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Research Report

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HISTORY OF TIMBER TAXES

In 1856 the Territorial Legislature declared "... all lands shall be subject to taxation as real estate ..." Oregon timber land (not the timber standing on it) still follows this rule. Timber land today pays local property taxes. Nonetheless, timber taxation has changed since 1856, most notably in 1929, 1955, 1961, 1977, 1981, 1991, 1993, and 1999. In the most general sense there are four stages in the history of timber taxation. The initial stage is dominated by old growth timber, which was both under assessed and unevenly assessed. These inequalities lead to stage two and the centralization of assessment. During stage two, much of the old growth in Eastern Oregon is cut and values on the roll in the West increase to politically unacceptable levels. Stage two ends with a severance tax in the East and a redefinition of timber value in the West. In stage three, appraisal methods are improved and much of the old growth in the West is cut. The end of stage three brings indexed land values and a severance tax in the West. Stage four includes changes in response to Measure 5 (1990) and Measure 50 (1997) and Legislative findings that "Timber on private lands managed on a sustained yield basis should be treated as a crop and not taxed as real property." This report describes these changes in seven sections.

- I. The Early Years: 1856 to 1948
- II. State Role Increases: 1948 to 1960
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I. **The Early Years: 1856 to 1948**

Highlights

- Property Tax on Combined Value of Land and Standing Timber
 - Valuation Was Difficult and Uneven
- Supply of Mature Timber Exceeds Demand
- Forest Fee and Yield Tax for Cutover Land

For most of the early years, the property tax was the principle source of revenue for state and local government. The property tax is an *ad valorem* tax because it is based on the value of the property being taxed. Thus, if the value of one type of property grows faster than other types, its tax burden rises. But if all types grow at about the same rate, then relative tax burdens will stay about the same.

Through the Great Depression, Oregon logged mostly old growth, mature trees. Timber owners paid property taxes on the full value of their timber and the land beneath it. But timber was abundant. So prices were low and grew slowly. Also, assessors often underestimated timber volumes (see below). Hence the tax burden stayed relatively low.

County assessors valued trees and land together – by looking at sales of comparable property or by simply valuing the marketable timber standing on the property. Assessors usually added little or no value for the land itself. Although these simple methods were probably adequate, poor data often led to under-appraisals and wide variations in appraisal quality across the state.

There were lots of reasons for poor data. Sales data, though plentiful, was difficult to gather. Standard timber classifications were undeveloped, making data difficult to analyze. Much timber land was remote, accessible only by foot on horseback, making it difficult to gauge the volume of timber on many parcels.

And finally, much of the levy was a statewide tax. Lower values in a county meant that county paid a smaller share of the statewide levy. Therefore elected assessors felt pressure to keep values down – especially if other counties were doing likewise.

After logging the old growth, owners usually left land to natural regeneration (or erode) or converted it to farm or urban use. In the early 1900's, many owners considered logged land so worthless and the payback from future timber harvests so far in the future that they stopped paying property tax. The property reverted to county ownership. This practice was especially common in Clatsop, Columbia, and Douglas Counties.

To stop these foreclosures, and to encourage replanting, the 1929 Legislature passed the optional Forest Fee and Yield Tax. In essence, the new tax let owners choose to pay most of their timber taxes when they cut their trees, instead of each year as the trees grew. To qualify, the State Board of Forestry had to find the land (1) suitable chiefly for forest use, and (2) currently lacking merchantable quantities of timber.

Qualified timber land was identified on the tax roll as reforestation lands and both the timber and timber land were exempt from property taxes. Instead, owners paid a yearly 5¢ per acre "Forest Fee" and a 12½% of value "Yield Tax" after harvesting the timber. The Forest Fee and Yield Tax endured with few modifications until 1977, when it was repealed. The repeal phased these reforestation lands into the regular program of property tax on

forest land value and lower severance taxes at the time of harvest, over a period of roughly 25 years.

II.

