

Forest Stewardship

Estate Planning

Is the future of your family lands secure? If you own forestlands, you probably want them to remain in the family and be cared for and enjoyed by your heirs. All of us recognize that forest stewardship is future oriented; many landowners view their property as a legacy for their descendants. Without a well-designed estate plan, however, your good intentions might leave your family with little more than an overwhelming tax burden. It used to be enough simply to will the property to your heirs, but that may no longer be sufficient. Today's rising land values, combined with state and federal estate and inheritance taxes, can make it difficult for heirs to follow through on the objectives of their benefactors. Here is a hypothetical but realistic example of what can happen.



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Bob Wood and his wife, Sue, owned several hundred acres of Bob Wood and his wife, Sue, owned several hundred acres of hardwoods bordering a state highway and state forest. In part because the land had become a prime site for residential development, the value of the property (land, improvements, and timber) was assessed at \$2 million in 2008. This surprised the Woods because they paid less than \$200,000 for the land in the 1950s.

They wrote their will, leaving the jointly owned property first to each other, and then bequeathing it to their son, John. Their belief was that, after they both died, John would take over and the land would be safe. They knew that John would want to keep the land in forest and probably live in the family home. Bob died first, leaving the property to Sue. When Sue died, the property went to John. Later that year, John received notice that he owed a combined federal and state inheritance tax of \$179,800. Because there was no large cash component in his inheritance, and because federal rules require payments within nine months, John had no choice but to sell the land quickly to pay the taxes.

The land had been assessed for its potential development value, and that value was realized. John both lost the land and watched it become single family lots almost overnight. His parents' good intentions were not enough to allow him to keep the land they all valued so much. To make matters worse, John had to pay both federal and state income taxes on the money he received for the land. A well-designed estate plan would have ensured that the Woods' land was passed down intact and without a heavy estate tax burden.



In 2001, the federal government passed the Taxpayer Reconciliation Act, which raises the maximum personal exemption from federal estate taxes from \$1 million to \$3.5 million in 2009. In 2010, the tax is repealed and reappears in 2011 at 2001 levels.

Estate Planning

Proper estate planning is the key to avoiding the kind of inheritance nightmare John Wood faced. This bulletin outlines the procedures necessary to create an estate plan that will ensure the orderly transfer of your cherished forestland, intact and with a minimum tax burden. To protect all that you have invested in the stewardship of your lands, it is critical that you take this additional, future-oriented step. Estate planning is complicated, however, and involves many different skills, some of which you will need help with. This bulletin also provides advice on how to assemble a strong estate planning team.

The first thing to do when planning your estate is to prepare an inventory of all of your assets—real estate, other personal property, cash, insurance policies, stock, and so forth. Remember that all of these items will be counted as part of your taxable estate.

Next, identify your goals for the future use and disposition of your property. Your goals might include protecting the forested, undeveloped condition of the land you enjoy; managing it for timber; and/or providing financial security for a spouse or other heirs. Planning *early* increases the potential for all of your goals to be met. Taking a “wait and see” attitude can be risky. It is important to discuss goals with family. For example, ask what happens to the forestland if no estate plan is made.

An estate plan does not diminish your current options for the property, but rather provides a basis for good decision making and ensures future security. An estate plan can be changed, to some extent, at any time.

It is better to have a plan and change it than not to have one at all.

Who Should Be Involved in Developing Your Estate Plan?

Unfortunately, the estate planning process can be a do-it-yourself venture only in unusual cases. Most landowners will have to involve several parties and recognize that there will be some initial expense; however, the costs are minimal in comparison to the possibility of losing the family lands. You can reduce the initial outlay by becoming familiar with the process of estate planning and doing some of the work yourself. In addition to those who will be your heirs, a good team includes your family attorney (see sidebar, page 4), an accountant who specializes in estate planning, an insurance agent, a forester or natural resource specialist, and possibly a representative from a local conservation organization or town planning board. Such a combination ensures that the needs of everyone involved will be addressed.

The rationale for involving a member of the local planning board is not to constrain your options, but to recognize that your property can be subject to many external pressures. For example, your property might be seen as prime development land by some. The planning board member can help you and your heirs anticipate future pressures and account for them in the estate plan. Not all parties will agree on all issues, but you should remember that the final decisions rest with you.



Securing the Future

Federal inheritance taxes apply only if your taxable estate is worth more than \$2 million in 2008. However, Pennsylvania inheritance taxes apply for estates over \$3,000. Do not assume that your land's value is low. Today's fair market value on land, improvements, and timber can be surprising. Getting your property appraised is a necessary step in the estate planning process. A complete appraisal includes physical inspection of the property, research of deeds and local land use regulations, a complete investigation of market conditions applicable to this type of land, and a determination of value. Be sure that the appraiser has the credentials to do a fair appraisal of forestlands and has no conflict of interest, such as an interest in selling the property to developers.

