



# Timber and Taxes

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## The Current Status of the Federal Estate & Gift Taxes

An estate tax is a tax on the right to pass property at death. A gift tax is a tax on lifetime gifts. The federal government has levied an estate tax since 1916 and a gift tax since 1932.

An estate tax is fundamentally different from an inheritance tax. Estate taxes are levied at the estate level before transfer of the assets. They do not have different tax rates, exemptions and deductions based on the relationship of the heirs to the decedent. An inheritance tax, on the other hand, is levied on the right to receive property from a deceased person. Because of this, there are usually different tax rates, exemptions and deductions based on the relationship between the decedent and the recipient of the decedent's property.

Only a few states still have estate and gift taxes. Others have an inheritance tax.

### Determination of the Gross Estate And Its Valuation

The gross estate is defined as the value of all property owned by the decedent on the date of death. Therefore, the first step in the estate settlement process is a complete inventory of the estate assets.

### Valuation

Once property interests have been established, they must be valued. The general rule is that property comprising the gross estate must be listed at its fair market value. This may be as of the date of death or as of the alternate valuation date. Fair market value is defined as the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and each having reasonable knowledge of all the relevant facts. Timber will usually have to be cruised and appropriate stumpage prices applied. The alternate valuation date is the date that falls six months after the decedent's death. Once elected, it applies to all property in the gross estate; the executor may not alternately value some assets and not others.

### Special Use Valuation for Timberland

Section 2032A of the Internal Rev-

enue Code permits certain forest property (land, timber and personal property associated with the woodland) to be valued for federal estate tax purposes on the basis of its current use (i.e., timber production) rather than at its highest and best use (i.e., industrial or residential development). This is commonly called "special use valuation." The woodland must be considered a business, however. Investment property is not eligible.

### Reduction in Value

Special use valuation cannot reduce the fair market value of the gross estate by more than \$750,000 as adjusted for inflation since 1999. For 2010 the limit is \$1,000,000. If the woodland in question was owned by both spouses, the limitation applies separately in each estate.

### Qualifying Conditions

In the right situations, special use valuation of forest land can save a substantial amount of estate taxes. Careful planning—both pre-death and post-death—will be required, however, in order to qualify and receive the maximum benefits. There are six major pre-death requirements:

- (1) The decedent must have been a resident or citizen of the United States, and the property must be located in the United States.
- (2) The property must pass to certain defined family members who are termed qualified heirs.
- (3) The decedent and/or a family member must (a) have owned the qualifying property for at least five of the last eight years immediately preceding the decedent's death; (b) had an equity interest in the operation at the time of death and for at least five of the last eight years before death; and (c) during at least five years of such ownership, the qualifying property—in the case of woodland—must have been used for timber growing by the decedent and/or a member of the decedent's family, and have been devoted to such use on the date of the decedent's death.
- (4) The decedent and/or a fam-

ily member must have materially participated in the operation of the woodland for at least five years during the eight-year period ending on the earliest of (a) the date of the decedent's death; (b) the date on which the decedent became disabled, providing disability continued until the date of death; or (c) the date on which the decedent began receiving social security retirement benefits, provided the benefits continued until the date of death.

- (5) The adjusted value of the real and personal property qualifying for special use valuation must comprise, at fair market value, at least 50 percent of the adjusted value of the decedent's gross estate (gross estate less secured debts).
- (6) At least 25 percent of the adjusted value of the decedent's gross estate must be qualified real property.

### The Taxable Estate

The definition of taxable estate is the value of the gross estate minus all permitted deductions. There are seven of these, as follows.

**Funeral Expenses.** These include the costs of internment, the burial lot or vault, grave marker, future care of the grave site and transportation of the body to the burial place. Funeral expenses must be reduced by any reimbursement from the U.S. Department of Veterans Affairs and from the Social Security Administration to anyone other than the decedent's spouse.

**Administration Expenses.** These include costs incurred for collection, storage and preservation of estate property; payment of estate incurred debts; distribution of estate property; executor fees; attorney fees; and tax preparation fees, among others.

**Debts.** These are personal obligations of the decedent that existed at the time of death, including interest accrued to the date of death. They include, among others, such things as mortgages, personal loans, liens, unpaid income taxes on income includable on a return of the decedent for a period prior to his (her) death, and unpaid property taxes accrued prior to death.