State Role Increases: 1948 to 1960

Highlights

- Rising Timber Prices
- Centralized Appraisal
- Separation of Land and Timber Values

The end of World War II spurred a great increase in consumer spending – the baby boom, suburban housing developments, and a lot of new commercial construction. The demand for lumber and wood products leapt ahead. Timber prices began rising much faster than prices generally – so fast that by the late 1970's they had increased tenfold. Timber and timber land became recognized as a major asset to Oregon's economy. This recognition led to a growing awareness of the inaccuracy of timber volumes and values on the tax rolls.

In the early years, county assessors were almost solely responsible for valuing timber property. But in 1948, the State Tax Commission used a new technology of detailed aerial photography to measure timber volume. They found much more timber than contained on county tax rolls. Although by this time the State no longer levied a property tax, discoveries like this led the 1951 Legislature to find that consistency and equity in local taxation was a state concern. So they gave the State Tax Commission more power to reappraise and oversee the appraisal of all property in the state.

One of these changes, HB 41 in 1955, directed the State Tax Commission to reappraise all timber property in more detail. The bill also, for the first time, required assessors to separate the values of standing timber from timber land on the tax rolls.

III.

Eastern Severance Tax and Western Advalorem Tax: 1961

Highlights

- The “deferment Factor”
- Reducing the Tax Burden
- Collecting Tax at the Time of Harvest
- Small Tract Option for Western Oregon

Cruising all of Oregon's timber land was a long and arduous task. Most of the work went into valuing the standing timber. Land carried only nominal values. By 1961, the reappraisal plus rising timber prices drastically increased the value of timber on Oregon's tax rolls. Timber assessed values in Western Oregon climbed from \$38 million in 1955 to \$111 million in 1961.

The reappraisal process provoked a lot of controversy. Most of it centered on one element – a slippery but important concept known as the "deferment factor."

To explain, appraisers usually begin by looking at a stand of timber's immediate harvest value – how much money the owner would clear if the timber were cut and sold immediately at today's prices. But in the 1950's, there was still lots of old growth around, especially in Western Oregon. So most mature timber was not cut immediately – but held for future years. If the appraiser assumes that timber prices will not change in the future (the normal assumption at the time) then deferred cutting of mature timber will not increase its gross value. However, net value will fall because costs increase. The holding costs are primarily interest, but also include taxes and allowances for risks like fire and disease.

The "deferment factor" tries to measure this reduction. The factor depends largely on the expected holding period or depletion rate of the standing timber – the longer the period, the greater the value reduction. But the concept is tricky. In the extreme, it was clearly impractical, since each stand could have a different value, depending on the owner's harvest plans. During the 1950's, the Tax Commission assigned factors to areas, usually counties. By 1960 the factor was 30% statewide (thus, market value = 30% of immediate harvest value).

In 1960 the Tax Commission finished a new sales study. It showed that a 50% factor was more reasonable. The higher figure reflected a declining depletion period as harvests rose and the stock of old growth declined. So the Commission raised the factor to 35% in 1961 and announced its intention to increase it 5% a year until it got to 50%. This meant owners were facing roughly a 67% increase in timber assessed values over the next four years.

Meanwhile, as rising timber demand brought changes to timber property appraisals, the industry itself was changing. Rising prices and advancing technology permitted more intensive forest management and greater harvests. The industry began to realize that supply was not inexhaustible. Although timber is a renewable resource, the renewal period is long – 30 to 50 years for the fir of Western Oregon, 60 to 100 years for Eastern Oregon's pine. Efforts to ensure a steady future wood supply led to the idea of "sustained yield" forestry – growing new trees as fast as mature growth is cut.

The rising timber tax burden led many to argue that the industry could not withstand a full property tax system. Also, the advalorem system worked against sustained yield – because it required cash outlays while the trees were not producing revenue. The latter concern was particularly strong in Eastern Oregon because the growing cycle was longer and, by 1961, most large old growth timber stands in the East had been cut.

All this came together during the 1961 Legislative Session. The legislature designed two timber tax systems – one for Eastern Oregon (counties east of Cascade Range summit), the other for Western Oregon.

For the East, the legislature passed HB 1114. This bill exempted all standing timber from property taxes, leaving only the land value on the tax rolls. To replace property taxes on

the standing timber, HB 111 began the Eastern Oregon Severance Tax. Under this tax, owners paid 5% of the market value of all private timber harvested.

