductible is governed by the “passive loss rules.” Owners who hold their forest as part of a trade or business and who qualify as “material participants” (Endnote 2) in the management of the forest can fully deduct qualifying management costs against income from any source. Owners who hold their forest as part of a trade or business but cannot meet one of the tests for material participation in management – for whom forest ownership is a “passive activity” – can deduct management expenses, property tax, and interest expenses only to the extent of their income from passive activities during the year. Unused deductions can be carried forward for use in future years. Owners who hold their forest as an investment can deduct management expenses against income from any source or capitalize them. For non-corporate owners, the deductions are taken as "miscellaneous itemized deductions" so that only the amount above 2 percent of their adjusted gross income is actually deducted. The amount below the 2-percent floor is lost for deduction and cannot be capitalized. Property taxes are fully deductible for investors. Investment interest expenses are deductible only to the extent of their net investment income for the year, but unused deductions can be carried forward for use in future years (Haney et al. 2001).

Depreciation and the section 179 deduction

Depreciation permits owners to recover their investment in qualifying income-producing property as it loses value over time due to wear and tear, age, deterioration, or obsolescence. Qualifying property includes machinery, buildings, equipment, and temporary improvements to the land – for example, fences, culverts, and bridges – but not the land itself or permanent improvements to the land. Depreciation methods and recovery periods for different types of property are specified by the Internal Revenue Service. Depreciation is available to all owners who hold their forest to produce income – whether as an investment or as part of a trade or business – although for investors the deductions are subject to the 2 percent of adjusted gross income floor (Haney et al. 2001).

The section 179 deduction is a large, one-time deduction for part or all of the cost of qualifying depreciable property. Qualifying property includes tangible personal property, but not improvements to the land, buildings, or components of buildings. The amount of the deduction is limited: it was $20,000 for the 2000 tax year, reduced by $1 for each dollar over $200,000 of section 179 property that an owner placed in service during the year. The section 179 deduction is only available to owners who hold their forest as part of a trade or business. It is not available to investors, or to trusts or estates. Where it applies, the effect of the deduction is to permit owners to recover the cost of income-producing property more quickly than they could with depreciation alone (Haney et al. 2001).

Deductions for casualty losses or other involuntary conversions

The fourth provision available to taxpayers in general is a deduction for income-producing assets lost in a casualty or non-casualty loss, theft, or condemnation. Both casualty and non-casualty losses are caused by natural or outside events. The difference is that a casualty loss must be sudden, unexpected, and unusual, as from fire, windstorm, or ice, while a non-casualty loss only needs to be unexpected and unusual, as from disease, insect attack, or drought. No deduction is permitted for normal levels of damage or mortality. These deductions are available to all owners who hold their forest to produce income – whether as an investment or as part of a trade or business (Haney et al. 2001).

A loss deduction is limited to the owner's basis (investment) in the asset that was lost. Since NIPF owners' basis in their timber usually is much less than its actual value, a salvage harvest of timber damaged or killed in a casualty or non-casualty loss often results in a taxable gain rather than a loss deduction. But owners can postpone recognition of the gain – and the tax on it – by using the gain to restore or replace the converted property within the allowable replacement period (usually two years; Haney et al. 2001).

Reforestation tax credit

The last three federal income tax provisions examined are available solely to forest owners who establish or hold timber for sale or for use in producing commercial products. The first of these is the reforestation tax credit, a 10 percent investment tax credit on up to $10,000 of an owner's expenses to establish or reestablish trees on their holding during a year. The credit is a dollar-for-dollar reduction in the amount of tax the owner owes, up to the $1,000 maximum. Recapture rules apply if the trees are not held for at least five years (Haney et al. 2001; Endnote 1).

Amortization of reforestation expenses

Forest owners also can amortize (write off) up to $10,000 per year of their expenses to establish or reestablish timber on their holding over eight tax years. Because of a rule known as the "half year convention," only one-fourteenth of the eligible expenses can be deducted in the first year, one-seventh in each of the next six years, and the final one-fourteenth in the eighth year. Owners who also use the reforestation tax credit must decrease the amount they amortize by half of the credit taken. Recapture provisions apply if the trees are not held for at least 10 years (Haney et al. 2001; Endnote 1).

