

Chapter 9. Tax Implications of Forest Stewardship

INTRODUCTION

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 or animals, or other activities not related to the production of income. Such activities may, however, increase the market value of the property. Forest stewardship simply refers to the care of forest land in the best sense of conservation and wise use. Tax law may be of benefit in these efforts. You need to be aware, however, that the current tax laws may not support all of your efforts. This chapter discusses the tax incentives for wise stewardship of forest land.

TAX LAW KEYED TO PRODUCTION OF INCOME

Tax law is keyed to the production of income. Expenses incurred for an activity carried out to produce income as either a trade or business or an investment generally can be recovered, as discussed in Chapter 5. A critical factor is that the expense incurred for an activity must be directly related to its potential to produce income. Even though you may expect to sell timber sometime during your life, timber production may not be the primary factor motivating your activities.

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 on page 39.

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 don't receive any income related to wildlife, the expenses may not qualify as ordinary and necessary business or investment expenses. In some cases, however, the expenses might qualify to be added to the basis of your property, as discussed on page 39.

Many of the best opportunities to promote stewardship with your forest land are associated with forest estate planning. This topic is the focus of a companion publication, *Estate Planning for Forest Landowners: What Will Become of Your Timber Land?* (General Technical Report S0-97, U.S. Department of Agriculture, Forest Service, Southern Forest Experiment Station, New Orleans, Louisiana). 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 ecological value of forest land and want to guarantee that it will remain as forest land, 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 and produce timber on the property. Such transfers are a way for you to control the use of the land during and after your lifetime. By selling such a restriction, you would get some income from the development rights, or 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 consult *Preserving Family Lands: Essential Tax Strategies for the Landowner*, by Stephen J. Small, 75 Federal Street, Boston, Massachusetts 02110-1913. Another source, *Landowners Guide to Conservation Easements*, by Steven Bick and Harry L. Haney, Jr., being published by the American Farm Bureau Federation, Park Ridge, Illinois, is based on a national survey of conservation easements and focuses on strategies a landowner should consider to accomplish his or her goals when donating or selling a conservation easement on forest land.

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 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.
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 only for one 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.
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 some designated time period, or for a time period fixed by an identifiable event, such as your death, expires.
3. A restriction on how the property may be used if the restriction is perpetual.

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 9-1.

Example 9-1

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 \$1,200 per acre. However, land in the general area that is restricted solely to forestry uses consistent with the county's open-space program has a FMV of \$600 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, which 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:

\$1,200 x 300 acres \$ 360,000

Less FMV of the property after granting the easement:

\$1,200 x 100 areas = \$120,000
 \$ 600 x 200 acres = 120,000 - 240,000

Value of the easement. \$ 120,000

Because of the need for accuracy, a professional appraisal 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 over \$500. You must attach an appraisal summary (Section B of Form 8283) 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 and Gift Tax Exclusion for Land Subject to a Qualified Conservation Easement. The allowable portion of the value of land subject to a qualified conservation easement may be excluded for estate and gift tax purposes. This is in addition to any charitable deduction claimed at the time of the donation for either income, gift, or estate tax purposes. It also is in addition to the estate tax deduction for a qualified family-owned business. The excludable amount must be reduced by any charitable deduction claimed for gift or estate tax purposes. The exclusion is limited to 40 percent of the value of the land subject to the easement. The maximum amount that can be excluded is \$200,000 in 1999, \$300,000 in 2000, \$400,000 in 2001, and \$500,000 in 2002 and thereafter. 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: (1) within 25 miles of a metropolitan area, (2) within 25 miles of a national park or national wilderness area subject to significant development pressure, or (3) within 10 miles of an urban national forest. Land qualified is subject to designation by various Federal agencies. 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.

Details of this exclusion will be included in future editions of IRS Publication 448, *Federal Estate and Gift Taxes*.