For the West, the legislature began two new systems: partial property tax exemption for most land, and, for small owners, the Western Oregon Small Tract Option.

HB 1438, the partial property tax exemption bill:

1. exempted all timber under 12" in diameter (reproduction timber) from property taxes;
2. placed all larger trees on the roll at 30% of immediate harvest value (25% for old growth tracts with a present depletion rate of greater than 30 years);
3. began an additional tax on the normally exempt value paid in the year of harvest only (usually 70% of value times the local property tax rate);
4. left timber on the property tax rolls, but allowed qualified owners to ask that their land become "designated forest land." This meant that the property tax assessor would consider only its value for growing timber ("use value") and not its value in any other use.

HB 1758, the Small Tract Option, allowed small land owners to pay property taxes on the "productivity value" of the land instead of using the partial exemption system outlined above. The optional program was open to owners of 1,000 acres or less of Western Oregon forest land for land that bore trees averaging 60 years of age or less. HB 1758 set optional values by site class, according to the table below.

Site Class	Value Per Acre
I (most productive)	\$80
II	\$60
III	\$40
IV	\$15
V (least productive)	\$5

In summary, after 1961 all Oregon private timber and timber land paid taxes under one of four systems:

1. severance tax (Eastern Oregon);
2. partial property exemption (Western Oregon)
3. small tract option (Western Oregon); and
4. forest fee and Yield tax (Eastern and Western Oregon).

The net effect of these systems was to stem the growth of the timber tax burden and generally to tax trees more when cut and less while growing than would the normal property tax system. The one exception to the general shift toward harvest taxes was the small tract option. The option put the same value on the land by site class regardless of its standing timber.

IV.

Improved Appraisal Methods: 1964 to 1976

Highlights

- Valuation of Forestland
- New Data, Higher Forestland Values
- Industry Appeals of Forestland Values

The 1961 Legislative changes, by separating the tax treatment of standing timber from timber land, put increased emphasis on accurate land values. In 1964, the Legislature gave the job of appraising Eastern Oregon timber land back to county assessors, but left Western appraisals with the Tax Commission.

The Tax Commission assigned land values using a residual method – looking at sales contracts for timber and timber land and subtracting out the estimated value of standing timber.

Although fine in theory, the residual method has a serious practical problem – standing timber constitutes the major share of most timber sales. This meant that small errors in estimating timber values would result in large percentage errors in the residual land values. In particular, immature (“reproduction”) timber is difficult to value. It has little value if cut immediately. The real payoff does not come until maturity.

At the time, the Commission used an “income approach” to estimate immature timber values. Under the income approach, current value is some future value less costs and allowances for risk and profit, all discounted back to the present. This method is highly dependent on arguable assumptions, especially normal profit margins, interest rates, and allowances for risks.

Looking for a better way, the Commission began by dividing all Western Oregon timber land into 40 acre sites and seven basic productivity classes. The classes represented different soil quality and water conditions. They also gathered data on slope, surface conditions (rocks, etc.), and brush on each site. This more detailed data allowed the Commission to use the “abstraction” method – a more direct comparison of the components of timber property sales.

Under the abstraction method, the appraiser first removes the value of all improvements and marketable timber. The appraiser then writes a series of equations. Each equation describes one sale from the timber land market data the appraiser has gathered.

For example, suppose one sale contained all forestland of the same site class. Two hundred acres was land alone, 300 acres contained class C reproduction timber, and 100 acres has class B reproduction timber, and the total selling price is \$30,000.

The equation for this sale is:

$$\begin{array}{rcl} \text{Price per acre (land alone)} & \times & 200 \text{ acres} \\ + \text{ price per acre (with C reproduction)} & \times & 300 \text{ acres} \\ + \text{ price per acre (with B reproduction)} & \times & 100 \text{ acres} \\ = \$30,000 & & \end{array}$$

The equation shows the appraiser’s problem, the acreages and total price are known, but the unit prices are not. To solve it, the appraiser builds all equations, one for each sale, then tests different sets of unit prices. The set of prices that, when substituted into every

equation, comes closest to explaining all the total sales prices, is said to best “fit” the observed data. The appraiser then uses this set to appraise all forestland.

