
Chapter 8. Tax Implications of Forest Stewardship

Forest landowners derive many benefits from their property. You may have a special interest in providing wildlife habitat, conserving soil and water, protecting endangered plants and animals, or other activities not related to the production of income. Such activities may increase the market value of the property. Forest stewardship simply refers to management of forest land to protect, restore, or enhance all forest resources. Tax law may be of benefit in these efforts. You need to be aware, however, that current tax laws may not support all of your efforts. This chapter discusses the basic tax incentives for wise stewardship of forest land.

Treatment of Management Expenses Keyed to Production of Income

Tax law is keyed to the production of income. In general, expenses incurred for an activity carried out to produce income as either a trade or business or an investment can be recovered, as discussed in chapter 4. A critical factor is that the expense incurred for an activity must be directly related to its potential to produce income. Even if you may expect to sell timber sometime during your life, timber production may not be the primary factor motivating your activities. Note, however, that whether or not you manage your forest land for the production of income, if you itemize deductions, you can include the property tax paid on your forest land under “Taxes You Paid,” on Internal Revenue Service (IRS) Form 1040, Schedule A.

You may have a special interest in wildlife and manage your forest land to attract certain species. In some cases, wildlife management activities—such as planting food plots and shrubs for food and cover or maintaining a timber species and stocking mix to favor certain species—may be related to the production of income if your land is leased for hunting. In other cases, expenditures for these activities may be made strictly to increase your enjoyment of the property. To claim your management costs as a deductible expense for tax purposes, you need to manage your property so that your activities do not bring into question your intention to eventually make a profit from the property, as discussed in chapter 4.

In many instances, it is possible to carry out wildlife habitat management activities as part of your timber management program and receive income from both activities. Your wildlife

management expenses may be incidental to your timber management activities. In this case, the expenses could be treated as timber management expenses. If, however, wildlife management activities dominate your forest management program and you do not receive any income related to wildlife, the expenses may not qualify as ordinary and necessary business or investment expenses. But in some cases, the expenses might qualify to be added to the basis of your property, as discussed in chapter 4.

Capital Costs Recovered When Property Is Sold or Subject to Casualty Loss

Whether or not you are managing your forest land to produce current income, it would be to your advantage to keep records of amounts you spend for capital improvements. You should record the basis of your land and timber, as discussed in chapter 4. If you make permanent improvements to the land, such as construction of roads and ponds, the improvements would increase the basis of your land. You cannot, however, claim depreciation deductions on depreciable land improvements, such as drainage structures, unless you are managing for the production of income. Your basis in the land would be used to determine your taxable gain if you ever sold the land in whole or in part. You also could recover your basis in the timber if you sold it with the land or had a timber sale, as discussed in chapter 5.

Capital Gains Treatment Applies

Income from the sale of your land and/or timber would qualify as a capital gain, whether or not you manage your forest land for the production of income. The lower capital gains tax rate for noncorporate taxpayers would apply to the net gain—the sales revenue, minus the basis in the land or the timber sold.

Estate Planning

Many of the best opportunities to promote stewardship with your forest land are associated with estate planning. This topic is the focus of a companion publication, *Estate Planning for Forest Landowners: What Will Become of Your Timberland?* (USDA Forest Service Southern Research Station General Technical Report SRS-112). One such opportunity, conservation easements, is discussed here because of its potential to significantly increase long-term stewardship.

Conservation Easements

If you are highly motivated to engage in activities that improve the conservation and ecological value of your forest land and want to guarantee that it will remain as forest land in perpetuity, it may be in your best interest to sell, donate, or otherwise transfer all or part of your ownership interest in the property to an organization specializing in the management of forest and other lands for conservation purposes. Your options are not limited to the outright transfer of your entire ownership interest. You can legally transfer less than your entire interest. For example, you can transfer a restriction on the use of the property for purposes other than forest land, such as housing, commercial, or industrial development. You could transfer this restriction and retain the right to live on, produce timber, and otherwise continue your enjoyment of your property. These types of agreements generally are referred to as conservation easements or private conservation contracts.

Such transfers are a way for you to control the use of the land during and after your lifetime. By selling a restriction, you would in effect get income from the development rights without having to sell the property as a whole. This would be taxable income. By donating the restriction (in perpetuity) to a qualifying organization, you may qualify for a charitable deduction on your income tax return. For additional information on this topic, you may want to read *Preserving Family Lands: Essential Tax Strategies for the Landowner* by Stephen J. Small, 75 Federal Street, Boston, MA 02110-1913. The National Land Trust Alliance (<http://www.lta.org/>) or local land trusts also are excellent sources of information.

