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## Chapter 1

# The Importance of Forestry Estate Planning

### Forest Ownership

Forests comprise one-third of the Nation's land area. Nearly three-fifths of all forest land—430 million acres—is privately owned. More than four-fifths of privately owned forest land—363 million acres—belongs to nonindustrial owners.<sup>1</sup> Nonindustrial private forest owners are the individuals, families, and organizations which own forest land but do not operate primary wood-processing facilities; that is, they are not classified as forest industry. With the recent consolidation of forest industry ownership and industry's subsequent divestiture of much of its forest holdings, the proportion of forest land in nonindustrial private ownership is on the increase.

Forest land and timber values have risen rapidly in many parts of the country in the past decade; market values frequently reflect factors other than commercial timber production. The estate tax structure is in a state of flux, posing an ever-present danger for estates with substantial forest holdings. Without proper estate planning, forced liquidation of family forests or severe disruption of management regimes is a distinct possibility. Fragmentation of holdings and changing land uses can result.<sup>2</sup> Furthermore, the uncertainty created by the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16), discussed in several of the following chapters, has frozen many forest land estate planning efforts. In many States, estate planning is further complicated by the recent decoupling of the State estate or inheritance taxes from the Federal estate tax, as discussed in chapter 18.

### A Diverse Group

Most nonindustrial private forest land in the United States is owned by individuals, married couples, family estates and trusts, or other informal family groups. Ownerships of this type number over 10 million and account for approximately 250 million forest acres. The remaining nonindustrial private acres are owned by more formal organizational entities,

including corporations, limited partnerships, and limited liability companies, many of which also are family-held. Nearly 90 percent of nonindustrial private forest ownerships are less than 50 acres in size. Well over half of nonindustrial private forest acres, however, are in holdings of 100 acres or more, and one-fifth are in holdings of 500 acres or more. The typical nonindustrial private forest owner is 60 years old.<sup>3</sup>

### What Can Happen?

If you own forest land and are approaching or in retirement, you may be asking yourself questions like: Can I afford to take early retirement, so I can work on projects on the tree farm I have always wanted to while I enjoy good health and vigor? How can I transfer the knowledge and experience gained from managing the land to my family? Are the wildlife plots, timber management practices, hiking trails, and cabin by the creek that I planned still feasible? If my spouse and I retire to the tree farm are the resources adequate that we can enjoy a satisfactory life style? How will retirement affect our timber investment income? Will sharing that income with our children serve to enrich and motivate them?

Going a step further, if you, your spouse, or both of you were to die today, what would happen to the forest land that you have worked together a lifetime to obtain? Do you have a forest management plan? If you do, will it continue to function as an effective tool for the survivors and provide for them in an equitable manner without disruption? Are your forestry investments structured so that they will retain their value at your death? Have you taken steps to minimize death taxes? Will timber or land or both have to be sold to pay family administrative expenses and estate taxes?

Examples abound of profitable forested estates that had to be partitioned or liquidated entirely to settle estate debts and pay death taxes following the owner's death. This is true especially in unplanned situations, and is exacerbated when the heirs quarrel over the terms of the estate settlement. Such complications tend to dissipate valuable forest resources.

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<sup>1</sup> Smith, W.B.; Miles, P.D.; Vissage, J.S.; Pugh, S.A. 2003. Forest resources of the United States, 2002. Gen. Tech. Rep. NC-241. St. Paul, MN: U.S. Department of Agriculture Forest Service, North Central Research Station. 137 p.

<sup>2</sup> Greene, J.L.; Bullard, S.H.; Cushing, T.L.; Beauvais, T. 2006. Effect of the Federal estate tax on nonindustrial private forest holdings. *Journal of Forestry*. 104(1): 15–20.

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<sup>3</sup> Butler, B.J.; Leatherberry, E.C. 2004. America's family forest owners. *Journal of Forestry*. 102(7): 4–14.

## The Purpose of This Book

The purpose of this book is to address the above issues. It is written to provide nonindustrial private forest owners and the legal, tax, financial, insurance, and forestry professionals who serve them a working knowledge of the Federal estate and gift tax law as it relates to estate planning for forest properties. The unique character of timber assets is addressed in terms of the estate planning goals of a forest owner. The purpose is to enhance, rather than replace, communication with estate advisors, and to make the planning process more efficient. In all cases, well-qualified professional advice is essential.

