

The Four Seasons

The Newsletter of Dwight L. Stewart, Jr. & Associates LLC

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HOT! HOT! HOT!

The housing market continues into mid-2004 as a mainstay of the U. S. economy. Although housing starts were down slightly, attributed somewhat to a rise in loan interest rates, they remained ahead of last year's numbers. While interest rates are still expected to increase modestly throughout the remainder of the year, new home construction is expected to stay strong.

REPORTING A TIMBER CASUALTY LOSS

For forest landowners, our lives will be forever dated by Hurricane Hugo, which occurred 15 years ago this September. Many of us assumed that Hugo would be the storm of a lifetime. However, the January 2004 ice storm cut a broad swath across South Carolina, damaging or destroying many forests that were established after Hurricane Hugo. Salvage of ice storm damaged pine has for the most part ended. While many tracts of timber were damaged, those that received 25% damage or less were not salvageable because of the economics of harvesting.

Timberland owners may be eligible for a timber casualty loss. Usually, the deduction should be claimed for the tax year in which the casualty occurs. If an area is designated by the President of the United States as a disaster area, a deduction can be claimed in the year before the year in which the loss occurred. South Carolina was designated as a disaster area after the January 2004 ice storm. The amount of any gain or loss from a timber casualty is determined in the same manner as for timber sales in general. However, the amount of gain or loss is reported as an involuntary conversion, a section 1231 transaction. A presidential declaration of disaster also extends the period which a landowner may avoid paying capital gains taxes on any gain realized as a result of casualty event. If the salvage income exceeds the landowner's adjusted basis, then the resulting gain is taxable unless the landowner invests the gain in replacement property within two years. A presidential declaration extends this period to 3 years.

The amount of loss is limited to the adjusted basis in the timber, minus any income from salvage. For many landowners, the adjusted basis will be much less than the current fair market value. Generally, the change in fair market value of timber damaged or destroyed is the value immediately before the casualty and immediately after the casualty.

Landowners should contact their tax advisors for information on possible casualty loss deductions. A good web site is www.timbertax.org.

LAWSUIT RECEIVES CLASS-ACTION STATUS

According to published reports, a federal district court judge in South Carolina has granted class-action status to a lawsuit filed by several South Carolina landowners who claim that International Paper Company's Quality Supplier Timber Procurement Program included anti-competitive practices such as price fixing that caused the landowners to lose timber revenues. The landowners claimed that IP dictated stumpage prices that quality suppliers could offer to landowners. That lawsuit was filed in October 2002.

Even though the judge's class-action ruling did not come with an automatic appeal right, IP is filing a motion with the 4th Circuit Court of Appeals in Richmond, VA, asking for the right to appeal the judge's ruling.

IMPROVED TREES IMPROVE THE YIELDS

In a project that began 50 years ago, researchers have

there are more chances to find trees that have qualities that make them valuable for forest products.

Researchers began the painstaking process of breeding better loblolly trees by selecting the best looking trees in natural stands. Trees without twisted and knarled branches and those that seem to be growing faster and bigger than their surrounding trees were selected. Cuttings from these trees were grafted onto root stock in a seed orchard. Breeding them occurs by collecting seeds from these trees and then pollinating them with each other.

After 4 to 8 years, seeds are collected and the resulting progeny show whether a mother tree is better genetically or looks better in the field because of some environmental factor. The goal is for trees to be faster growing, with much cleaner form, having fewer branches and smaller branches and a flatter branch angle. These improved trees are better for both lumber and for pulpwood.

Some nurseries, such as those owned by International Paper, can match tree families to sites. For instance, tree families that will perform well on wet sites can be identified. Results have shown that matching seedlings to the type of site on which they will be planted can increase growth.

WILL A CONSERVATION EASEMENT HELP YOU?

Life is about change and change takes place in every part of our lives. In the Southeast, population increases in many urban areas around big cities and along coastal areas have increased. We have seen land ownership patterns change as the number of farms and farmers have decreased and as large forest products companies have divested themselves of millions of acres of timberland holdings. These holdings, once thought to be a bedrock of timber supply, have been fragmented and in some cases, the new owners no longer own these tracts strictly for timber production.

Growth from urban areas and population centers has put pressure on surrounding lands that were at one time considered to be rural. Land values have continued to escalate in most areas, and the family owned farm that was once a modest investment is now a valuable asset.

Suppose, however, you are more concerned with leaving your property intact for your family or suppose you want to be able to maintain your property as an undeveloped area. Is there anything you can do?

The answer is, "Yes," and one mechanism to accomplish your goal is a conservation easement.

What is a conservation easement? A conservation easement sets apart the right to engage in certain types of land use. These restrictions can be an array of uses, such as intensive development or any other activity that you may want to restrict. Activities covered by the easement may be exercised only by the holder of an easement. However, the property owner continues to own title to the land and can use it for limited purposes that do not interfere with the easement.

A conservation easement can include almost any kind of restriction agreed to by the landowner and the easement holder. Conservation easements should be specific to the protection needs of a particular piece of land. The conservation easement is a legal document and is a signed contract between the landowner and an eligible donee organization, such as a land trust or a government agency. The easement is enforceable against the landowner and against any future owner of your land.

