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Progress in Forest Taxation in the United States

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Persistent efforts have been made by the Federal Government to arouse the interest of private enterprise in the practice of forestry. Until very recently, these efforts have been practically fruitless. The forces at work obstructing progress along this line simmer down to three major factors: (1) the long-time character of most forest investments; (2) the fear of the many natural agencies which are destructive to forest growing stock; and (3) the inequalities and uncertainties of taxation. The first of these may be corrected only by the building up of forests which produce incomes at fairly short intervals, preferably annual sustained yield forests. This building-up process, however, will undoubtedly be slowed down by the other two factors, the most important of which is probably the danger of destruction by fire, insects, and fungi. The amelioration of this great obstacle could, and probably will, be accomplished by a combination of insurance with aggressive control measures. The other factor, taxation, while not generally so destructive to forest investments as the natural agencies, is nevertheless an important obstacle, and one whose removal is urgently needed.

Forest taxation has occupied the minds of foresters ever since the forestry movement began in this country. Numerous efforts have been made in several states to correct the situation, first by granting tax exemptions and later by setting up a form of taxation known as the yield tax. These efforts, however, have all been in the nature of experiments and they have, in the main, been successful. It remained for the Forest Taxation Inquiry of the U. S. Forest Service to make a clear-cut analysis of the effects of taxation on forestry and to suggest sound and practicable remedial measures.

The Forest Taxation Inquiry which was authorized by the Clarke-McNary Law, began its exhaustive investigation in 1926. This organization, consisting of a staff of foresters and economists under the able direction of Dr. Fred R. Fairchild of Yale University, has now completed its study and the re-
suits are embodied in a report which is at present on press in Washington.

Forests in the United States have been taxed almost exclusively under the American property tax, which has been practically the sole reliance of many State governments and of all local governments since the founding of the United States. This all-embracing tax is notoriously inequitable and uncertain as it is administered at the present time, and the Forest Taxation Inquiry has amply demonstrated that these inequities and uncertainties fall with even greater force on forest properties than on most other kinds of real estate. The defects of the property tax as it is applied to forests may be divided into two main classes. In the first place, the inefficient administration of the tax and the uneconomic organization of the local governments bear heavily upon the owners of forest land. In the second place, the property tax by its very nature is inherently oppressive on forest property which produces income only after a long period of waiting.

Of the various reform measures suggested by the Taxation Inquiry, a good deal of stress is placed on those aimed at correcting the first class of defects. And rightly so, for any favorable revision of the tax itself could very easily be nullified by poor administration. This latter condition is evidenced by inequitable assessment and lax tax collection procedure. The Inquiry and also many other investigators have demonstrated that low-priced real estate is over-assessed in comparison with higher-priced real estate. Forest property and cutover land generally fall in the former category and are therefore discriminated against in the assessment. This results in widespread tax delinquency, which is aggravated by extreme laxity in collection practices. Delinquency places an added burden on tax-paying property and thus begins a vicious cycle of further delinquency followed by over-assessment, and so on, until bankruptcy of the local government results.

All of the above leads to the other important question of whether or not the present forms of local government should be retained. Students of government are almost unanimous in their condemnation of the extravagance of the multitudinous overlapping local governmental units. While most of the phases of our National life have gradually become adjusted to modern means of rapid transportation, short-sighted politicians still cling to a type of governmental organization instituted for a horse-and-buggy age. Millions of taxpayers' dollars could be saved by much-needed reorganization of state and local governments. Such reorganization would include the abolition and consolidation of certain political units; the zoning and segregation of agricultural from forest land and the disorganization of local governments in sparsely-set-
Forty-year-old plantation of Norway spruce.

tled regions, and the prevention of further land settlement therein; a redistribution of governmental functions, with more and more centralization in and assumption of these functions by the States; curtailment of unnecessary governmental services; the development of a highly-trained, appointive personnel; improved financial practices and a workable accounting system and budget; improved tax collection procedure; and efficient supervision and guidance by the State.

All of these remedies would benefit both forest property and other types of property. Efforts to correct the existing situation would therefore enlist the aid of all tax-paying interests rather than antagonize them by seeking special concessions for forestry. As far as improved assessments are concerned, forestry stands to gain to an even greater extent because of the almost universal tendency, mentioned above, of over-assessing the lower priced property classes. In order to obtain an equitable assessment, all property must be assessed at or very near the actual market value or at whatever percentage of actual value is stipulated in the law. This kind of assessment requires expert knowledge of values such as is not possessed by the great majority of local assessors. The appraisal of values for tax purposes could best be obtained by a State assessment organization which should consist of specially trained and adequately supervised appraisers. These men should have at their disposal accurate maps and surveys and adequate records of current property transfers to aid in the appraisals.
Improvements in the administration of the property tax and in the reduction of the cost of State and local government are fundamental and constitute a *sine qua non* of better forest taxation. Those interested in forest tax reform must therefore put their shoulders to the wheel alongside of other tax reformers and pass up no opportunity to work for a more enlightened and efficient operation of the property tax and of State and local government in general. But as the Forest Taxation Inquiry points out, the inauguration of the foregoing measures would not entirely solve the forest tax problem. Forest properties with deferred incomes would be treated unfairly, as compared with property yielding regular annual incomes, even if they were taxed under a property tax perfectly administered under an efficient system of government. The Inquiry has demonstrated mathematically that a property tax over a long period of years would take a larger proportion of the income from a deferred income property than from one producing an annual income. The property tax, therefore, favors a type of land use which yields an annual income over a use of land which requires long periods of waiting for income, and it is thus a real discouragement to the use of land for forestry, where deferment of income is the rule.

