
Chapter 2

Estate Planning Objectives and Considerations

The High Cost of Dying Unprepared

Do you have an estate plan? Perhaps surprisingly, the answer always is “Yes!” You can exercise your right to specify who will receive your various assets upon your death by preparing a will. If you fail to exercise that right, however, the State in which you are legally domiciled has a plan for disposing of your property. In fact, all States have laws of descent and distribution that apply to the estates of individuals who die intestate (without a will). The major exceptions to the laws are joint tenancies, where property passes to the surviving tenant, and life insurance contracts, where the proceeds pass to the named beneficiary. The State plans are general and fail to address a number of considerations. Simply put, they are rules that specify how the residue of an estate is to be divided once the “transfer costs” have been paid. Forest land is a unique asset and a poor fit for such a one-size-fits-all approach; almost always the State plans can be improved upon.

Do you have an estate plan? Perhaps surprisingly, the answer is “Yes”! Even if you have failed to exercise the privilege of expressing your desires by writing a will, the State in which you are legally domiciled has a plan for disposing of your property. In fact, all States have laws of descent and distribution for this purpose. If you have failed to exercise your right to specify who will receive your property at death, State law provides a general plan of rules that apply. The major exceptions are joint tenancies where property passes to the surviving tenant and life insurance contracts where the proceeds pass to the named beneficiary. Generally, the State’s plan can be improved because there are a number of considerations that it fails to address. Simply put, the rules are specific as to who gets the residue of the estate after the “transfer costs” have been paid

Unexpected Heirs

As noted above, all States have laws of descent and distribution that determine what happens to the property of a person who dies intestate. The surviving spouse, children, parents, siblings, and other relatives are considered in more or less that order. State law does vary in this regard, however, and becomes more complicated where blended second and third marriages are involved—especially where there are minor children. State statutes rarely consider the heirs’ needs, their contributions to the estate, or the tax consequences of the distribution.

Unexpected Values

The fair market value of appreciated real estate, closely held stock, jointly held property, and other interests with low current financial returns may greatly exceed the value attributable to such property from current cash flows. Fair market value often exceeds valuations based on the use value of the assets (see chapter 4 for a discussion of asset valuation for estate and gift purposes; see chapter 12 for a discussion of special use valuation). The Internal Revenue Service (IRS) focuses its estimates of value on the “highest and best use” of the property, preferring market transactions as evidence of value over other methods wherever possible. Consequently, the IRS valuations may be much higher than the value placed on estate assets in their current use by the executor. The demand for residential and recreational properties outside urban areas has driven up prices on forest land in many regions of the country. Heirs also may suffer from the hazards of unrealistic expectations from weak or worthless assets. Valuation is discussed in chapter 4.

Transfer Costs

Transfer costs include Federal and State death taxes, where applicable, and probate and estate administration expenses.

Federal estate and State death taxes—The Federal estate tax law encompasses taxable lifetime gifts combined with property passing at death in calculating the decedent’s tax liability. In 2008, during the transition under the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), the Federal estate tax rate effectively is 45 percent on taxable estate values in excess of the \$2 million applicable exclusion amount (see tables 3.1 and 3.2). States with an estate or inheritance tax law may levy additional taxes that can amount to as much as 10 to 20 percent of the Federal estate tax. State death taxes are discussed in chapter 18.

Currently (2008), the annual exclusion of Federal gift tax law exempts \$12,000 per donee per year and \$1 million in lifetime taxable gift transfers over and above the annual exclusion per decedent. Thus, the Federal gift tax rate effectively begins at 41 percent on amounts over \$1 million and increases to 45 percent on amounts over \$1.5 million (see table 3.1; Federal estate and gift tax procedures are discussed in more detail in chapter 3). State gift tax laws are discussed in chapter 18.