The main advantage of this approach is that it relies solely on timber market data, and not on external assumptions. The Tax Commission began using the abstraction approach in 1968. In 1969, the Department of Revenue replaced the Tax Commission, but continued the abstraction process.

But abstraction requires lots of data. Much of it was old – as much as five years old. Because values were rising, the lag tended to produce appraised values lower than current market values. Therefore, in 1975 and 1976, the Department worked to increase their store of current data. The new data showed that timber land values should be more than double what they were in 1976. In 1977, the Department certified these values to the Western Oregon counties. The major timber companies appealed.

V.

Western Land Value Formula and Western Severance Tax: 1977

Highlights

- Oregon Supreme Court Set Forestland Values
- Western Oregon Severance Tax
 - Transition
 - Distribution of Revenue to Taxing Districts
 - Revenue as Levy Offset

Every appeal of the 1977 land values involved essentially the same issues. Thus, to simplify matters, the 1977 Legislature passed SB 1077, which allowed owners to consolidate all the appeals into one “class action.” The bill also placed 1976 timber land values on the 1977 tax roll instead of the Department of Revenue’s higher values. These lower values, indexed, remained on the tax roll through 1982. Since the 1977 values eventually determined by the Oregon Supreme Court were higher than the values placed on the roll, this meant that the owners would have to pay extra taxes in 1983 for years 1977 through 1982.

The 1975 Legislature struggled with constructing a severance tax to replace the advalorem tax on timber in Western Oregon but was unable to reach agreement.

As the Western appraisal process progressed, owners were rapidly cutting old growth timber stock. By 1976, old growth volume on the tax roll was down to 40% of 1962’s level. Meanwhile, young growth volume changed little. So, like Eastern Oregon in 1961, this combination led to a Western Oregon severance tax. The terms “old growth” and “young growth” do not have generally accepted definitions. While most people would agree that trees in excess of 200 or 250 years are “old growth”, the definition varies both with the purpose of the distinction and the type and location of the timber. This report uses the Department’s age class 1 to define old growth. The minimum age for conifers in this class varies from 60 to 100 years depending on location.

The 1977 Legislature began the new tax by enacting HB 3274 with the following provisions:

1. Exempted standing timber from property taxes.
2. Replaced the property tax on standing timber with a 6.5% severance tax on private timber at harvest time.
3. Established a system to distribute the severance tax revenue back to local districts as an offset or reduction in property taxes (discussed below).
4. Left timber land on property tax rolls, but began a new system of indexing land values (discussed below).
5. Repealed the Forest Fee and Yield Tax. Assessed reforestation lands at 5% in 1978 plus 5% per year through 1997. Imposed additional severance tax rates of 7.5% in the East and 6% in the West. Reduced these additional rates by .25% per year through 2008 in the East and 2002 in the West.
6. Left the Small Tract Option intact.

In short, HB 3274 replaced property taxes on standing timber with a severance tax and revamped the property tax treatment of timber land. One of the major issues faced by the Legislature was determining the severance tax rate. Rates from 4% to 12% were proposed based on maintaining revenue, equity with other property, and the viability and importance of the timber industry. The Legislature eventually embraced the 6.5% rate.

Severance taxes would be collected at the state level and the Legislature designed a system for returning these taxes to local taxing districts with several goals in mind. First the Legislature required that these revenues be offset against district tax levies. This required an estimate of severance tax revenue and effectively reduced district tax bases (their Constitutional levying authority). The Legislature also provided for a transition period to allow the development of a history of harvest values at the district level, which together with forestland value would be the basis for distribution after the transition period. During the transition period, the value of standing timber on the 1977-78 tax roll was the basis of distribution.

To accomplish these goals, the legislature established the Western Oregon Severance Tax Administrative Account, the Western Oregon Tax Reserve Account, the Western Oregon Transition Account, and the Western Oregon Timber Tax Account. Severance tax receipts from the first quarter of 1978 plus Additional Tax receipts for calendar year 1977 were deposited into the Reserve Account. Thereafter receipts, sufficient to reimburse the General Fund for the cost of administering the severance tax, were deposited in the Administrative Account and, for the first three years, all remaining receipts were deposited in the Transition Account.