You have several options for ensuring that your estate transfers smoothly, painlessly, and intact. For example, you can gift the land a little at a time to your heirs, arrange for all or part of the land to be protected through a conservation easement, or give the land to a charitable organization. A combination of these options might be the best way to meet your goals. Each of these methods, along with its associated benefits and limitations, is outlined below. For more information see the references on page 5.



Lifetime Giving

One option to ensure that land stays in the family is the annual "gifting" of parts of the property. According to the Internal Revenue Service code, each owner of the property can give cash or the property equivalent of \$12,000 to any number of individuals each year without federal gift taxes being applied. If the property is owned jointly by two or more people, each person can give away this amount each year with no maximum limit on the number of recipients.

Before giving land to your heirs, be sure to assess their ability to continue paying the property taxes. Once the property has changed hands, it cannot be included in the taxable estate. Control of the land is an important issue, however. If the "transferor" (the "giver") retains control or use of the land, it may be seen as an incomplete gift. In that case, there would be no estate tax reductions, because the land still would be counted as part of the estate.

Lifetime giving does *not* ensure that the land remains undeveloped, unless it is accompanied by a conservation easement or some other land use restriction. It only puts off decision making for a generation.

Conservation Easements and Restrictions

Conservation easements and restrictions are a versatile way to both protect your current use of the land and maintain the open-space character of that land in perpetuity. A conservation easement is an agreement between you and a nonprofit conservation organization or government agency. It can be granted or sold to the organization. An easement allows you to continue to own the land, but places restrictions on its current and future use. It also vests oversight responsibility in the easement holder. Easements usually apply in perpetuity. Even when the land is sold, the easement continues on the designated property and transfers with the deed.

An easement may provide substantial tax benefits. Estate assets are reduced by the easement value, and when the easement is donated, the landowner can deduct up to 30 percent of the easement value each year for 5 years. An easement typically lowers the property value, sometimes reducing property taxes. This reduction might be a further incentive to grant an easement on your property.

Easements do not necessarily preclude all future development you might choose to pursue. Easements can be written very specifically to allow a limited level of development, beyond which restrictions apply. Public access, active forest management, or a total set-aside can be parts of an easement. A common misconception is that open recreational access is a necessary part of an easement; this is not true. It is, however, one option to be considered.

Conservation easement agreements must cover restrictions on use; rights reserved by the landowner; and who is responsible for holding, inspecting, and enforcing restrictions. The agreement must be filed with the county in which the land is located. This allows future owners or potential buyers to access the information contained in the agreement. Of course, the responsible organization and you should also retain copies.

Nonprofit conservation organizations are subject to economic forces that occasionally lead to their demise. It is a good idea to consider this in the easement process. The agreement must make clear what the fate of the easement would be in the event that the organization ceases to exist. You might want to specify a "backup" organization. By doing so, you can ensure that one will assume responsibility if another loses legal identity. Under Pennsylvania practice, a court of competent jurisdiction, usually Orphan's Court, will assign the easement to a similar organization if no other provision applies. Another option is to develop a plan to pass the easement on to a public agency if the organization fails.

QUESTIONS TO USE WHEN CHOOSING AN ESTATE PLANNING LAWYER

Estate planning for forest landowners is unique. Choosing a lawyer to assist in the process requires special considerations. The following questions are designed to help you assess the candidate's knowledge of estate planning as it relates to forestland.

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| Q. How is form "T," Forest Industries Schedules, used to formulate adjusted <i>basis</i> and depletion of timber lands? | A. Schedule "F" of Form "T" provides a series of questions that establishes depletion or adjusted basis.

NOTE: Basis is essentially a calculation of "book value" for the land. |
| Q. What is "Special Use Valuation" and how does it apply to forest ownership? | A. Special use valuation is a special provision within the Federal Tax Code that allows an estate to be evaluated by its present use rather than the highest and best use, which is normally used. Under certain circumstances, forest estates can be appraised for timber growing use rather than for potential development use, thus reducing the value of the estate and estate tax liability. |
| Q. Who is the consulting forester you have worked with in other estate planning endeavors? | A. Although the answer may include several foresters, you should expect the lawyer to have a working relationship with a capable and trustworthy forester. |
| Q. What is a "Conservation Easement"? | A. It is an agreement between a landowner and a conservation organization or public agency that restricts the use of the property in perpetuity, to keep the land in forest use. |
| Q. When a conservation easement is passed to a legal recipient, how many years does one have to use up (carry forward) the value in tax deductions? | A. Fifteen years. |
| Q. What is a "Remainder Interest"? | A. The act of making a gift now to take effect at the time of death. |
| Q. At what estate value must one begin being concerned about federal estate taxes? | A. In 2013, estates of \$5 million or more were subject to federal estate taxes. This exclusion is now set permanently and is indexed for inflation. |