Probate and administrative expenses—The cost of probate (discussed in chapter 5) and estate administration expenses comprise the other so-called “transfer costs.” Some States have adopted statutory limits for probate costs associated with small estates. Thresholds for applicable amounts under small estate laws vary from approximately \$5,000 to \$100,000. In estates exceeding this threshold, probate expenses may, in some cases, amount to as much as 8 or 9 percent of the value of the estate.

Generally, administrative expenses gradually fall as a percent of estate value as that value increases to \$1 million or more. On large estates, these charges may amount to 5 percent of estate value or lower if no problems are encountered. For example, on a \$2.5 million taxable estate the total average settlement costs (Federal estate tax, plus administration expenses equal to 5 percent of the estate) would be only \$350,000 in 2008 (table 2.1). This amount increases sharply to \$600,000 on a taxable estate of \$3 million.

Loss of leadership and income—The owner’s leadership and skill may be indispensable in successfully managing the forest land or timber business enterprise. Knowing boundary locations; having good relationships with neighbors, consultant foresters, loggers, and forestry vendors; having an understanding of silviculture; and having timber marketing experience all are part of a knowledge base built over a long period of time. At the owners’ death, this experience may be difficult or impossible to replace in the short run.

Nonindustrial forest owners typically are in an age group where they are near the peak of their earning power. At death these earnings could be sorely missed.

Shrinkage because of liquidation—When forest land or timber business assets have to be sold to pay taxes and administrative expenses or to retire indebtedness, the shrinkage losses can amount to a substantial portion of the estate. These losses can result from poor market timing, breakup of efficient working units, premature disposition of assets, and unfavorable financial arrangements. Partitioning of estate resources among the heirs also may have unfavorable consequences, both in terms of valuation and management efficiency. Such partitioning may be unavoidable due to differing objectives among the heirs.

Ancillary probate—Ancillary probate proceedings generally are required when real property is held in more than one State. The additional legal costs increase the estate’s overall administrative expenses. Certain legal forms and business organizational structures circumvent this situation, as discussed in part IV.

Table 2.1—The high cost of dying—average settlement costs at death based on Federal estate tax in 2008, plus an average administration cost of 5 percent

Taxable estate	Federal estate tax	Administration expenses	Total settlement costs
<i>dollars</i>			
100,000	0	5,000	5,000
200,000	0	10,000	10,000
300,000	0	15,000	15,000
400,000	0	20,000	20,000
500,000	0	25,000	25,000
600,000	0	30,000	30,000
700,000	0	35,000	35,000
800,000	0	40,000	40,000
900,000	0	45,000	45,000
1,000,000	0	50,000	50,000
1,250,000	0	62,500	62,500
1,500,000	0	75,000	75,000
1,750,000	0	87,500	87,500
2,000,000	0	100,000	100,000
2,250,000	112,500	112,500	225,000
2,500,000	225,000	125,000	350,000
3,000,000	450,000	150,000	600,000
3,500,000	675,000	175,000	850,000
4,000,000	900,000	200,000	1,100,000
5,000,000	1,350,000	250,000	1,600,000
6,000,000	1,800,000	300,000	2,100,000
7,000,000	2,250,000	350,000	2,600,000
8,000,000	2,700,000	400,000	3,100,000
9,000,000	3,150,000	450,000	3,600,000
10,000,000	3,600,000	500,000	4,100,000

Estate Planning Considerations Particular to Forestry

Estates with substantial forest land and timber values often have many of the problems described above. They also have many additional considerations that arise from the unique nature of the forest land asset and the economic climate in which the forest owner operates. The financial returns on timber investments are driven by three primary factors: timber growth (site productivity), timber markets (stumpage price), and the cost of capital (interest rates). Landowner investment and harvest decisions interact in complex ways with these factors, which in turn are influenced by Federal and State tax considerations.

Illiquidity of Land and Timber Assets

Land “dedicated” to timber production is characterized by a long investment horizon. Timely and appropriate management decisions are important in order to establish and maintain the desired level of timber growing stock to achieve its earning potential. This limits the potential number of buyers in the market for timbered assets and requires skill, timing, and luck to obtain top market values when transferring timber properties. In addition, timber prices are volatile and follow long and often irregular price cycles.