Ability to exclude qualifying reforestation cost-share payments from gross income

Under the final provision examined, forest owners can elect to exclude from their gross income a calculated part of qualifying government cost-share payments for practices to establish or reestablish trees on their holding. For the 2000 tax year, payments under five federal cost-share programs – the Forestry Incentives Program (FIP), Stewardship Incentives Program (SIP), Wetlands Reserve Program (WRP), Wildlife Habitat Improvement Program (WHIP), and Environmental Quality Incentives Program (EQIP) – as well as a number of state programs qualified for exclusion (Endnote 2). Because of the way the excludable portion is calculated, it is likely that the full amount of a cost-share payment will be excludable if the reforested area was harvested in the past three years, but only a fraction will be excludable it if was not. Recapture provisions apply if trees established using an excluded cost-share payment are disposed of within 20 years (Haney et al. 2001).

Procedure

Data for the study were collected by means of a mailed questionnaire using the Dillman (1978) Total Design Method. Each survey packet contained a cover letter, a page with brief descriptions of the seven federal income tax provisions, and a questionnaire. The questionnaire consisted of 58 questions, seven about knowledge and use of each of the seven tax provisions, and nine about demographic characteristics. The demographic characteristics surveyed were: total acres owned, forest acres owned, primary reason for owning forestland, whether the owner belonged to a forest owner organization, whether the owner had a written forest management plan, owner occupation, and owner education, age, and household income, by level.

The response categories provided for primary reason for owning forestland correspond closely to those used by

Birch (1996) in his national survey of nonindustrial private forest owners: "Part of my residence," "Esthetic enjoyment," "Part of my farm," "To provide products for farm or home use," "Recreation," "Timber production," and "Land investment." The response categories provided for owner occupation, education, and age also are similar to those used by Birch (1996).

The questionnaire was mailed to a total of 1,350 South Carolina NIPF owners in January, 2001, using a contact list of current, past, and prospective members provided by a national forestry organization. A follow-up survey was mailed in March 2001, to owners who had not responded to the first questionnaire. Returned questionnaires numbered 506 of which 469 were usable, for a response rate of 35 percent.

Data from the returned questionnaires were analyzed to quantify overall NIPF owner knowledge and use of beneficial federal income tax provisions, to distinguish the demographic characteristics associated with owner knowledge and use of provisions, and to identify the key reasons for non-use of provisions. Questionnaires were tallied to determine the number and percentage of respondents who were aware or not aware of each tax provision. The number and percentage of respondents who were aware of a tax provision but had not used it also were tallied, as were the reasons they cited for non-use. Chi-square tests at the $\alpha = 0.05$ level of significance were used to compare the demographic characteristics of respondents to this survey with those in Birch's (1996) survey for the southeast United States. Chi-square tests also were applied to the data from this survey, to compare the demographic characteristics of respondents who were aware or not aware of each provision. As well, among respondents who were aware of a provision, Chi-square tests were used to compare the characteristics of those who had used it with those who had not.

Results

An early finding of the study was that, compared to the respondents in Birch's (1996) study, those in this survey were older, were less likely to be blue collar workers, tended to own more acres of forest, and were more likely to own forestland primarily for timber production instead of esthetics or as part of their residence. This means the results of this survey may be more representative of owners who are relatively active and financially motivated in their ownership rather than NIPF owners in general.

Some 87 percent of respondents to this survey were aware of one or more of the seven federal income tax provisions examined. Eight percent were aware of only one provision, but awareness generally increased with number of provisions, until 25 percent of the respondents were aware of all seven provisions (**Table 1**).