Beginning in 1981-82, the remaining receipts were split with 80% going to the Transition Account and 20% going to the Timber Tax Account. The percent going to the Timber Tax Account increased by 20 percentage points each year, so that by 1985-86, all receipts went into the Timber Tax Account.

The Department determined the amount to be credited to each taxing district from both accounts. Distributions from the Transition Account were based on each district's share of the product obtained by multiplying the 1977-78 assessed value of standing timber (after several adjustments) by the districts current tax rate. Distributions from the Timber Tax Account were first made to western Oregon counties with 75% based on the county's share of a five-year moving average of the value of timber harvested (adjusted for reforestation lands) and 25% based on the county's share of forest land value in the year prior to

distribution. Within counties, these shares, for each district, were also weighted by the district tax rate in the latest levy.

These distributions went to county treasurers to the credit of each district, but actual distributions by the county treasurers to the districts, were limited to the amount offset against each year's levy. Offsets for the Transition Account were estimated at the district's adjusted 1977-78 timber levy multiplied by the percent of receipts distributed through the Transition Account plus any excess distribution from the prior year. Offsets for the Timber Tax Account were estimated at 75% of the prior year's severance tax multiplied by the percent of receipts distributed through the Timber Tax Account plus any excess distribution from the prior year. If distributions were less than offsets, the deficiency would be transferred from the Reserve Account.

For the land appraisals, the Legislature rejected the old market value approach. Instead, they set land values by formula. For 1978 and 1979, the formula set each year's value to 1977 market value, increased by the growth rate of stumpage prices of young growth Douglas Fir. The growth rate calculations changed during this period, but the 1977 market values continued in use through 1995.

VI.

Recession and Recovery: 1978 to 1990

Highlights

- Eastern Oregon Forestland Values
- Reforestation Tax Credit
- Western Oregon Severance Tax: Post Transition Adjustments
- Oregon Forest Land Protection Fund
- Stumpage Values
- The Forest Industry

Eastern Oregon timber tax policy changed little after the severance tax began (1962) and land appraisal responsibility reverted to local assessors (1964) until 1981. Nonetheless, the period saw many court suits on land values. Assessors generally used the income approach, which had all the problems discussed earlier in Western Oregon. In addition, Eastern Oregon land often has multiple uses – timber and grazing, or timber and recreation – which complicated the problem. Finally, the 1981 Legislature began an indexed land value system. HB 2191 set 1982 Eastern timber land values at \$25 per acre – about equal to the average level of assessed value in 1981. This value increased yearly at half the rate of a rolling five-year average of immediate harvest value in Eastern Oregon.

The legislature made numerous adjustments but few major changes in Western Oregon timber taxes between 1977 and 1991 despite the economic upheaval in the industry. These changes, discussed below, included creating a reforestation tax credit, resolution to the forest land value case, the phase-in of severance tax distribution, special treatment for certain hardwood stands, restoring solvency to the Oregon Forest Land Protection Fund,

and revising the Department's method of determining harvest values. Despite these changes, the general structure remained intact.

The 1979 Legislature passed a reforestation income tax credit for costs incurred to stock under productive forest land. Eligibility was limited to individuals who were small landowners (10 to 500 acres). Reforestation costs excluded any expenses paid by another cost share program or required to comply with the Oregon Forest Practices Act. The credit was 10% of eligible costs, with half-allowed upon completion and the remaining half when the State Forester certified that the stand was established. The 1985 Legislature increased allowable acreage (10 to 2,000 acres) and required preliminary certification by the State Forester, that the reforestation project was complete. The 1987 Legislature increased the credit to 30% and provided for S corporation distributions. The 1989 Legislature added silviculture treatments to eligible costs, changed the acreage limit to greater than 5 acres, extended the credit to corporations, included certain hardwood stands, and provided appeal processes. Following this period, the 1995 Legislature limited the value of preliminary certificates that the State Forester may issue.