Low, Irregular Income

Low income—Low or inadequate returns on forest assets often result from premature harvesting, over-cutting, and under-investing in reforestation and maintenance of timber growing stock. Under these circumstances, the potential returns from the forest land fail to be realized.

Irregular income—Ideally, the age classes of timber stands are distributed so that a more or less even flow of timber volume and revenue results. On most private forests, however, timber income is irregular because of past land use practices. As noted above, under-investment also contributes to an uneven flow of income. The average tenure of nonindustrial forest land holdings is approximately 10 years, while timber rotations may vary from 25 to 50 or more years. In addition, the average owner is 60 years of age. The combination of owner age and relatively short tenure suggests that sporadic cash flows will be the usual case. Even in all-aged stands, excess cutting or high-grading (cutting the best trees without regard for the future stand) will invariably disturb the cutting schedule and contribute to irregular income.

Continuity of Management

Continuous long-term sustainable management under a well-defined set of goals is the most effective way to ensure efficient timber production from forest holdings. This goal clearly is desirable from a societal point of view. From an owner’s perspective, its primary importance is in keeping timber assets productive. For all its public and private benefits, however, continuity of management often is at variance with an owner’s immediate goals and personal situation. Many variables affect an owner’s management and harvest decisions, and some may interrupt the continuity of management associated with an optimum financial return. As noted above, the average tenure of nonindustrial private forest landowners is a relatively short 10 years. Even with larger holdings that have longer average tenure, the holding period rarely approaches a typical rotation cycle of 25 to 40 years in the South, and longer in the North and West.

Within these short time frames, Federal tax laws further complicate the intergenerational transfer of forest property, contributing to the liquidation of growing stock and disrupting management continuity. Partitioning the estate often produces similar results. Careful planning is required to ensure continuity of management and the attendant benefits.

Unitary Nature of the Forest

Economies of scale in management, harvesting, and reforestation generally are achieved only on holdings of perhaps 1,000 acres or more. The exact size will depend on site quality, species mix, markets, and other variables. There is a rather well-defined inverse relationship between tract size and the unit cost of production; that is, as forest land size increases the cost per acre of reforestation, harvesting, and management operations decreases.

An even flow of timber and other outputs can be achieved only on holdings large enough to have a diversity of timber stands, age classes, and species. For example, if one assumes a 40-year rotation, defines the minimum operable stand size as 20 acres for cultural treatments, and wants income every 5 years, a 160-acre $[(40 \text{ years} \div 5 \text{ years}) \times 20 \text{ acres}]$ minimum of operable land stocked with age classes at 5-year intervals is required. If annual income is desired, an 800-acre minimum (40 years \times 20 acres) is necessary (assuming clear-cut management with no thinning). The problem, however, is that age classes are rarely uniformly distributed, and the distributions that do exist are upset as family changes or estate proceedings require liquidation to raise cash. A management plan can help to solve some of these difficulties.

Fragmentation of forest land holdings is encouraged by real estate markets and estate tax policies. Consider a 1,000-acre forest property with four parcels of approximately equal size, which have age classes that differ by 10 years per parcel. In the aggregate, an even flow of income and low-cost management is possible. At the owner’s death, however, one parcel each passes to the surviving spouse and three children (the values are equalized internally to account for the different levels of growing stock on each parcel). In the absence of a family agreement to the contrary, the death will disrupt the flow of timber income, and the cost of management operation will increase. A forest management plan will not prevent this outcome if the respective parties do not reach an agreement that encompasses continuity of management for the entire acreage.

