

The Effects of the Federal Estate Tax on Nonindustrial Private Landowners*

Tamara Cushing¹, Steve Bullard², John Greene³, and Ted Beauvais⁴

Abstract

The federal estate tax is designed to tax the transfer of accumulated wealth at the death of the taxpayer. Between 1987 and 1997, the estate tax was as high as 55% of assets above \$600,000. Timber and land values have increased significantly in many areas of the U. S. in recent years, and in some circumstances heirs liquidate timber, or sell or develop portions of inherited timber and agricultural lands to pay federal estate taxes. To better understand how the estate tax is affecting timberland owners, a survey was conducted of members of the Mississippi Forestry Association in 1998. Survey questions involved estate values, and estate tax liabilities that were incurred between 1987 and 1997. Respondents were asked if it was necessary to harvest timber, or to sell land from the estate to pay federal estate taxes. Responses were obtained from 1,385 people (a 66% response rate). Of the 1,385 respondents, 192 had been involved in an estate between 1987 and 1997. Forty-five percent of the estates exceeded the \$600,000 exemption; 12% of the estates exceeded \$3 million and were taxed at the highest marginal rate. Thirty-four percent of the estates paid federal estate taxes. Almost 10% responded that timber was harvested to pay federal estate taxes.

INTRODUCTION

There has been a lot of discussion about whether the federal estate tax has an impact on nonindustrial private landowners. Many case studies have been conducted showing the potential impact of the estate tax on a hypothetical landowner. Mississippi State University and the USDA Forest Service are collaborating on a study of the current and potential impacts of the federal estate tax on nonindustrial private forest and agricultural lands in the United States.

An increasing number of landowners are subject to the federal estate tax. There are three reasons for this increase. First, land and timber values have been increasing due to urbanization and increases in timber prices. Second, from 1987 to 1997 an estate could pass \$600,000 tax-free through the use of the unified credit. During this time, there was no indexing for inflation. Finally, tax provisions that were intended to help landowners are difficult to use.

There are two viewpoints on whether estate taxes are a problem. Advocates of the estate tax cite figures from the Internal Revenue

Service that show less than 2% of adult deaths result in a taxable estate. Opponents of the estate tax point to the number of small businesses that fold each year because of the estate tax. It is important to understand the effects of the federal estate tax on landowners because of the potential for a large transfer of forestland in the next 20-30 years. This study was designed to evaluate the effects of the federal estate tax on forest lands from 1987 to 1997. More information on this study is available in Cushing (1999).

METHODS

The survey instrument was developed in the spring of 1998 with input from the USDA Forest Service, the Mississippi State University Social Science Research Center, and faculty at Mississippi State University. A pilot test of members of the Mississippi Forestry Association was conducted. The total design method was used in all phases of survey design and implementation (Dillman 1978). The instrument contained fourteen questions focusing on the amount of the taxable estate and methods used to pay federal estate taxes.

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¹ Forest Economist, F & W Forestry Services, Inc., P.O. Box 3610, Albany, GA 31706-3610, former graduate research assistant, Mississippi State University.

² Sharp Professor of Forest Economics, Forest and Wildlife Research Center, College of Forest Resources, Mississippi State University, Mississippi State, MS 39762.

³ Research Economist, Forest Resource Law and Economics Research Unit, USDA Forest Service, Southern Research Station, New Orleans, LA 70113.

⁴ Natural Resources Planning Specialist in Cooperative Forestry, State and Private Forestry, USDA Forest Service, Washington, DC, 20090-6090.

Surveys were mailed to 2,129 Mississippi Forestry Association members who were classed as “individuals”. Of the 2,129 surveys mailed to members, 41 of the surveys were ineligible because the survey was undeliverable or the member was not an individual. A cover letter stated that the survey was confidential. Follow-up surveys were mailed in late July and mid-August. All surveys were individually coded to maintain confidentiality. Each landowner’s name was cross-referenced to a code corresponding to the organization and the landowner.

The targeted respondents for this survey were landowners who were “involved” in the estate of a nonindustrial private landowner during the period of 1987-1997. Landowners who had specific knowledge of the estate were considered involved in the estate. Most of the responses were for estates in Mississippi, however, some estates were reported for other states.

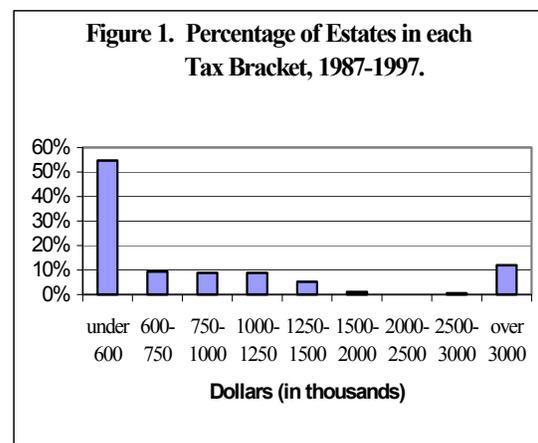
All responses were entered into a spreadsheet by the number coded on the questionnaire. Responses were grouped by the answer to the question: “*What was the value of the taxable estate?*” Descriptive statistics were calculated on the responses.

RESULTS AND DISCUSSION

A response rate of 66% resulted from the 2,088 questionnaires that were sent to individual members of the Mississippi Forestry Association. Three of the respondents had information on more than one estate; these respondents completed one survey for each estate. These “extra” surveys were not included in calculating the response rate, or in calculating the percentage of respondents who had knowledge of an estate. These responses were only included in calculating acreages, values, and taxes paid. Of the people who responded, 14% had been involved in the estate of a nonindustrial private landowner during the period of 1987-1997. Respondents that had not been involved in an estate were instructed to return the survey but not to fill out the remainder of the questionnaire. The respondent’s relationship to the decedent ranged from spouse or child to the decedent’s accountant, lawyer or forester.