**Casualty and Theft Losses.** These may be deducted if they occur during estate settlement and prior to distribution of the asset in question to the heir or legatee.

**State Death Taxes.** These include amounts paid for state estate, inheritance or other types of state death taxes.

**Charitable Deduction.** A deduction is allowed for estate assets that are transferred by the decedent's will to specified public or charitable entities or uses. These include federal, state and local governments; religious, charitable, scientific, literary and educational organizations; and certain types of fraternal and veterans organizations.

**Marital Deduction.** Property interests that pass from the decedent or his(her) surviving spouse can be deducted from the decedent's gross estate.

#### Determination of Tax Due

The next step is to compute the estate tax that must be paid. The base is the taxable estate to which the applicable tax rates are applied to determine the tentative tax. From the tentative tax, certain credits may be deducted to determine the actual tax due. These are four in number: (1) the credit for federal gift taxes paid on certain pre-1977 gifts; (2) the foreign death tax credit; (3) the credit for federal estate taxes paid on certain estate transfers to the present decedent; and (4) the unified credit.

For estates of decedents dying in 2009, the unified credit sheltered the first \$3,500,000 of the taxable estate from tax. If any of the other three credits applied, the amount sheltered would be increased accordingly. The tax due was levied at 45 percent. For 2009 and previous years, estate assets received a stepped-up basis for income tax purposes. This meant that the basis in the hands of the heirs was the estate value as discussed above.

At this writing (February 2010), no estate of a decedent dying in 2010—regardless of size—is subject to the federal estate tax. There is a total exemption. However, as an offset, only a limited stepped-up basis for inherited property applies. Just the first \$1,300,000 of estate assets will receive a stepped-up basis. This amount rises to \$3,000,000 for property passing to a surviving spouse. The basis of all other property will be a carry-over basis—i.e., the decedent's basis. Under current law, however, the estate tax will return in 2011 with only the first \$1,000,000 of the taxable estate being sheltered from tax by the unified credit. The maximum tax rate will also rise to 55 percent.

President Obama's 2011 budget as presented to Congress contains a provision that would repeal the 2010 total estate tax exemption and extend the 2009 rules retroactively to the estates of those dying in—and thereafter to

2011 and beyond. What Congress will do, however, remains to be seen.

#### Special Provisions For Paying the Estate Tax

The estate of an individual who dies owning a closely held business interest—including an interest in forest land—may, by meeting certain requirements, qualify for a special elective method of paying the estate tax attributable to that interest. Under Section 6166 of the Internal Revenue Code, payment of the tax may be totally deferred for the first five years, with the estate making four annual payments of interest only. This is followed by payment of the balance in up to 10 annual installments of principal and interest. The interest rate on the first one million dollars (indexed for inflation since 1998) of taxable value is a low two percent.

#### The Gift Tax

The federal gift tax law provides an annual exclusion (indexed for inflation) from tax. Currently this amount is \$13,000 per donor per donee. Additionally, each person has a one-time lifetime exemption of one million dollars. To the extent that the lifetime exemption is used, it reduces the amount sheltered from the estate tax at the donor's death. For example, suppose a person died in 2009 who had made lifetime gifts in the amount of \$500,000 subject to the one million dollar exemption. The \$3,500,000 sheltered from the estate tax, as discussed above, would be reduced to \$3,000,000. The gift tax on taxable gifts in 2009 ranged from 41 to 45 percent.

The federal gift tax was not repealed for 2010 as was the federal estate tax. Thus all taxable gifts in 2010, under cur-



## FLTC Tax Report

by Frank Stewart, RF



**Death Tax:** Scott Brown's (R-MA) recent U.S. Senate victory in winning Senator Ted Kennedy's (D-MA) former seat is a political watershed. But in all the excitement, it appears the media has overlooked one key aspect of Brown's victory: the proposed "retroactive death tax" may well be dead. Majority Leader Harry Reid (D-NV) simply does not appear to have enough votes to bring the death tax back to life for all of 2010. Many had believed, with a supermajority of 60 votes in the United States Senate, that the Senate would retroactively reinstate the death tax, which was eliminated—in 2010-only—by a phased-in decline of the tax passed in 2001. The tax is scheduled to return full force at up to a 55 percent rate in 2011 and afterwards.