Example 2.1. Consider the 1,000-acre property noted above, which is composed of four parcels of approximately equal size. A forest management plan will include an inventory of the timber stands by

species, age, volume, and condition. An operational plan will project and treat each stand based on the owner's goals (including the estate plan, if desired). The options for a 40-year rotation (investment period from seed to harvest) are illustrated by the cutting cycle: (1) harvest 25 acres per year from mature timber for an even flow of wood products; (2) harvest 250 acres in every 10-year period when the highest prices are expected; (3) harvest the growth from all merchantable timber on a 5-year cutting cycle; (4) cut timber when the family needs money; or (5) any combination of the above. The plan will depend on the timber market, the family's needs for income, and the biological condition of the forest. A forester can transform the timber inventory into the most effective operational plan to meet the owner's goals and to utilize the maximum potential of the forest. A forest management plan is discussed in more detail below.

Difficulty in Obtaining Credit

Forests are unimproved real estate and largely unproductive in the premerchantable and young growth stages of a rotation. A forest landowner, typically 60 years or more of age, with standing in the community and forestry experience, should have excellent credit. In contrast, it may be more difficult initially for a surviving spouse to obtain credit if he (she) does not have an established credit record. It may be even more difficult for the children, depending on their age and maturity. The loss of income and family leadership exacerbates the problem of credit worthiness when coupled with liquidity needs of the family to cope with estate transfer costs. This is an important issue to address in the planning process.

A Forest Management Plan as Part of the Estate Plan

The primary goal of estate planning is the accumulation and conservation of wealth, including its transfer to heirs and other beneficiaries. With respect to forest land in the estate, a forest management plan is essential to both the goal of producing income and that of preserving the land's inherent productivity through sustainable management.

The management plan may address several goals such as income, wildlife management, and value appreciation. It should have both strategic and operational dimensions. The strategic plan focuses on long-term goals such as optimizing the rotation length or structuring the age-class distribution of timber growing stock to produce an even flow of income. The operational plan focuses on the production of net income over a relatively short period, typically 5 years.

The first step in building an operational plan is to obtain a current inventory with stand-level detail. All forestry operations during this period, including wildlife activities, together with their related costs and revenues are scheduled. For the revenues, mature stands are analyzed for rate of return and income to be generated. Financial decision rules are developed to guide the replacement of less productive stands by harvesting them. Similarly, the expected returns for reforestation, timber stand improvements, and other projects are analyzed and the decision rules used to choose the most productive use of limited investment capital. Once the operational plan is in place, an annual budget targets the specific stands to be harvested and details plans for reforestation and other silvicultural activities. These plans are completed in the context of the owner's objectives and the prevailing market environment.

A good operational plan has the flexibility to make adjustments: (1) in revenues as owners' needs and/or market conditions fluctuate; (2) in expenditures as liquidity and the cost of capital vary; and (3) in either or both as unexpected external factors such as shifts in public policies or casualty losses occur.

The short-term operational plan functions within the context of the strategic plan, which is developed to meet the long-term management goals for the forest land. Species selection, stocking levels, and rotations are addressed in the strategic plan, as well as the interaction among the various timbers, wildlife, and other goals. At the operational level, however, each stand functions as an individual investment from which thinning and final harvest revenues are projected. Similarly, annual management expenses for property taxes, timber stand maintenance, competition control, and growing stock enhancements such as fertilizer are prescribed. These are inputs for making management decisions on stocking control and property maintenance.

The scope and sophistication necessary to develop a forest management plan depend on the individual owner's circumstances. For a small property with modest timber value, the owner may be able to achieve his (her) forest land objectives with a relatively simple plan. As property size and timber value increase, however, more attention should be devoted to the plan, reflecting the greater investment in the resource and its potential earning capacity.

Specific Estate Planning Objectives

Although it may be difficult for family members to agree on the planning objectives for the estate and its forest property, reaching agreement is necessary for development of the estate plan. Conflicts often arise when estate plans have multiple objectives, and must be resolved before progress on the plan can be made. Rarely is it possible to satisfy all

objectives completely, so priorities have to be established for allocating the two primary estate resources—income and property.