Qualifications for Charitable Deduction of Conservation Easements

Under some circumstances, a donation of a restriction on the development of your forest land may qualify as a charitable contribution. The charitable contribution deduction may apply to your income, estate, or gift tax liability. The criteria necessary to qualify for a charitable deduction need to be carefully evaluated. These criteria are discussed in IRS Publication 526, *Charitable Contributions*. You should seek legal counsel to facilitate the process. Three basic criteria must be considered.

Qualified Organization. Your contribution must be made to one of the following types of qualified organizations:

1. A unit of the local, State, or Federal government;
2. A publicly supported charitable, religious, scientific, educational, or similar qualified organization; or

3. An organization that is controlled by, and operated for, the exclusive benefit of a government unit or a publicly supported charity.

Conservation Purpose. Your contribution must be made solely for one or more of the following purposes:

1. Preservation of land areas for outdoor recreation by, or for the education of, the general public;
2. Protection of a relatively natural habitat for fish, wildlife, plants, or a similar ecosystem;
3. Preservation of open space, including farmland and forest land. The preservation must yield a significant public benefit. It must either be for the scenic enjoyment of the general public or under a clearly defined Federal, State, or local government conservation policy; or
4. Preservation of a historically important land area or a certified historic structure.

Qualified Real Property Interest. Any of the following interests in real property qualify. Forest land and associated timber are real property:

1. Your entire interest in real estate other than a mineral interest;
2. A remainder interest—that is, the interest that remains after an interest that you hold for a time period, which either is designated or is fixed by an identifiable event, such as your death—expires; or
3. A perpetual restriction on how the property may be used.

Valuation of Donation

The value of a donation of a conservation easement generally is equal to the value of the entire property before the donation, minus its value after the donation, as discussed in IRS Publication 561, *Determining the Value of Donated Property*. The best evidence of this difference in value often is sales of similar properties in the area that were bought and sold, some without any restrictions and some with restrictions similar to those you are considering for your property. The basic principle is demonstrated in Example 8.1.

Because of the need for accuracy, a professional appraiser should be used to determine the value of your donation. If you claim a deduction of more than \$5,000 for donated property, you must get a qualified written appraisal made by a qualified appraiser in addition to filing the information required on claimed deductions of more than \$500. You must attach an appraisal summary (Section B, Part III of IRS Form 8283:

Example 8.1.—Value of a Donated Conservation Easement.

You own 300 acres of forest land. Similar land in the area has a fair market value (FMV) of \$5,000 per acre. Land in the general area that is restricted solely to forestry uses consistent with the county's open-space program, however, has a FMV of \$2,000 per acre. Your county wants to preserve green space in the area of your property and prevent further development. The county is most interested in preserving the 200 of your acres that are visible from a major highway. You grant the county an enforceable open-space easement in perpetuity on the 200 visible acres, restricting its use to selective timber harvesting consistent with the open-space easement. The value of the easement is:

FMV of the property before granting the easement:	
\$5,000 x 300 acres	\$ 1,500,000
Less FMV of the property after granting the easement:	
[((\$5,000 x 100 acres) + (\$2,000 x 200 acres))	- 900,000
Value of the easement	\$ 600,000

Noncash Charitable Contributions) to your income tax return. The amount of deduction you claim may be subject to other restrictions, as discussed in IRS Publication 526, *Charitable Contributions*.

Estate Tax Exclusion for Land Subject to a Qualified Conservation Easement

A percentage of the value of land subject to a qualified conservation easement may be excluded from the gross estate of

a decedent. The applicable percentage that can be excluded is limited to 40 percent of the value of the land subject to the easement, but it is reduced by 2 percentage points for each percentage point that the value of the qualified easement is less than 30 percent of the value of the land before the easement. This means that if the value of the easement is less than 10 percent of the value of the land before the easement, the applicable percentage will be zero. The maximum amount that can be excluded is \$500,000.

The decedent's basis in land for which the exclusion is used carries over to the heirs; there is no step-up in value.

To qualify, the land must be located in the United States or in a U.S. possession. The land must have been owned by the decedent or a member of the decedent's family during the 3 years ending with the decedent's date of death. The land must be subject to a qualified conservation easement granted by the decedent, a member of the decedent's family, or the trustee of a trust that holds the land. In addition, land subject to a qualified easement granted after the death of the decedent by the executor of the estate may qualify.

For additional information see the instructions for Schedule U of IRS Form 706: United States Estate (and Generation-Skipping Transfer) Tax Return, available at <http://www.irs.gov/pub/irs-pdf/i706.pdf>.

