



## **Token Timber Taxation: Case of Mendocino County, CA**

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# Token Timber Taxation: Case of Mendocino County, CA

Working Paper

Mason Gaffney, 2000

Standing timber is generally now exempt from property taxes, by law or custom. Land remains on the property tax rolls. This sounds like a Georgist idea; advocate Ellis Williams, a forest economist, has made the point. It is, however, just partial and discriminatory Georgism. Standing timber is exempt, but log decks, milled lumber, and buildings are not. The bias is apparent between capital in different forms. The kind with higher labor-content - buildings - is taxed higher so the kind with less labor-content - timber - may be exempt.

Timber still yields some revenue when it is cut. The idea has been to substitute a yield tax for the property tax. In practice, though, yield tax rates are much too low to be revenue-neutral. In California, for example, the yield tax rate is 2.9%. 2.9%, levied just once at the **end** of each sixty years, is obviously less than 1% levied every year, starting from year one. Values are very low in the sapling years, it is true, but well above zero; and, in the last few years before harvest, the stumpage is worth nearly as much as its final harvest value. I have calculated that a yield tax of 25% or so (varying with the tree life and the interest rate) is needed to have a present value equal to that of a 1% property tax. The present system works as though you exempted half the buildings in a city from a tax and raised the rate on the others.

Here is the revenue result in one major California timber County, Mendocino. Its major property value is timber, but the County government and its subdivisions hardly get crumbs from the yield tax on it: \$3.9 millions in 1993, compared to \$45 millions from all property.

This is not because they are cutting timber slowly; actually, they are depleting the inventory. Neither is it because other values are high. This County has no large cities. The County Seat, Ukiah, contains only 15,000 people. Most of its people live outside cities, and its annual timber harvest is twice as high as the sum of all its other “agricultural” gross output (including fishing). The **net** cash flow from timber harvests is much more than twice as high as the **net** cash flow from other property, because stumpage value is added mainly by property (land and growing stock), while other farm products like grapes, fruits, and milk are more labor-using.

How about land under the timber? It is separately valued, and kept on the property tax rolls. However, it yields revenue of only \$1.2 million: 1/3 of what the yield tax renders.

Why so little? They could raise the valuation of timber land to compensate for exempting the trees. In addition, “timberland” in some areas is sold for vacation homes and resorts. Assessors once began using those sales to justify higher valuations. They also observed smaller timberland owners paying higher unit prices than giant corporate owners, and up-valued parts of the vast spreads accordingly.

Timber owners had other ideas, however. Major owners led by SP (520,000 acres of timber in California) took alarm and went to Sacramento for relief. They got their lands put in a “Timber Preserve Zone” (TPZ) wherein land is assessed only on its putative value for raising timber, regardless of market value, regardless of alternative uses, and regardless of non-timber income from land growing timber. These “compatible” (untaxed) uses include grazing, resorts, vacation homes, campsites, fishing, hunting, watershed protection, tourism, rifle ranges, rights-of-way,

mining, log storage, landings, roads, logging camps, etc. (and possibly even landing strips and small airports). There is also marijuana: possibly the state's most valuable crop, but unrecorded. There is the possibility of finding minerals, hydrocarbons, or geothermal sources – the huge Geysers geothermal field is not far away, Santa Rosa is even closer, and the San Andreas Fault runs through Mendocino County.

TPZ is hardly known outside the timber counties. UCLA Law School Professor Don Hagman was one of the few to agitate against it before his tragic early death from falling (?) off a cliff in Mendocino County. TPZ covers vastly more acres than the better-known “Williamson Act,” which provides for preferential low assessment of farmland. In Mendocino County, TPZ land of medium grade (“Site III”) is now tax-assessed at \$136/acre. This is about 7% of its value for growing timber (disregarding the value of compatible uses), and a lesser fraction of its value for higher-valued “incompatible” uses like retirement homes that require formal “conversion” (obtainable on demand) out of TPZ. This is how they keep the tax payments on TPZ land down to only \$1.2 million.

Mendocino County, on the north coast, is redwood country. Redwood's value on the stump (“stumpage”) this year (2000) is 53¢ per board foot (pbf) when mature. In Shasta County, timber stumpage is worth about half that, 28¢ pbf, and is heavily logged at that value - Shasta is our biggest producer. Since it is worth logging great volumes of Shasta timber to get 28¢ pbf, then there is a lot of surplus in Mendocino timber at 53¢ pbf. An additional premium attaches to redwood because it is fireproof, and relatively free of diseases and pests that afflict other species. On top of that, redwood mostly reproduces voluntarily and asexually, minimizing regeneration costs. It is a most accommodating species, but only on its limited terroir. This surplus is what makes this north-coastal land so valuable for timber culture. This surplus, unvexed by taxation, is what makes these lands so attractive to, and the playthings of corporate raiders, merger specialists, speculators, arbitrageurs, lawyers, and junk-bond salesmen living thousands of miles away.

Redwood, in spite of its fabled longevity, grows faster, when young, than most western timber (although much slower than Yellow Pine in the southeastern states). An acre of good (Site II) Mendocino land will yield a crop of 40,000 bf after 60 years of growth, worth about \$20,000 on the stump at the 1995 price. Discounting that to the present, using a real interest rate of 4%, means dividing it by about 10, for a present value of \$2,000. If regeneration cost were \$100 per acre, we would subtract that from the \$2,000, leaving \$1900. Add 10% for the present value of all harvests after 60 years, and you have very roughly \$2,100 per acre for the SITE value based purely on redwood timber culture, considering no other values. Yet, under TPZ its assessed value for taxation is only \$156, about 7% of its true value just for timber culture.