Timing, equity, organization, and tax strategies are among the more common considerations to be addressed in the planning process. Timing addresses the choices between current and future consumption (i.e., enjoyment in this generation or the next). Equity deals with the shares of inheritance among the heirs, special needs of certain family members, and the contribution of various family members to building the estate. The form of ownership or business organization often must be decided in terms of who will be in control and whose philosophy of management will prevail. Tax-saving strategies must be integrated with the other goals in a way that retains a balanced plan. In some instances, maximum tax savings may be sacrificed in order to realize a goal in another area. Finally, there is the element of trust. If members of the immediate family and any in-laws cannot respect and trust one another, the planning effort becomes much more difficult.

Preretirement and Postretirement Security

It is essential that adequate resources be allocated for the financial security and well-being of the estate owner(s) before and during retirement. Involvement in management activities and professional interests may be important in retirement. Planning for continuity of business activities is discussed below.

Security and Compassion for Family Members

The financial security, comfort, and happiness of the surviving spouse, either husband or wife, should be the highest priority for most estate plans. The ability of the survivor to care for the children, manage daily affairs, and deal with grief due to the decedent's death must be considered. With most estates, the husband and wife have worked together for many years to accumulate the estate assets, often at considerable sacrifice. The death of either spouse usually is followed by a period of adjustment with respect to both personal and business affairs. The survivor's comfort and happiness during this time will depend greatly on the amount and types of assets received from the estate, and on the control the survivor has over his (her) resources.

In some cases, State law provides for the surviving spouse to have certain minimum rights in the real and personal property "solely owned" by the deceased spouse, regardless of what may be stipulated in a will. The further implications of property ownership are developed in part IV. Proper estate planning can help to ensure that the amount left to the survivor at the death of either spouse will be adequate.

Specific adjustment can then be made, if necessary, by means of a will—subject to State law. Wills are discussed in more detail in chapter 5.

Equitable Treatment of Children

State laws of descent and distribution generally provide for equal distribution of property among children. Although equal distribution is desirable in principle, it may not address important differences in the children's situations or contributions to the family. Differences to consider include: (1) a large investment in a particular child's education; (2) an extra investment in one child's business or purchase of a home; (3) a large contribution from a child to the parents in money or in kind; (4) care for children with physical or mental disabilities; and (5) the children's differing contributions toward managing the forest land. Equitable adjustments for these types of situations can be addressed by a will or by other planning techniques. A realistic assessment of the working relationships among children and in-laws is essential. In the absence of a will, State law will control the distribution of the decedent's property.

Continuity of the Forest Enterprise

The time required to settle an estate can vary from a few months to several years, depending on the complexity of the settlement. Plans should be made for continuity of management of the forest land, or assets and opportunities can quickly disappear. It is essential to take advantage of favorable timber markets within the context of the forest management plan and to make timely investments in reforestation and cultural practices that keep the assets productive. Protection from timber trespass, theft, and natural hazards (insects, diseases, and wildfire) also is important. Proper estate planning can ensure that an operational forest management plan continues after the death of the decedent. The will or other instrument should direct that business operations of the estate continue during this critical transition period.

Minimize Transfer Costs

Generally, one of the principal goals of estate planning is to minimize the impact of transfer costs at death. As discussed above, transfer costs include Federal and State death taxes, probate expenses, and the costs of administering the estate.

Minimizing tax liabilities—Careful attention to the tax consequences of property disposals is required. Gifts made during the decedent's lifetime may be subject to gift taxes (see chapter 9 for a discussion of the advantages and disadvantages of gifts). Property given to the spouse during the decedent's life or at death is shielded from tax by the marital deduction; however, this only defers the ultimate

payment of the tax (see chapters 6 and 19 for discussion of the tax effects of the marital deduction). State death taxes, which vary greatly from one State to another, also must be considered (see chapter 18). Careful planning is required to minimize taxes without jeopardizing other objectives. The husband and wife must make a fundamental choice in estate planning: (1) minimize taxes at both deaths and pass the maximum value to the children, or (2) minimize taxes and other costs at the death of the first spouse, leaving the surviving spouse with the maximum possible wealth and control over estate assets. The latter approach will ultimately cost the children more in estate taxes and administrative costs.

