

Statements for the Record:

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Federal Estate Tax: Uncertainty in Planning Under the Current Law November 14, 2007, at 10:00 a.m. 215 Dirksen Senate Office Building

“In a free society with private property rights and a market system, private property is a condition of functionality. Government intervention creates distortion.” -- Adam Smith
“Wealth of Nations.”

“When a society wants less of something they tax it: The estate tax is a tax on American capital... a tax on the economic mechanism that produces income. Do we truly want to reduce our means of income production in the United States?” -- Vernon Smith, Nobel Laureate, “U.S. Treasury Roundtable on the Estate Tax” 2003

Chairman Baucus, Ranking Member Grassley, Members of the Committee, on behalf of the Forest Landowners Association and the Forest Landowners Tax Council we thank you for the opportunity to submit this written testimony on the implications of the estate tax for almost 11 million U.S. citizens who are non-industrial private forest landowners. More specifically, the implications and opportunities non-industrial private forest landowners see for elimination or refinement of that onerous tax statute. Many of you have spent a lot of time on this issue and we in the forestry community appreciate it.

We are:

***J. Blake Sullivan** holds a Masters of Forestry from Duke University and a Bachelors of Business Administration from Columbus State University. He is Chair of the Governmental Affairs Committee, on the Executive Committee, a Board Member of the Forest Landowners Association. His other leadership experience includes a presidency with the Georgia Forestry Association, board chairmanship of the Georgia Forestry Foundation, and executive committee membership for the Coalition for Fair Lumber Imports. He was honored in 2002 with the Forest Landowners Association's Forest Landowner of the Year Award and in 2004 with the Wise Owl Award from the Georgia Forestry Association. Since 1986, he has served as the President and owner of Sullivan Forestry Consultants, Inc., a multi-disciplinary forestry consulting firm that provides forest management and real estate brokerage services for a diverse group of clients.*

***Henry Barclay** is the managing partner of Lehmann, Ullman and Barclay LLP which has been involved in timber related services almost since its inception in 1912. He attended Tulane University and was graduated from the University of Alabama. He is a frequent speaker and seminar leader on timber business and income and estate tax issues. Henry is a Board Member and Chairman of the Forest Landowners Tax Council and is*

Treasurer and a Board Member of the Forest History Society. He is immediate Past President of the Alabama Forest Owners' Association and contributes a quarterly tax review for their newsletter. He is a member of the Forest Landowners' Association, the Alabama Forestry Council, the American Institute of Certified Public Accountants, the Alabama Society of Certified Public Accountants and its Birmingham Chapter, the Birmingham Estate Planning Council and the Birmingham Tax Forum.

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America's non-industrial private forest owners -- who own 59 percent of America's forestland, including family farms -- are bearing more responsibility than ever before for the nation's environmental quality and sustainable timber production. However, the possibility of untimely timber harvests and disruption of established forest management programs due to federal death tax policy is becoming increasingly pervasive as timber and land values continue to rise. This trend is counterproductive to society's goals of sustainable forestry and environmental quality. Succinctly put, the Forest Landowners Tax Council position on the death tax is that it should be immediately and permanently eliminated.

The estate tax generates approximately 1.5 percent of annual federal revenues but affects persons of similar net worth in dramatically different ways. For example, an heir faced with a sizable estate tax bill who has inherited fairly liquid assets such as stocks or bonds will find it much easier to pay such bills compared to an heir who inherits relatively illiquid assets such as forest property, the sale of which could eliminate a family's heritage or result in a substantial environmental cost.

We are troubled by the arcane and misleading methods used by the Joint Committee on Taxation and by their failures to produce transparency in those methods. This concern includes but is not limited to a simplistic "scoring" of legislative proposals relative their effect on the U.S. Treasury, while ignoring those proposals' effects upon the U.S. economy as a whole. The results of what has been called their "static economic analyses" fail to account for our dynamic economy and the positive revenues that can be generated to the Treasury by leaving funds in that economy to multiply through capitalistic enterprise. Using a dynamic approach to scoring the elimination of the estate tax, in 2003 the CONSAD Research Corporation¹ calculated that rather than a net loss to the Treasury there would in fact be a net gain to the Treasury of approximately \$38 billion over a 10 period.

The estate tax provides a disincentive for heirs to retain their family forestland or to continue to sustainably manage their forests even if not sold. The federal estate tax can also cause an estate faced with a substantial tax bill to harvest timber in an environmentally insensitive way, disregard a long-term professional forest management plan, forfeit ownership, or parcel out portions of the property -- thus breaking up

¹ "THE EFFECTS ON GOVERNMENT REVENUES FROM REPEALING THE FEDERAL ESTATE TAX AND LIMITING THE STEP-UP IN BASIS FOR TAXING CAPITAL GAINS", CONSAD Research Corporation, 121 North Highland Avenue, Pittsburgh, Pennsylvania 15206, (412) 363-5500, July 16, 2003.

ownership, fragmenting forested landscapes, and encouraging alternative development patterns that often have negative impacts on the environment and forest management. This problem may become even more widespread in the near future, as about half of today's non-industrial private forest landowners are over the age of 60.