Brown, a supporter of permanent death tax repeal, gives opponents of the tax 41 good votes in the Senate. With 41 votes (there are 100 senators) the Republicans could block any proposals to retroactively reinstate the death tax. His vote also means that Senator Reid no longer commands a supermajority. Any tax hikes—including the Death Tax—will now face the potential filibuster of at least 41 senators. Brown's victory does not necessarily translate into permanent death tax repeal, but it is a significant step in that direction.

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rent law, are subject to tax. The rate has been reduced to 35 percent however. Taxable gifts are those in excess of the annual exclusion and the one million dollar lifetime exemption.

### Conclusion

While we wait for Congress to act with respect to the federal estate and gift taxes, it is virtually impossible to do meaningful estate planning with any confidence. A number of countries throughout the world have eliminated death taxes in their entirety. Others who still retain a death tax exempt forest and farm land as long as the property continues in its current use. The United States would do well to emulate these nations.

**William C. Siegel is an attorney and consultant in private practice specializing in timber tax law and forestry estate planning. He is retired from the US Forest Service where he served as Project Leader for Forest Resource Law and Economics Research with the Southern Forest Experiment Station, where he still serves as a volunteer. He provides this column as a regular service to National Woodlands readers. Mr. Siegel welcomes comments and questions. They may be directed to him at: wcsiegel@aol.com.**



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## News from the Regions



### Proposed Massachusetts Law Could Impact Biomass Power

Proponents of a law being proposed in Massachusetts have been gathering signatures for the initiative to appear on the ballot later this year. Bill number 09-14 would require waste-to-energy and biomass renewable energy sources relying on combustion or pyrolyzation (decomposition caused by heat) to emit no more than 250 pounds of carbon dioxide per megawatt hour in order to be considered "renewable energy generating sources," "Class I renewable energy generating sources," "Class II renewable energy generating sources," "alternative energy developments," or "alternative energy properties" under state laws concerning renewable and alternative energy programs.

Under current state law, retail electricity suppliers are required to provide a minimum percentage of kilowatt-hour sales to end-use customers in Massachusetts from "Class I renewable energy generating sources" and "Class II renewable energy generating sources." The proposed law would prohibit retail electricity suppliers from satisfying these requirements through the use of waste-to-energy and biomass renewable energy sources that rely on combustion or pyrolyzation if such energy sources emit more than 250 pounds of carbon dioxide per megawatt hour.

### Canada to Restrict Ash Movement From New York

The discovery of Emerald Ash Borer (EAB) in New York has prompted Canada to add the state to its EAB import restrictions. Enforcement took effect on January 18, allowing a transition period

for Canadian facilities to implement risk-mitigation measures and obtain permits to import ash from New York. Canadian and U.S. definitions of regulated articles are identical.

To import ash commodities (lumber, wood and bark chips less than 2.5 cm in two dimensions), a permit is required and may dictate additional requirements. To import logs and other commodities larger than the dimensions specified above, the Canadian facility must have a Quality Management System Manual and be a participant on the EAB Approved Facility Compliance Program. Program participants are eligible for permits that allow for log imports during the low-risk period (October 1 through March 1). Ash nursery stock and firewood of all species is prohibited from entry into Canada.

There are separate rules for moving materials into regulated and non-regulated areas of Ontario and Quebec. The regulated areas include: Montreal, Ottawa, Sault Ste. Marie, Toronto and the Niagara peninsula.



### Oregon Plastic Bag Ban Proposed

Oregon State Senator Mark Hass (D-Beaverton) is spearheading a bill that would outlaw single-use plastic bags at retail store checkouts. Under the proposed legislation, paper bags would remain legal.

Hass says that plastic bags add to the litter problem, are difficult to recycle, harm marine life and are made from fossil fuels. "I don't think people understand the true cost of these bags," Hass told *The Oregonian* newspaper.

The proposed legislation is seen by political observers in the state capital as a long shot at best. Opponents maintain that contrary to popular belief, the ecological costs and benefits of paper versus plastic aren't that clear cut.

The Oregon Department of Environmental Quality's expert on environmen-