The discussion and examples presented in this book should be regarded as educational rather than legal or accounting advice. You should carefully review your own personal situation—family goals, financial portfolio, land and timber inventory, and specific considerations—with an attorney and estate planning advisor. The applicable laws and regulations, which often are complex, uncertain, and dynamic, must be applied to your specific situation and context before making legal and financial decisions. The book is written within the framework of Federal law, but an understanding of applicable State laws that affect the ownership, management and transfer of forest land assets also should be incorporated into estate planning deliberations. Because estate law varies widely among the 50 States and territories, much of it is beyond the scope of this publication. Nevertheless, State death tax laws and regulations must be considered even as the estate plan addresses the Federal statutes.

## Structure

This book is divided into four major parts, which are further divided into chapters. Part I develops the foundation for estate planning. Estate planning considerations and objectives, the planning process, and valuation principles are discussed, as well as the Federal estate and gift tax process, and the legal basis for estate planning.

Part II of the book explains general estate planning tools and illustrates their application to nonindustrial private forest land. Separate chapters discuss the use of the marital deduction, disclaimers, and strategies for gifting forestry assets. The role of trusts, life insurance, and installment contracts in estate planning also is addressed.

Part III introduces and explains forestry-specific estate planning tools, including special use valuation and deferral and extension of estate tax payments. The advanced planning and requirements necessary to qualify for and effectively utilize these tools is covered in detail using examples.

Part IV discusses the various forms of forest land ownership and their relationship to forest estate planning. Alternative business structures for timber estates, including the advantages and disadvantages of each, are discussed. Chapter 18 treats State transfer taxes, many of which now are decoupled from Federal law, and summarizes the basic features of the statutes in each State. Chapter 19 presents a comprehensive example of the financial benefit of planning a forest estate—or the cost of not planning.

The appendices include a glossary and selected Internal Revenue Service (IRS) tax forms and tables.

## Readiness Questionnaire

Effective estate planning is an ongoing process consisting of three major components. The first concerns effective management of the estate assets during the owner's lifetime. The second component, building on the first, is concerned with ensuring that the transfer of estate assets at death will be made in accordance with the owner's wishes, with a minimum of problems and minimum tax liability. The third component encompasses nontax situations that only can be addressed while living, through personal understanding of family circumstances and their interaction with effective planning. To better understand where you are in this process; take a few minutes to complete the Readiness Questionnaire on the following page (fig. 1.1).

**Check the appropriate blank to the left of each statement.**

Yes	No	
_____	_____	1. I have discussed the requirements for cash in the event of my spouse's death. I have knowledge of estimated Federal and State death taxes, as well as the debts and other costs payable at that time.
_____	_____	2. Specific plans exist to satisfy immediate financial needs in the event of my spouse's death.
_____	_____	3. I know what estate planning can accomplish, have set the objectives for my own estate plan and have discussed a plan for continued management of the family's timberland with family members.
_____	_____	4. Both my spouse and I have complete and up-to-date wills.
_____	_____	5. I understand the reason for probate and how it functions.
_____	_____	6. I know how to use trusts as an estate planning tool for saving taxes, lessening probate costs, and managing my assets.
_____	_____	7. My spouse and I know how to use the marital deduction for Federal estate tax saving in conjunction with the applicable credits.
_____	_____	8. I am aware of the tax savings available by using the gift provisions of the tax law, and the advantages and disadvantages of gifting versus testamentary transfers.
_____	_____	9. I understand the role of life insurance in my estate planning and how that role(?) changes over time.
_____	_____	10. I am aware of the details of my spouse's life insurance policies and know how to shelter policy proceeds from Federal estate tax.
_____	_____	11. I understand the different ways to hold timber property in my estate and the advantages and/or disadvantages of each.
_____	_____	12. I know how much family income will be received from retirement plans, social security, annuities, the family timberland, and other sources.
_____	_____	13. Both my spouse and I know how to contact our attorney, accountant, banking officer, life insurance agent, and forester. We both know where important documents are stored.

Figure 1.1—Estate planning readiness questionnaire.