Nearly 80 percent of the respondents were aware of two provisions available to taxpayers in general, treatment of qualifying income as a long-term capital gain and annual deduction of management expenses (**Table 2**). In contrast, just over 40 percent of the respondents were aware of one of the provisions available solely to forest owners, the ability to exclude qualifying reforestation cost-share payments from gross income (**Table 2**). For the rest of this section the findings for the seven federal income tax provisions are discussed individually.

Treatment of qualifying income as a long-term capital gain

As noted above, this provision was one of the two with the highest levels of owner awareness and use: 78 percent of survey respondents were aware that income from the sale or disposal of timber can qualify as a long-term capital gain (**Table 2**). Of the respondents who were aware of the provision, 85 percent had used it (**Table 2**). Respondents who were aware of the provision differed from those who were not on most of the demographic characteristics tested: they tended to own more acres of land and more acres of forest, they were more likely to belong to a forest owner organization and to have a written forest management plan, and they tended to have

Table 1. — Number of beneficial federal income tax provisions of which respondents were aware.

	Number	%
Not aware of any provisions	59	12.6
Aware of only one provision	38	8.1
Aware of only two provisions	35	7.5
Aware of only three provisions	54	11.5
Aware of only four provisions	39	8.3
Aware of only five provisions	59	12.6
Aware of only six provisions	68	14.5
Aware of all seven provisions	117	24.9

Table 2. — Respondent awareness and use of beneficial federal income tax provisions.

	Long-term capital gain treatment		Deduct management expenses		Depreciation and section 179 deduction		Loss deduction		Reforestation tax credit		Reforestation amortization		Exclude cost-share payments	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
Aware of the provision	364	77.8	363	77.6	235	51.4	277	60.2	255	54.8	260	56.4	194	42.1
Had used the provision	308	84.6	308	84.8	155	66.0	64	23.1	199	78.0	207	79.6	137	70.6
Had not used provision	56	15.4	53	14.6	80	34.0	213	76.9	56	22.0	53	20.4	57	29.4
Not aware of the provision	104	22.2	105	22.4	222	48.6	183	39.8	210	45.2	201	43.6	267	57.9

higher levels of formal education and household income (**Table 3**).

Among respondents who were aware of the provision, those who had used it tended to own more acres of land and more acres of forest than those who had not (**Table 4**). Most respondents who had not used the provision believed it did not apply to their situation (36%) or that the benefit was too small to bother with (21%; **Table 5**).

Annual deduction of management expenses

This provision was the other of the two with the highest levels of owner awareness and use: 78 percent of survey respondents were aware they could deduct ordinary and necessary forest management expenses annually, as they occur (**Table 2**). Of the respondents who were aware of the provision, 85 percent had used it (**Table 2**). As above, respondents who were aware of the provision differed from those who were not on most of the demographic characteristics tested: they tended to own more acres of land and more acres of forest, they were more likely to belong to a forest owner organization and to have a written forest management plan, and they tended to have higher levels of formal education and household income (**Table 3**).

Among respondents who were aware of the provision, those who had used it were more likely to own their forestland primarily for recreation or timber production than those who had not (**Table 4**). Most respondents who had not used the provision believed it did not apply to their situation (35%) or that the benefit was too small to bother with (33%; **Table 5**).

Depreciation and the section 179 deduction

Only 51 percent of survey respondents were aware they could recover the cost of equipment and property purchased to produce income from their forest through depreciation and the section 179 deduction (**Table 2**). Of those who were aware of them, 66 percent had used one or both of the provisions (**Table 2**). Respondents who were aware of the provisions differed from those who were not on nearly all of the demographic characteristics tested: they tended to own more acres of land and more acres of forest, they were more likely to own their forestland primarily for timber production, they were more likely to belong to a forest owner organization and to have a written forest management plan, they were more likely to be white collar workers, and

Table 3. — Results of Chi-square tests for differences in demographic characteristics between respondents who were aware of beneficial federal income tax provisions and respondents who were not aware of the provisions, $\alpha = 0.05$.

