Provincial and State Forestland Property Taxation Systems at Work

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Abstract:
The Canadian province of Ontario and the state of Idaho in the United States share many characteristics that are similar. As the forest tax systems in these jurisdictions are explained by the authors, comparisons will allow the reader to determine similarities with the forest tax system in their own state or province. Traditional valuation methodologies include the Ad valorem, productivity, site value and flat property tax systems. In some jurisdictions there are more than one of these property tax systems available for forestland owners to choose from. There are advantages and disadvantages to each. Property tax systems should be fair, neutral, administratively simple, and stable. They should efficiently provide revenues to support services to taxpayers without creating undue hurdles for forest management and production. Taxpayers should easily understand a property tax system. The tax system should also provide a stable source of revenue for the support of schools, roads, local government, and in some instances hospitals.

Many forest economists have presented their view of forest property taxation. This presentation will focus on the practical aspects of setting up and maintaining forest tax systems across the border affecting our one forest under two flags.

Keywords: Forestland Property Taxation Systems in the US and Canada
Introduction:

The objective of forest property tax programs is determined by the taxing jurisdiction as a component of the system designed to promote the management of privately owned forests and as a component of the broader property tax system. A balance between the ever-shifting influences of the economy, the resource and the political climate, make the efforts at administration of a forest property tax program particularly challenging. Programs should be designed to be fair, neutral (in terms of the management of the resource), administratively simple (to increase efficiency) and stable (for the planning purposes of the landowner and the taxing entity).

Two forestland property taxation systems are presented in this paper. One is from the State of Idaho in the United States. The second is from the Province of Ontario in Canada. The two forestland property taxation systems within these jurisdictions are very different in structure, administration and methodology. Both systems have been very dynamic. As this paper is being written, a discussion is taking place, which may shift the system of valuation in Idaho from a direct capitalization model to a yield model that is also referred to as a soil expectation or discounted cash flow model. In 2003, Ontario modified the valuation of eligible properties from a productivity-based system to a sales comparison of similar managed forest properties system. The approach is currently under review. Both of these taxation systems serve to produce revenue for the taxing authority that is used to supply the services required by the citizens that the taxing authority serves.

The Forestland Taxation System in Idaho:

Idaho, like the majority of the states within the United States uses a system that is termed “current use” valuation. The forestland is valued in a way that produces values used for taxation that are less than the values that would be developed through a sales comparison methodology. This makes assessments under the forest tax law attractive to forestland owners who often ask the county appraisal staff for the forms they need to fill out to get the “timber exemption”. Because of this contact with the landowner, an opportunity is created to obtain better management of the forest resources in private ownership than would otherwise take place. A forestland management plan is required to qualify for designation as forestland under the forest tax law. The landowner is required to obtain the forest management plan from a professional forester or the signature of a professional forester approving the plan written by the landowner. This process requires the forest landowner to become familiar with the resource they own. The answers to questions about forest insects and diseases, stocking levels and potential productivity assist the landowner in determining possible management options and the expectations they should have for their land. Equity in the forest tax system is obtained when landowners with similar land have the same tax liability.

There are two systems of valuation available to forestland owners in Idaho, if their total forestland ownership is between five and 5,000 acres in size. If their ownership is over 5,000 acres in size they must be in the “productivity option”. About eighty percent of the forestland, and about half of the forestland owners have their land assessed and taxed.
under the productivity forest tax option. In 2004 the value of these lands for taxation purposes was about $700,000,000. The revenue that was provided to local government, schools, roads, cemetery districts and hospital districts in the rural counties of the state was a little over $7,805,000. The balance of the land is in the “bare land and yield” forest tax option. These lands generated revenue of a little over $1,152,000 that served these same needs. Under the bare land and yield tax option forestland owners pay a yield tax of three percent of the stumpage value at the time of the harvest and they pay a deferred tax if the ownership or use of the land changes.