This low tax valuation is enforced by legislating the assessed values statewide (*California Revenue and Tax Code*, Section 434.5). The legislated formula mandates that “income-based” assessments be found using *past* prices, projected in the far future with no adjustments for inflation, but discounted at a high interest rate (i.e., a rate *not* adjusted for inflation). It is clear for whose benefit this law was framed.

Meantime, urban demand is probing up north into southern Mendocino County from the Bay Area and Sonoma County, its southern neighbor.<sup>1</sup> Mendocino has a long, scenic coastline with premium amenity values. Some of the TPZ land has a speculative value for resort, retirement and vacation uses, well above its timber value. The coastal town of Mendocino bustles with tourists, and also receives rent as the venue for a TV series (where it doubles as “Cabot Cove, Maine”). Celebrities and retirees seeking community with privacy find it in the posh “Sea Ranch”, far to the north along tortuous State Highway #1, but with an airfield nearby, for those with money. One celebrity with a vacation home in Sea Ranch was the economist Milton Friedman – it’s an easy flight by private or chartered plane from near The Hoover Institution. None of this is reflected in tax assessments: TPZ protects against that, even though owners may convert out of TPZ at will. Land may be classed as TPZ regardless of past, present, or intended use.

The private area of Mendocino County is 1.9 million acres. Half of that is timberland, with 863,000 acres in TPZ. At an estimated \$1.36/acre in taxes, this contributes \$1.2 million to the County budget. The County gets \$45 million from all property, of which the timberland fraction is 2.7%.

Add to that the yield tax of \$3.9 million and you have timber and timberland together providing about \$5 million of County taxes. However, the County and its subdivisions, especially school districts, get over \$100 million in subventions from Sacramento, paid by taxes on income, sales, and businesses in other counties. By comparison, the \$5 million is a paltry share indeed to raise from the most valuable resource in the County.

Timberland owners around the country have sold this bill of goods to legislators. In many states, less than half the private land is fully taxable, because of such laws. These are not all southern and western states, either, as one might surmise. In NH, for example, only 45% of the private land (and none of the Federal land) is fully taxable. The rest is sheltered by the state’s “Current Use” tax law, their version of our TPZ law.

Champions of these laws argue that land taxes, accumulating with interest over long growth periods, would eat up all the profit from growing timber. Let us see. Taxes of \$1.56 per acre per year, accumulating over 60 years at a real interest rate of 4%, come to \$371 per acre in constant 1995 dollars. At that time the timber stumpage will be worth about \$20,000 in 1995 dollars, or 54 times the accumulated future value of the site taxes. In addition, the timber will have shielded the owners from the eroding effects of inflation, a very real benefit that is assumed away by the “simplifying” technique of using constant dollars and “real” interest rates. On top of that, it is a good bet the real value of timber will have risen after 60 years of population growth.

Thus, land taxes would have to be 54 times what they are now to consume the whole value of timber harvests. The fact is, present taxes are a negligible token. Timberland is effectively sheltered from the full weight (light as it is) of the 1% property tax imposed on ordinary land. It contributes, as we have seen, only about \$1.2 million a year to help support public services in Mendocino County.

The acre value of timberland is low compared with downtown values in San Francisco, where one little square *foot* in the hottest spot may fetch \$2,000. That is \$87 million per acre!

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<sup>1</sup>There is plenty of empty land in Sonoma County, and even south of that in Marin County, but each of those has anti-growth land policies that force demand to leapfrog farther from the center of the metropolis, San Francisco.

However, there are very few such golden acres, compared to a million acres of timberland in Mendocino County, 35 million acres in California, and 737 million acres in the U.S. That is 32% of the area of the 50 states. (The fraction of public and private land in forests is, by coincidence, the same: 32%).<sup>2</sup>

Owing to the success of timber people in spreading their peculiar gospel, almost all of their land is underassessed. Almost all state yield taxes, imposed in lieu of property taxes on standing timber, are too low to be revenue-neutral. Add to that, Congress since 1943 has made timber a “capital asset” for federal (and therefore state) income tax. Many costs of managing and carrying this capital asset are expensable - certainly interest and property taxes are. The net result is that timberland contributes very little to public revenues at any level.

Residents of timber counties are typically scattered, and poorly organized. Timber companies are huge, rich, few, and tightly organized. In Mendocino County, Georgia Pacific and Louisiana Pacific, absentee owners, together own 500,000 acres - 58% of the County's timberland - and Georgia-Pacific owns Louisiana-Pacific. Timber firms influence state forestry schools, hiring professors as consultants. They patronize research in forest economics at think tanks like Resources for the Future in Washington, D.C., which has never criticized their tax preferences, but trained its big guns on public agencies: the Forest Service and Bureau of Land Management. “The industry” controls tax laws in 50 states, and sloughs tax burdens onto others. It will continue to do so until voters in the timber counties wake up and organize to control state timber tax laws.

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<sup>2</sup>Arthur Daugherty, 1995. Major Land Uses in the U.S., Ag. Ec. Rpt. #723, ERS, USDA, September.