Tax rules state that you "give" the easement to a donee organization. However, you are not really giving the donee organization anything valuable in the usual sense of the word. A conservation easement simply extinguishes some development rights, terminating them and restricting their use forever. The easement gives the donee organization only the right to enforce these restrictions on your property.

Although the legal name is a conservation easement, the usual definition of an easement allows someone else to use your property. For instance, a utility company may have an easement across your property for a power line or a neighbor may have an easement across your property to use a road to adjoining property. However, it should be understood that a conservation easement is something different. A conservation easement is a restriction on the use of your land.

There are federal tax rules that must be followed for a conservation easement to be valid for tax purposes. First, you must restrict the use of the land. Very importantly, this restriction must be **perpetual** and the restriction must be enforceable under state law. Second, the restriction must be given to a donee organization that is eligible to receive it, such as a land trust or a government agency. The donee organization does not get anything that it can sell or anything that it can transfer to some other property. As mentioned above, the easement extinguishes most or all of the development rights and terminates them forever.

Third, the conservation easement must protect some significant conservation value or benefit. This may include protection of open spaces or wildlife habitat. The easement may also include the preservation of an area of historic importance or a certified historic structure.

Needless to say, restricting the use of your property for future generations is not a decision that should be entered into without considerable thought and research.

According to tax rules, a person "donating" a qualified conservation easement may deduct the appraised value of the easement from their adjusted gross income, provided that the deduction does not exceed 30% of their adjusted gross income in the year of a gift. Any excess balance of the deduction may be carried over for up to 5 succeeding years, subject to the same annual 30% limitation. (IRC Section 170).

The appraised value of the easement is the difference between the value of the land with the easement and without the easement.

The easement can affect estate taxes. Section 2031(c) allows

executors to exclude from federal estate tax the value of the land encumbered by a qualified conservation easement. The law also allows beneficiaries to exclude from the taxable estate 40% of the value of the land subject to qualifying conservation easements.

Section 2031 also provides that an executor or trustee can elect to donate a qualified conservation easement after the death of the decedent, thereby reducing the value of the land subject to the estate tax and allow the estate to be eligible for the section 2031 (c) exclusion.

DOES EVERY TRACT QUALIFY?

In his book entitled Preserving Family Lands: Book 3, Stephen J. Small provides some basic information and rules. Mr. Small is an attorney and has written several books on preserving family lands. Mr. Small cites an example that he received from a real estate developer who said, "I have an approved subdivision plan. There are wetlands on the property, and I can't build on the wetlands. Can I put a conservation easement on the wetlands and take a big income tax deduction?"

Mr. Small's answer to the first question was that a conservation easement could probably be placed on wetlands. Wetlands have an important environmental value. The answer to the second question regarding the income tax deduction was more complicated. For instance, if you could put 40 house lots on a farm, but instead you donate a conservation easement and give up that right, you may be able to take a big income tax deduction.. However, if you can't build on wetlands in the first place, giving up the right to build on wetlands may achieve some conservation purpose, but you may have very little value to give away.

A conservation easement appraisal is actually two appraisals and a landowner should seek the advice of a competent tax advisor. The value before the easement should capture the development potential of the property, including among other things, how many house lots could be placed on a property, what they would sell for, how long it would take to get developmental approval, and what it would cost the buyer of the property to put in roads, utilities, and other needed infrastructure. In many cases, an appraiser needs to work with a landowner to produce a land use plan, which is an actual development plan that is not to be used for development purposes, but as a basis for calculating value. This analysis needs to take into account the risks that a particular development project would require to be successful, as well as other things, such as entrepreneurial profit and the time value of money. An appraisal is a fair market value of the property after the easement is placed on it. **The question that must be answered is what would the property bring on the open market with a conservation easement placed on the property?**

If you are interested in exploring a conservation easement for your property, a good planning team is essential to being successful. This team should include tax advisors who

are familiar with conservation easements, as well as an attorney and an appraiser. It is essential that this team should be brought in early and that you "run the numbers". It is important not to assume anything in tax and financial planning.

If you are interested in exploring a conservation easement further, please give us a call and we will be glad to discuss conservation easements with you.

LAND FOR SALE

Clarendon County

70 acres—located near Manning in Jordan community. Good timber investment & recreational tract w/lots of deer and turkey. \$1,200.00/acre

72 acres - excellent hunting tract in great deer and turkey area. Good interior road system w/2 natural ponds— under contract

73.36 acres—mixture of woodland & cropland w/excellent deer & turkey populations—Convenient to Sumter on 521. - \$1,350.00/acre

28 acres—under contract—excellent country home site, convenient to Sumter—\$1,500.00/acre

27 acres—woodland & cropland w/1525 sq. ft. 3 BR/2BA house located in Sardinia community—\$72,000.00

DILLON COUNTY

56 acres—near Latta & I-95. 14-yr. old planted pines—paved road frontage \$75,600



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Published by Dwight L. Stewart, Jr. and Associates of Manning, SC. We are consulting foresters, licensed real estate brokers, and Dwight L. Stewart is a certified appraiser for South Carolina and Georgia. Our firm has been in the 100 Largest Farm Management Firms in the nation for the last four years, as compiled by Crop Decisions magazine, the journal of agricultural professionals. You can reach us at:

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