Nearly 11 million non-industrial private forest owners hold 59 percent of the nation's commercial forestland base. These landowners hold their forests for a variety of reasons including, but not limited to, recreation, wildlife habitat, preservation, timber production, and investment. Most do not rely on their forest property as a primary income source but often receive periodic economic benefits from forestland ownership. These lands provide 49 percent of the nation's timber supply and 53 percent of outdoor recreational opportunities.

In 2000 at a Forest Service conference on fragmentation of U.S. private forestlands, John Greene² (Law and Economics Research, U.S. Forest Service, New Orleans, Louisiana) brought data from the only research that has been done regarding the effects of the estate tax on forestland ownership. He said: "It appears that in about two-fifths of the cases where federal estate tax is due, timber or land is sold to pay part or all of the tax. A large fraction of these sales are forced, because other estate assets are not adequate to pay the tax. Ownerships forced to sell timber or land to pay the estate tax range from under 100 acres to several thousand acres of forestland, and average in the large size class. It appears that 2 million acres of forestland must be harvested and over 1 million acres must be sold each year to pay the federal estate tax. Of the acres that are sold, it appears that several hundred thousand each year are converted to other, more developed, uses." [*emphasis added*]

Co-author, Blake Sullivan, is currently working on an estate: "A widow died this past June and the farm owned by her family for over 50 years is now having to harvest timber to come up with money to pay the death tax. Her beneficiaries now become 'land rich and cash poor'. Since all of the cash is going to pay the death tax the family will be forced to sell land to produce income necessary to support the ongoing operations of the farm. The farm she dreamed of leaving her family will now be so much less than she ever envisioned. As the World War II generation dies off, our rural lands which have ingrained and supported American ideals and values are disappearing. Often the death tax is the single greatest force causing this change."

The federal estate tax provisions represent a great burden to many individuals who inherit forestland. The current law presents a difficult target for planning purposes. Also, heirs to a taxable estate have but nine months after the owner's death to convert timber and/or timberland assets to cash for estate tax payments; a relatively short-term response for a crop that ranges from 15 to 60 years to mature. In response to this substantial tax and short payment schedule, many heirs are forced to disrupt forest management programs, prematurely harvest timber, and otherwise engage in unsustainable forest practices that can degrade the quality of both the environment and the land, thus limiting future forest

² September 19, 2000, A conference entitled "Forest Fragmentation 2000: Sustaining Private Forests in the 21st Century" held in Annapolis, Maryland.

management options. The tax may also force the estate to subdivide or sell all or portions of the family land that might otherwise be managed in a sustainable manner, in order to meet the estate tax obligation. The conversion of forestland to other uses or the unsustainable harvest of its resources is of major concern to the American people and forest landowners.

Co-author, Henry Barclay, makes the following observation: “Most, if not all, forest landowners have tended their investment in land and timber well. Currently, those investments of land and timber are more valued than ever by society. However, to pay death taxes, many executors and beneficiaries find it necessary to interrupt their management plans by cutting timber early or by selling timberland. There are many instances of farms and forests that are damaged by this onerous tax. But, here's what we find most interesting: the repeal of the death tax is supported by about 70 percent of our fellow citizens, but some who oppose death tax repeal, for example Warren Buffet, have become wealthy from this tax by investing in life insurance companies which feed off of ordinary Americans’ fear of this devastating tax.”

The special use valuation provisions of the federal estate tax law are of little help to forest landowners. Although technically applicable to forestland and timber, they were written primarily to apply to agricultural production. The eligibility and valuation rules are largely incompatible with the reality of non-industrial forest management and can only be used by timber estates with the greatest of difficulty. For example, specially valued timber cannot be harvested for 10 years after the owner's death, even if required as part of an ongoing forest management plan or for salvage purposes because of insect, disease, or fire damage. Even for those forest estates that qualify, the current \$940,000 limitation on reduction below fair market value effectively excludes substantial acreages.

Quick Points on the Estate Tax:

- The estate tax brings in less than 1.5 percent of total revenues, and it is estimated that enforcement of the tax costs the federal government 65 cents for every dollar it raises.
- According to the Joint Economic Committee, in this century the estate tax has reduced stock of capital in the economy by \$497 billion, a 3.9 percent reduction (The Economics of the Estate Tax, December 19, 1998)
- Family businesses could better use their resources to modernize equipment, expand operations and create new jobs, rather than spend hundreds of thousands of dollars for lawyers, accountants and insurance to deal with the estate tax.
- A person who works hard, pays taxes along the way – both corporate and income taxes – and invests and saves money should not be penalized with a punitive tax at his or her death. Through this onerous tax the federal government is sustaining a public policy that undermines the fundamental principles that our nation supports – hard work, savings and fairness.
- Death should not be a taxable event.

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