Value of the taxable estate. Respondents who had been involved in an estate were asked to indicate the value of the taxable estate by choosing from ranges that corresponded to the

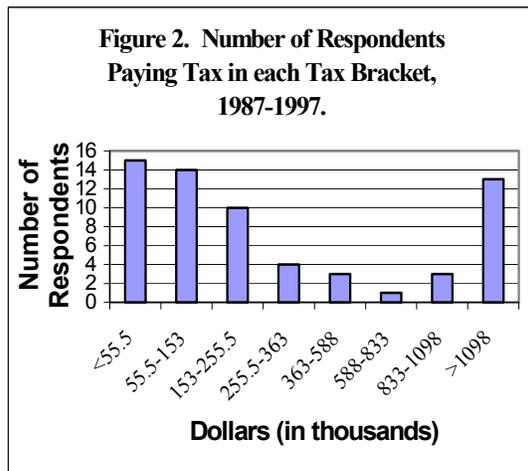
tax brackets for the federal estate tax. Almost 55% of the respondents (105 responses) indicated a taxable estate value less than \$600,000. Because the estate had a value of less than \$600,000, no federal estate tax was due. Twelve percent (23) of the respondents reported a taxable estate in excess of \$3 million. This was the highest tax bracket (55%) for the federal estate tax during this period. Figure 1 shows the percentage of estates in each tax bracket, 1987-1997. The Internal Revenue Service reports that less than 2% of adult deaths result in a taxable estate. In contrast, this study shows that almost 46% of the forest landowners’ estates in this study were subject to the federal estate tax between 1987 and 1997.



Amount of tax paid. Respondents were asked to indicate the amount of tax paid on the estate by choosing from ranges that corresponded to the tax brackets for the federal estate tax. Of 185 responses to this question, 34% (63) paid tax. The amount of tax paid ranged from one dollar to over \$1,098,000. Figure 2 shows the number of respondents paying tax in each tax bracket, 1987-1997. A total of 122 estates reported paying no tax. Twenty-five of those estates had a taxable value of over \$600,000. Of the 12% that indicated a taxable estate in excess of \$3 million, only half paid taxes in that bracket. No explanation was provided as to how the estate reduced or avoided taxation.

Method of payment. Respondents who indicated that an estate tax was paid were then asked how those taxes were paid. The questionnaire described five payment scenarios and the respondent was asked to indicate the appropriate scenario(s). Of the 63 estates that

paid taxes, 73% used assets other than land or timber to pay the tax. Some respondents commented that insurance proceeds or loans were used instead of harvesting timber. Almost 10% responded that timber was harvested to pay the tax. Approximately 14% (9) of the respondents indicated that the estate had used other assets *and* harvested timber or sold land. The responses to this question do not necessarily indicate that the timber had to be harvested because no other assets existed, just that timber was harvested and the proceeds were used to pay the tax.



Number of acres sold or harvested. Respondents who indicated that timber was harvested or land was sold to pay the tax were asked to report the number of acres that were affected. Of the nine respondents who indicated that timber was harvested, five reported that timber was clearcut. The total acreage of clearcuts for the five respondents was 1,355 acres. Another four respondents replied that 1,444 acres were thinned. Three respondents indicated that land was sold to pay the tax. The total amount sold was 270 acres. Meanwhile, all survey respondents reported a total of 223,266 acres.

Use of professional estate planning services. The final question asked whether the decedent had used professional estate planning services. Of the 197 responses to this question, 50% had not used professional estate planning services. Seven percent (14) did not know if planning had been done. Many respondents commented that some providers of the estate planning services

had either given bad advice or over-charged the client.

THE NEXT STEPS

The information generated from this pilot study was used to refine the survey instrument for a national study. The national study is currently being conducted with a sample of members of the National Woodland Owners Association, the American Tree Farm System, and a random sample of landowners throughout the United States.

CONCLUSION

Estate taxation is an area of concern for landowners and foresters throughout the United States. Forty-seven percent of Mississippi Forestry Association members involved in an estate reported estate values over the \$600,000 exemption in effect from 1987 to 1997. Almost 10% of the respondents indicated that timber was harvested to pay federal estate taxes.

In 1997, Congress passed the Taxpayer Relief Act of 1997. This act provided some relief in estate taxation. The unified credit will gradually increase from 1998 to 2006 when taxpayers will be able to pass up to one million dollars tax-free. Another provision in the Taxpayer Relief Act of 1997, allows qualified family-owned businesses to exclude up to a total of \$1.3 million from the estate. The \$1.3 million exclusion includes the unified credit equivalent (\$650,000 in 1999). As the unified credit equivalent increases, the amount of the family-owned business exclusion will decrease so that at all times the family-owned business will receive a total of \$1.3 million worth of exclusions. If landowners can qualify for the family-owned business exclusion, it could significantly reduce the impacts the estate tax has on nonindustrial private landowners. The increase in the unified credit will allow landowners to pass more of their assets tax-free, but this study showed 12% of the reported estates had taxable values in the highest tax bracket. Once the unified credit reaches one million in 2006, more than 27% of the estates included in this study would still have a taxable estate over the unified credit amount.

Many of the estates in our survey had not had professional estate planning. Landowners should be encouraged to have their property appraised on a periodic basis. Those landowners who are approaching the exemption amount should be encouraged to seek professional planning help. Planning is a must

for landowners to be able to maximize available tax benefits.

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