![Figure 1](image)

**Historic Timber Harvest**
**State of Idaho**

There was a rapid rise in stumpage values in Idaho in the early 1990’s when there was a sharp shift in the log supply in the state (Figure 1). This market change was a result of the rapid curtailment of many timber sales from the USDA Forest Service. Many mills lost their ability to stay competitive in this dynamic market and closed. Of the thirteen mills that have closed in recent years (almost half of those in operation at the time) a new mill, designed to cut lumber from small logs has reopened on one of the old mill sites. The new mill is doing well, cutting primarily 2X4’s and 2X6’s in 8, 9 and 10-foot lengths, primarily from Douglas-fir, grand fir, and western larch, with lesser amounts of lodgepole pine, western red cedar, western hemlock and Engelmann spruce. By 1994 stumpage values had stabilized in most of the state. The exception is Forest Value Zone 3 where only one mill remains in production and stumpage values continue to decline, (Figure 2).
There has been a significant effort on the part of a committee comprised of four forest industry representatives, one non-industrial forestland owner representative and five representatives from the ranks of county commissioners and assessors to consider a different valuation model in Idaho. The name of the committee is the Committee on Forest Taxation Methodology (CFTM). Through a series of meetings the variables in the proposed model have been discussed and analyzed. The impacts of the model on forestland values have been of major concern to the committee members. While the variables are still under discussion at this time, the committee has tentatively adopted a ten-year rolling average, ten-year Treasury Constant Maturity rate, adjusted for inflation, to establish a base rate of 4%. To this, a real price appreciation (RPA) for stumpage of 1% is added. The RPA has been developed from the Bureau of Labor Statistics dataset for Softwood Logs and Bolts. These rates in combination determine the guiding discount rate for the model. It has been suggested that these rates remain fixed for the first seven years of implementation to avoid extreme volatility in the model. Stumpage values and costs (two of the other variables in the model) will be allowed to move with market trends to maintain model sensitivity to the market. Rotation ages are likely to be fixed at 60 years for good productivity forestland, 70 years for medium and 70 to 80 years for poor. The new model (similar to the one shown in Figure 3) promises to provide values that are more stable than those created from the previous direct capitalization model. The direct capitalization model was more sensitive to changes in stumpage values and interest rates. By 1999 the previous model had produced tax loads nearly four times higher than those experienced in 1990. The increases in the tax loads were primarily the result of a similar increase in stumpage values during this period (Figure 2). Since the peak of nearly $6.00 per acre in 1999, forest tax loads have declined. If the new model is implemented the forest tax loads would be in the range of $3.50 per acre.
The Forestland Taxation System in Ontario:

The Province of Ontario has a total land area of 106.8 million hectares, of which 14.8 million hectares are privately owned. Of the total land base, 69.1 million hectares are forested, of which 6.8 million hectares are privately owned. Private forests account for approximately 14% of Ontario’s growing stock, including over 40% of the gross total volume of hard maple and nearly 50% of the gross total volume of other hardwoods. The total contribution of private forests could exceed 15% of the volume processed in Ontario.

The provincial government of Ontario protects and encourages the stewardship of privately owned forests through a framework for sustainability with both a regulatory and an incentive component. The regulatory component includes legislation that enables municipalities to restrict development in woodlands and discourage inappropriate harvesting practices. The incentive component promotes stewardship and offers property tax relief for eligible forested properties. Tax relief for forested properties is through the Managed Forest Tax Incentive Program (MFTIP).

Program background

The MFTIP was initiated in 1998 and has grown to include over 10,000 properties with over 700,000 ha (1.75 million acres). The objective of the MFTIP is to value forestland according to its current use and encourage stewardship. Managed forest properties are to be assessed based on their current use and taxed at a rate that is 75% below the municipal residential tax rate.

To be eligible for the MFTIP, the property must have at least four hectares (9.88 acres) of forest, be owned by a Canadian citizen and have an approved Managed Forest Plan. Landowners develop their Managed Forest Plan based on their interests and reasons for owning the property such as: enhancing wildlife habitat, providing recreational opportunities; protecting environmentally sensitive areas; and creating economic opportunities through harvesting forest products. The plan helps ensure that public benefits are realized from MFTIP. Management activities on properties in the MFTIP are
to be carried out according to “good forestry practices” as defined in the *Forestry Act*. The plan is approved by a private consultant accredited by the province as a Managed Forest Plan Approver. The cost of obtaining an approved Managed Forest Plan and the opportunity cost associated with managing according to “good forestry practices” can be significant. Landowners, who apply and qualify, have their property classified in the Managed Forest (MF) property class, as set out under the provincial *Assessment Act*.