OTHER QUESTIONS TO ASK

- Q.** How many estate plans have you prepared for nonindustrial private forest owners?
- Q.** What is your fee schedule?
- Q.** How will you determine what my interests and objectives are? (It is important that you choose a lawyer who has *your* interests and objectives in mind.)
- Q.** Can you provide three nonindustrial private forest landowner references who have received estate planning services from you? (You should contact these references for recommendations.)

Other Tax Benefits

If property is owned jointly, the owners have the option of providing for a trust in the will. Let's say the estate is worth \$3 million in 2002 and one owner dies first. If \$2 million worth of the estate goes into trust, or to the heirs at that time, then the remainder is worth \$1 million. This allows the surviving owner a greater chance of giving enough to keep the estate value below the estate tax threshold (\$1 million). Although trusts are not fully explained here, they also are a useful tool in this process. Be sure to ask your advisers about them.

As mentioned above, giving the property in advance of the death of the owner eliminates any estate tax from that part of the property. This may be of little interest, however, if you have no children or family to whom you wish to give the land. In this case, if you wish to keep the land in forest use, a charitable contribution or bargain sale may be appealing. This can provide tax benefits as well.

Charitable Contributions and Bargain Sales

Property can be sold at a “bargain price,” which is some fraction of its actual market value. This type of sale is considered by the IRS to be partly a sale and partly a gift. If property is sold for 50 percent of its value, then 50 percent will be considered a gift. Income from the sold portion may be subject to income tax, while the gifted portion may be subject to gift taxes. This can be an effective way to transfer the title of some or all of your property without excessive estate taxes. Careful calculation is crucial.

Conclusion

Part of good stewardship is casting an eye to the future. Remember that forests are “our link to the past, our legacy for the future.” Dealing with our own mortality can be difficult, but it is reassuring to know that we can see to the long-term care of our land. If you do not already have an estate plan, please start developing one today. There are plenty of resources available to help you, but you must take the first step. Your heirs and fellow stewards will thank you.

MORE INFORMATION

Estate Planning Opportunities for Private Forest Landowners

by Michael G. Jacobson and John C. Becker. 2002.

Available from the National Timber Tax Website,

timbertax.org.

Small, Stephen J. 1997. *Preserving Family Lands I and II*. Available from the Landowner Planning Center, Boston, MA, phone: 617-357-1644.

Information on conservation easements is available from your local land trust or contact the Land Trust Alliance, 1331 H Street NW, Suite 400, Washington, D.C. 20005, Website: **lta.org**, phone: 202-638-4725.

The National Timber Tax Website (**timbertax.org**) provides tax management information for timberland owners.



Prepared by Michael Jacobson, professor, and Michael Washburn, graduate research assistant, Penn State. Attorney questions developed by Lloyd Casey, United States Forest Service, Radnor, Pennsylvania. Legal review provided by The Natural Lands Trust, Media, Pennsylvania, and The Western Pennsylvania Conservancy, Pittsburgh, Pennsylvania. Cover illustration by Doug Pifer.

Illustrations on pages 2, 3, and 5 by Heidi Smith.

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Penn State College of Agricultural Sciences research and extension programs are funded in part by Pennsylvania counties, the Commonwealth of Pennsylvania, and the U.S. Department of Agriculture.

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This publication is available in alternative media on request.

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Produced by Ag Communications and Marketing

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Code UH105 4/14pod

The Forest Stewardship Program is administered nationally by the USDA Forest Service and is directed in Pennsylvania by the DCNR Bureau of Forestry with assistance from a statewide steering committee. The Forest Stewardship Program assists forest landowners in better managing their forestlands by providing information, education, and technical assistance. For more information about program services, contact the Pennsylvania Forest Stewardship Program, DCNR Bureau of Forestry, PO Box 8552, Harrisburg, PA 17105-8552; phone: 717-787-2160. For more information about publications, contact the Pennsylvania Forest Stewardship Program, Department of Ecosystem Science and Management, 416 Forest Resources Building, University Park, PA 16802-4705; phone: 800-235-9473.