Minimizing administrative costs—Certain steps can be taken to reduce administrative costs, and even to avoid probate, but at the cost of flexibility and perhaps additional taxes. Because all choices have advantages and disadvantages, they should be carefully considered in terms of overall objectives.

Provide Flexibility and Durability

There always are tradeoffs in saving estate taxes. Rigid plans rarely work well over long periods of time because of changes in the family, the law, and the economy. It generally is best to choose an executor who can be trusted to make decisions that benefit all concerned to the maximum extent possible and to provide him (her) the flexibility to do so. When it is necessary to protect the interests of a specific heir, however, the desired outcome should take precedence over flexibility.

Estate Planning Team for Forest Landowners

Forest Landowner

The role of the forest landowner on the estate planning team is to set the overall objectives for the estate plan and ensure they are met in a cost-effective manner. Owners who relinquish this role to other team members run the risk of ending up with a plan that meets objectives other than their own. As noted above, developing the objectives is best done in discussion with the other members of the family.

Consultations with professional advisors should be preceded by a personal fact-finding process that includes an analysis of the family situation and takes into account current and projected lifestyle desires and financial needs. The fact-finding process also should include an inventory comprising the description, form of ownership and value of all estate assets. Legal descriptions of all real property, locations of deeds and other important documents, and all indebtedness

should be listed. Values for all assets should be projected for the next 5 years. The forest management plan will provide the basis for timber volume and value projections. Additionally, insurance policies, beneficiary designations, and policy options should be reviewed.

Attorney

The family attorney usually has the primary responsibility for coordinating the estate planning process. If he (she) lacks sufficient knowledge of the Federal and State tax laws governing the transfer of real and personal estate assets, an attorney specializing in estate planning should be engaged. When particular complications exist or difficulties in the business operations warrant, expert help is well advised. The attorney articulates the owner's objectives to the other team members, supervises the inventory of personal data and estate assets, and works with other professionals to evaluate alternative estate planning strategies. The attorney drafts the will and other legal documents that are required to execute the completed estate plan, including the supervision of changes in property titles and insurance beneficiaries to conform to the plan.

Certified Public Accountant (CPA)

A CPA understands the complex interplay among the estate, gift, and income tax laws and prepares and files the appropriate tax returns and other tax documents. Because he (she) typically has access to the client's financial and tax records, the CPA can discuss appropriate estate-planning opportunities.

Institutional Trust Officer

An institutional trust officer, who may be both lender and corporate trustee, often has an awareness of the financial needs of the estate. As a banker, he (she) can help explain the financial and tax aspects of alternative planning choices, and has expertise in the trust department that can be used during the decedent's lifetime and later by the survivors. A trust officer also has knowledge of how various types of trusts can help meet specific estate planning objectives. The role of trusts in estate planning is covered in chapter 9.

Chartered Life Underwriter (CLU)

A CLU can develop an insurance program that will provide the kind and amount of insurance required to meet the estate's estimated financial needs. The purchase of life insurance can provide the liquidity necessary to cover the estate's transfer costs, ensure protection of estate assets, and build estate assets at critical times. In some States, insurance consultants offer professional estate planning evaluations for a fee that is dependent only on the service

provided rather than on the sale of a particular insurance package. The recommended insurance coverage can then be purchased from the company of choice, with consideration being given to price as well as to the company's strength and rating. This approach avoids any appearance of a conflict of interest when dealing with an insurance broker. The role of insurance in estate planning is covered in chapter 10.

Forester

A forester is a nontraditional member of an estate planning team; nevertheless, he (she) can provide an invaluable service if there are substantial forest assets in the estate. A forester can prepare a forest management plan that specifically addresses estate-planning goals and functions as an integral part of the overall estate plan. A forester routinely brings management, marketing, and harvesting skills to the planning process, and often has knowledge of forest taxation issues and how they interact with other estate considerations.