	Long-term capital gain treatment	Deduct management expenses	Depreciation and section 179 deduction	Loss deduction	Reforestation tax credit	Reforestation amortization	Exclude cost-share payments
Total acres owned	Significant	Significant	Significant	Significant	Significant	Significant	--
Acres of forest owned	Significant	Significant	Significant	Significant	Significant	Significant	--
Primary reason for owning forestland	--	--	Significant	Significant	--	Significant	--
Belong to a forest owner organization	Significant	Significant	Significant	Significant	Significant	Significant	Significant
Have a written forest management plan	Significant	Significant	Significant	Significant	Significant	Significant	Significant
Level of education	Significant	Significant	Significant	Significant	--	Significant	--
Occupation	--	--	Significant	Significant	--	Significant	--
Age class	--	--	--	--	--	--	--
Total household income	Significant	Significant	Significant	Significant	Significant	Significant	Significant

Table 4. — Results of Chi-square tests for differences in demographic characteristics between respondents who were aware of and used beneficial federal income tax provisions and respondents who were aware of the provisions but did not use them, $\alpha = 0.05$.

	Long-term capital gain treatment	Deduct management expenses	Depreciation and section 179 deduction	Loss deduction	Reforestation tax credit	Reforestation amortization	Exclude cost-share payments
Total acres owned	Significant	--	Significant	Significant	Significant	Significant	--
Acres of forest owned	Significant	--	--	Significant	Significant	Significant	--
Primary reason for owning forestland	--	Significant	--	--	--	--	--
Belong to a forest owner organization	--	--	--	--	--	--	--
Have a written forest management plan	--	--	Significant	--	--	--	--
Level of education	--	--	--	--	--	--	--
Occupation	--	--	--	--	Significant	--	--
Age class	--	--	--	--	--	--	--
Total household income	--	--	--	--	Significant	--	--

they tended to have higher levels of formal education and household income (**Table 3**).

Among respondents who were aware of the provisions, those who had used them tended to own more acres of land and were more likely to have a written forest management plan than those who had not (**Table 4**). Most respondents who had not used the provisions believed they did not apply to their situation (57%) or that the benefit was too small to bother with (21%; **Table 5**).

Deductions for casualty losses or other involuntary conversions

Sixty percent of survey respondents were aware they could take a loss deduction for timber or other income-producing assets lost in a casualty or non-casualty loss, theft, or condemnation (**Table 2**). But only 23 percent of those who were aware of the provision had used it (**Table 2**). Again, respondents who were aware of the provision differed from those who were not on nearly all of the demographic characteristics tested: they tended to own more acres of land and more acres of forest, they were more likely to own their forestland primarily for recreation or timber production, they were more likely to belong to a forest owner organization and to have a written forest management plan, they were more likely to be white collar workers, and they tended to have higher levels of formal education and household income (**Table 3**).

Among respondents who were aware of the provision, those who had used it tended to own more acres of land and more acres of forest than those who had not (**Table 4**). Most respondents who had not used the provision believed it did not apply to their situation (49%) or that the benefit was too small to bother with (16%; **Table 5**).

Reforestation tax credit

Just 55 percent of survey respondents were aware they could take a 10 percent reforestation tax credit on up to $10,000 of their expenses to establish or reestablish trees on their holding during a year (**Table 2**). Of those who were aware of the provision, however, 78 percent had used it (**Table 2**). Respondents who were aware of the provision tended to own more acres of land and more acres of forest than those who were not. They also were more likely to belong to a forest owner organization, to have a written forest management plan, and to have a higher level of household income (**Table 3**).

Among respondents who were aware of the provision, those who had used it were likely to own more acres of land and more acres of forest, to be white collar workers, and to have a higher level of household income than those who had not (**Table 4**). Most respondents who had not used the provision believed it did not apply to their situation (39%) or that the benefit was too small to bother with (31%; **Table 5**).