While the early forest tax investigators did not make such a rigid and complete analysis as did the recent Taxation Inquiry, they did recognize that the deferment of income was the seat of the difficulty. As a result, they turned to the obvious remedy of removing forest property from the property tax and taxing the income when it was received. The yield tax, which grew out of the early investigations, has indeed become firmly rooted, but it is only of minor importance because it has been applied to only a negligible amount of forest property. The reasons for this limited use of the yield tax are: (1) the great reduction in the revenues of many local governments which would occur if the tax were applied universally to all forests, and (2) the extreme difficulty of determining the proper rate of the yield tax. These, and other weaknesses of the yield tax, were considered so formidable by the Taxation Inquiry that that body recommended against this form of forest taxation.

Three modifications of the property tax have been recommended by the Forest Taxation Inquiry as superior to the yield tax. The first of these, known as the *adjusted property tax*, consists of adjusting the assessed value each year by subtracting from it any positive amount resulting from the following calculation: (1) One year's interest at a rate stipulated by law—the rate to approximate the risk-free, tax-free rate paid by the most stable governments on long-term borrowings—is computed on the assessed value at the beginning of the
year; (2) the taxes paid during the year are added to the amount computed under (1), and (3) the income received during the year is subtracted from the result obtained in (2). This plan gives an almost perfect adjustment of the property tax to the deferment of forest income, but it is rather complicated and difficult to explain.

The second plan, called the deferred timber tax, first separates land value from timber value and taxes the former under the ordinary property tax. The payment of the timber taxes, however, is deferred until income is received from the sale of timber. Thus deferred timber taxes are accumulated, without interest, as a charge against the property. Whenever any income is received the accumulated taxes are paid, but the payment is limited to an amount equal to a specified percentage of the gross income from the sale of stumpage. This portion of the gross stumpage value should be specified by law, should be large enough to cover the accumulated timber taxes under all but the most unfavorable conditions of income deferment, and will probably amount to from 30 to 40 percent.

Under this plan the owner of forest property is relieved of the excess burden of financing his tax payments. This burden is to be assumed by the State, which receives the money paid by the owners at the time of receipt of timber income and makes up the deficit from other sources. It might appear that this plan is similar to the yield tax because of the imposition of a 30 to 40 percent tax on timber when it is cut. This tax, however, is limited to the accumulated timber property taxes and is therefore not a yield tax. But it retains one of the most
important advantages of the yield tax; namely, tax payments is made contingent upon the receipt of income.

The third plan, called the differential timber tax, is a simple adjustment of the taxes on growing timber to typical conditions of income deferment. It consists of a flat deduction of 25 to 50 percent from the value of the timber; the rate, to be specified by law, depending upon the typical period between timber incomes. This plan represents a rough, but very simple, means of adjusting the property tax to the degree of timber income deferment.

These three plans were first explained by Professor Fairchild at the annual meeting of the Society of American Foresters at Milwaukee in December, 1933, where they were briefly discussed. They also came in for a good deal of discussion at the Conservation Conference called in Washington in January, 1934, by the Secretary of Agriculture on Article X of the Lumber and Timber Products Code. At that time the second plan, the deferred timber tax, was recommended by the Conference as the one best applicable to present conditions in most States.

In October, 1934, R. C. Hall, Assistant Director of the Forest Taxation Inquiry, went to the Pacific Coast at the request of the Governors of Oregon and Washington to help work out a practicable plan of forest tax relief for those two States. Here also the deferred timber tax proved to be the most popular. It was endorsed by the Taxation Committee of the Forestry Division of the Planning Council of both States, by the Western Forestry and Conservation Association, and by the Forestry Committee of the Portland Chamber of Commerce. The plan is also being considered by an Interim Committee of the Oregon Legislature on Forest Taxation. Bills are now being drafted in both States which would place all old-growth timber under the operation of a deferred timber tax. The fate of these bills in the current State Legislatures will be watched with keen interest by both foresters and lumbermen.

The Conservation Conference on Article X recommended that the Federal Government finance the deferred timber taxes in the form of a loan for a period of five years. This provision has also been requested by those endorsing the plan in Oregon and Washington. Federal, rather than State, financing is by no means necessary to the successful operation of the plan, but it is believed that the Federal Government may extend credit to the States for this length of time under Article X of the Lumber Code in order to encourage the adoption of the plan. In return for this Federal aid it is expected that better forestry practice—a matter of general public interest—will be obtained under the new tax system. The Forest Service has estimated roughly that the following amounts would
be required annually, under present conditions, to finance the deferred timber tax in the two States where it is under consideration:

<table>
<thead>
<tr>
<th>State</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oregon</td>
<td>$2,275,000</td>
</tr>
<tr>
<td>Washington</td>
<td>600,000</td>
</tr>
</tbody>
</table>

The enactment of a deferred timber tax law in Washington and Oregon would be an important forward step in forestry. Not only would it help the timber holders in the most important forest region in the United States, but it would set an example for other States to follow. On the other hand, too much must not be expected from even such an important move. The other necessary improvements in the administration of the property tax and of local government must also be instituted before a sound and equitable tax system may be obtained. Such improvements will necessarily come about slowly. Furthermore, even if the tax obstacle were totally removed, the widespread private practice of forestry would be far from assured. As noted at the outset, there are other obstacles, chief of which is probably the danger from forest fires. Sound measures for tax adjustment, however, should not await adequate fire protection and practicable forest fire insurance. Many large holders of forest land, who possess diversified fire risks, would be enabled to practice forestry if they were given assurance of a method of taxation designed to fit forestry.

Cut over pine land in the South.