**Assessment methodology**

In the MFTIP, the Province through the Ministry of Natural Resources (MNR) is responsible for program administration, eligibility requirements and ongoing program support. The Ministry of Finance (MOF) establishes the policy framework for property assessment and property tax in Ontario. The Municipal Property Assessment Corporation (MPAC) is the administrator of the assessment process and carries out the assessment policies that are established by the Province in accordance with the appropriate legislative and regulatory requirements.

From 1998 to 2003, eligible MFTIP properties were assessed using a subset of farmland rates, reflecting the productive capacity of the land and the value of the land for farming purposes. For farmland rates, variables such as soil quality, drainage, mineral composition and climate are factored into the valuation. Consideration is not given to sales of farms to persons whose principal occupation is other than farming. When the MFTIP was established, limited data was available on managed forests property land values and a subset of farmland rates were used as a proxy for the valuation of managed forests. Through ongoing sales analysis, it became evident to MPAC that the values of managed forests and farms had not kept pace with each other. Sales data confirmed that market valued managed forest properties differently than farms.

Beginning in 2003, MPAC changed valuation procedures for the MF property class such that the assessed value would be based on a sales comparison of other managed forest properties in an area (i.e., the farm land rate proxy would no longer be used). Aggregate analysis conducted around the time of the change in valuation procedures found that for 2003, managed forest properties experienced an average tax of $168 per property. The average value of the MFTIP incentive was $501. The average annual property tax bill in 2004 for a managed forest property is close to $230. The average value of the MFTIP incentive is estimated to be $696. Higher assessments and associated taxes were found in near urban areas and in proximity to recreation areas.

**Program status**

As a result of the change in valuation procedures, MNR received an application for review from the Environmental Commissioner’s of Ontario (ECO) requesting a review of the MFTIP. The ECO is Ontario’s independent officer of the Legislative Assembly who reviews and reports on the government's compliance with the *Environmental Bill of Rights (EBR)*. The *EBR* is legislation that recognizes the people of Ontario have the right
to participate in government decisions about the environment and the right to hold the government accountable for those decisions.

The applicants alleged that the change in valuation procedures would lead to significant environmental harm. MNR and MOF were involved in the review and could not conclude that the change in assessment methodology for managed forest has resulted in, or could result in harm to the environment. The report recognized that each landowner has his or her own circumstances, interests and ability to support the carrying cost for their property. An amount that appears inconsequential to one landowner may impact another significantly and result in efforts to sell or sever land or practice poor forest management practices, such as heavy cutting, to produce income. Ontario continues to rely on the regulatory component of the sustainability framework (i.e., enabling legislation to allow municipalities to restrict development in woodlands and discourage inappropriate harvesting practices) to protect woodlands. The Ontario government is committed to maintaining the MFTIP and working with private landowners on program refinements and is currently deliberating the best method to assess properties in the MFTIP.

For additional information on the MFTIP and private land in Ontario, visit http://ontarioforests.mnr.gov.on.ca.

Comments from the Administrators:

The objective of forest property tax programs is determined by the taxing jurisdiction as a component of the system designed to promote the management of privately owned forests and as a component of the broader property tax system. Forest property tax programs are a highly visible expression of the societal importance placed on private land forests and directly benefit the landowner by reducing their property tax burden.

Both Idaho’s and Ontario’s forestland property taxation systems, while different in structure, administration and methodology have been dynamic and recently subject to transition. In Idaho, it is anticipated that the shift from a direct capitalization model to a soil expectation model will be more stable in determining forestland values. In Ontario, it is hoped that further deliberation will move the Province towards the assessment of privately owned forests that will recognize the current use of the properties and better encourage stewardship of these lands now and into the future.

Forestland taxation systems will continue to respond to conditions created by the ever-shifting influences of the economy, the resource and the political climate. With that fact in mind it is useful to remember an anecdote shared by one of the folks who worked on the Idaho forestland taxation changes: “Don’t tax thee, and don’t tax me, tax the guy behind the tree.” After considering some of the details of the forest tax systems discussed in this paper the reader may remember similarities they have seen in the forest tax system in their state or province. It may also be obvious from this discussion that there will likely be changes in their system of valuation in the near future.