Amortization of reforestation expenses

The findings for this provision were similar to those for the reforestation tax credit: 56 percent of survey respondents were aware they could amortize up to $10,000 per year of their expenses to establish or reestablish trees on their holding over eight tax years (**Table 2**). Of those who were aware of the provision, 80 percent had used it (**Table 2**). Respondents who were aware of the provision differed from those who were not on nearly all of the demographic characteristics tested: they tended to own more acres of land and more acres of forest, they were more likely to own their forestland primarily for recreation or timber production, they were more likely to belong to a forest owner organization and to have a written forest management plan, they were more likely to be a white collar worker or a farmer, and they tended to have higher levels of formal education and household income (**Table 3**).

Among respondents who were aware of the provision, those who had used it tended to own more acres of land and more acres of forest than those who had not (**Table 4**). Most respondents who had not used the provision believed it did not apply to their situation (51%) or that the benefit was too small to bother with (23%; **Table 5**).

Ability to exclude qualifying reforestation cost-share payments from gross income

Owner awareness was lower for this provision than for any of the others studied: only 42 percent of respondents were aware they could elect to exclude from their gross income a calculated part of qualifying government cost-share payments for practices to establish or reestablish trees on their holding (**Table 2**). But of those who were aware of the provision, 71 percent had used it (**Table 2**). Respondents who were aware of the provision were more likely to belong to a forest owner organization and to have a written forest management plan than those who were not. They also tended to have a higher level of household income (**Table 3**).

Among respondents who were aware of the provision, those who had used it did not differ statistically from those who had not on any of the characteristics tested (**Table 4**). Most respondents who had not used the provision believed the benefit was too small to bother with (29%) or that it did not apply to their situation (22%; **Table 5**).

Table 5. — Reasons respondents who were aware of beneficial federal income tax provisions cited for not using the provisions.

	Long-term capital gain treatment		Deduct management expenses		Depreciation and section 179 deduction		Loss deduction		Reforestation tax credit		Reforestation amortization		Exclude cost-share payments	
	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%
It's too complicated	2	3.8	3	5.5	3	3.9	11	5.8	1	2.0	0	0.0	5	10.2
The benefit is too small to bother with	11	20.8	18	32.7	16	21.1	31	16.2	16	31.4	10	23.3	14	28.6
It doesn't apply to my situation	19	35.8	19	34.5	43	56.6	93	48.7	20	39.2	22	51.2	11	22.4
I don't want to use it	1	1.9	1	1.8	2	2.6	5	2.6	2	3.9	0	0.0	7	14.3
Other	20	37.7	14	25.5	12	15.8	51	26.7	12	23.5	11	25.6	12	24.5

Discussion and conclusions

The results of this survey appear to be more representative of NIPF owners who are relatively active and financially motivated in their ownership than of southeast U.S. owners in general. For this reason, the study findings regarding the percentages of owners who are unaware of or elect not to use the seven federal income tax provisions examined can be considered conservative.

Owner awareness of two provisions available to taxpayers in general – treatment of qualifying income as a long-term capital gain and annual deduction of management expenses – is fairly high at just under 80 percent. Among owners who are aware of these provisions, use also is high at roughly 85 percent. But owner awareness of the other provisions available to taxpayers in general – depreciation and the section 179 deduction and deductions for involuntary conversions – is much lower at 50 to 60 percent. And even among owners who are aware of them, use of these provisions is modest (**Table 2**).

Little more than half of forest owners are aware of the three tax provisions intended specifically for them – the reforestation tax credit and amortization provisions and the ability to exclude qualifying reforestation cost-share payments from gross income. Use of the reforestation tax credit and amortization provisions, however, is high among owners who know about them (**Table 2**).

Three demographic characteristics are associated with owner knowledge of all seven of the beneficial tax provisions: membership in a forest owner organization, having a written forest management plan, and a high level of household income. Other characteristics are associated with owner knowledge of lower numbers of provisions: total acres owned and forest acres owned are associated with knowledge of six provisions, level of education is associated with knowledge of five provisions, and primary reason for owning forest land and occupation each are associated with knowledge of three provisions. Of the characteristics tested, only owner age is not associated with knowledge of any tax provisions (**Table 3**).

None of the demographic characteristics tested is associated across-the-board with owner use of beneficial tax provisions. Total acres owned is associated with use of five provisions, forest acres owned is associated with use of four provisions, and primary reason for owning forest land, having a written forest management plan, owner occupation and level of household income each are associated with use of one provision (**Table 4**).

One would expect rational NIPF owners to take advantage of income tax provisions that reduce their taxes or increase their cash flow. Many owners, however, do not use provisions even though they are aware of them. The two most frequently cited reasons for not using a tax provision were, "It doesn't apply to my situation," and "The benefit is too small to bother with." While it is tempting to dismiss these responses as uninformed, there are straightforward situations where each provision would not apply to an owner. For example, the section 179 deduction would not apply to owners who hold their forest as an investment, deductions for involuntary conversions would not apply to owners who have not suffered a loss or condemnation, and the ability to exclude qualifying reforestation cost-share payments from gross income would not apply to owners who elect to include the payments in their income and recover them through use of the reforestation tax credit and amortization provisions. It is likely, then, that at least a fraction of the "It doesn't apply to my situation" responses are valid.

But owners saying, "The benefit is too small to bother with" is more problematic. This response represents a value judgment that the effort involved to take advantage of a provision is not worth the tax benefit that would be received. But the benefits from several of the provisions the response was associated with – long-term capital gain treatment of timber income, the reforestation tax credit and amortization provisions, and the ability to exclude reforestation cost-share payments from gross income – are substantial. If the "The benefit is too small to bother with" response can be taken as a measure of the number of uninformed responses, then perhaps 60 percent of the "It doesn't apply to my situation" responses tallied in **Table 5** are uninformed and 40 percent are valid.

The findings of this study confirm the need for additional efforts to improve NIPF owner awareness of beneficial federal income tax provisions, particularly the provisions designed specifically for them. Historically, the tax handbooks, short courses, popularized articles, and extension workshops available to owners have focused on tax aspects timber production. This approach has been beneficial and certainly needs to be continued. It seems likely, however, that approaches aimed at informing owners of the tax implications of other forest uses – non-traditional products, recreation, and stewardship, for example – would appeal to the interests of additional owners. Moreover, the study findings suggest two areas where public or private action might improve owner awareness and use of beneficial tax provisions: encouraging and assisting nonindustrial forest owners to develop written forest management plans – perhaps by making the development of a plan a requisite part of receiving forest management assistance – and encouraging them to join a forest owner organization.

Endnotes

1. The American Jobs Creation Act of 2004 changes the law concerning three of the provisions examined for this study: treatment of qualifying income as a long-term capital gain, the reforestation tax credit, and amortization of reforestation expenses.

   Section 315 of the Act specifies that an outright sale of stumpage – as with a lump-sum sale – qualifies as a section 631(b) disposal. Owners who hold their forest as part of a trade or business may still elect to dispose of stumpage with an economic interest retained – as with a pay-as-cut contract – but doing so is no longer required. For tax purposes, the "date of disposal" for a disposal with economic interest retained remains the date the volume of cut timber is first definitely determined, but for an outright sale it is when ownership of the timber changes hands. This provision takes effect after December 31, 2004.

   Section 322 of the Act changes the tax treatment of reforestation costs. Owners now can deduct outright up to $10,000 per year of their out-of-pocket costs to establish timber, and amortize any additional amount over eight tax years. The reforestation tax credit is repealed. Although the reforestation tax incentives have changed, the rules as to what costs qualify under them remain the same. This provision took effect on October 22, 2004. The reforestation tax credit and amortization provisions described in the article apply to reforestation costs incurred before that date.

2. IRS Revenue Ruling 2003-59 issued in June, 2003, added the Conservation Reserve Program (CRP) to the list of federal programs for which taxpayers can exclude a calculated part of cost-share payments from their gross income. In prior years, taxpayers were required to include CRP cost-share payments in their gross income. Taxpayers who qualified as farmers, however, could deduct certain soil and water conservation expenses – including tree planting expenses – equal to as much as 25 percent of their gross income from farming during the year (Haney et al. 2001).

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