The 1979 and 1983 Legislatures changed the eligibility requirements for the Small Tract Option. The 1979 Legislature replaced the requirement that existing stands be under 60 years with the requirement that they be under 8 inches in diameter. The 1983 Legislature restored a maximum age limit but reduced it to 40 years.

The land value case dragged along. The Tax Court trial transcript eventually covered 3,700 pages. The Tax Court finally upheld the Department's values. But the Supreme Court disagreed in part, and set values roughly halfway between the values for the owners and the Department. Even so, values were higher than what had been on the roll since 1977. So the decision meant extra tax payments plus interest of about \$24 million for the years 1977 through 1982. The 1989 Legislature set forest home value at the average value per acre of the total contiguous ownership plus improvements to the land not to exceed \$4,000.

The 1979 and 1981 Legislatures made minor changes to severance tax distribution, which clarified the calculation of district shares and changed some dates. The 1985 Legislature made several changes:

- It repealed the Administrative Account and the Transition Account and required that all severance tax receipts be deposited in the Timber Tax Account. It provided for payment of refunds and administrative expense from this Account.
- The old Reserve Account was rolled over into a new Reserve Account with the same purpose but ongoing funding. The Department was required to maintain a balance in the Reserve Account equal to 10% of the average severance tax receipts over the prior three years. This was done through periodic fund transfers to or from the Timber Tax Account.
- The calculation of district shares based on harvest value was changed to use a five-year moving average of district tax rates.
- The Department was required to provide a preliminary estimate of severance tax revenue for district budgeting in January and a final estimate in August. The final estimate plus the amount on deposit with the County Treasurers to the credit of each district was certified as the district offset.

Following a large hit on the Reserve Account in May of 1988, the 1989 Legislature required that, any shortage in distributions below the offset amount for a fiscal year, be transferred from the Timber Tax Account in the following August. It also created an Offset Guarantee Account to be available to the 1991 Legislature. One-half the tax available for distribution in excess of \$29 million for 1990-91 and in excess of \$30 million for 1991-92 was deposited in the Offset Guarantee Account. This was roughly \$10 million a year.

The 1989 Legislature required that intensively managed hardwood stands be treated like Christmas tree farms. Thus the land was assessed under farm use and harvests were exempt from severance tax. If an owner elected to take a reforestation tax credit, harvests continued to be subject to severance tax.

Oregon requires all forest land owners to provide fire protection by providing their own approved fire protection systems, by joining a fire protection association, or by paying the State Forester to provide fire protection. Oregon's basic level of fire protection is composed of 12 districts whose budgets are adequate to control most fires. When financial resources are exhausted at the district level, emergency funds are provided from the Oregon Forest Land Protection Fund (OFLPF).

The 1987 fire season was unusually severe and exhausted the OFLPF forcing the State Forester to obtain additional funding from the federal government, the Emergency Board, and from landowners. The Legislature increased the maximum fund balance, required the purchase of catastrophic insurance, and increased the acreage assessments and harvest taxes supporting this fund. The Legislature continued the requirement that 50% of the State Forester's fire protection costs be paid by assessments on forest landowners.

The Department of Revenue is required to construct stumpage value tables by species and grade for a number of value zones within each market area. A harvester or other owner then applies these values to the volume harvested (MBH) by species, by grade, and by area to determine the taxable value of the harvest. Since 1977 when the severance tax was enacted in Western Oregon, the Department has used average sale prices in each area for timber on the stump to construct the stumpage value tables. Two issues were raised regarding the determination of these values. The first was that combining private and public sales may not accurately reflect the value of timber harvested from private land because public timber is subject to export restrictions. The second was that insufficient sales data in certain species and grades may result in unreasonable values. In this regard, the Department was required to average the available sales data and the industry sought both to give the Department additional latitude and to make the values determined subject to direct appeal.

As a first step in resolving these issues, the Legislature required buyers and sellers of timber to report all sales or purchases of logs to the Department, required the Department to develop a log purchase value index, and to study other methods of valuing timber. The new index was required for two value periods (1/1/92 through 12/31/93) in determining stumpage values, where there is insufficient sales data. Note that log sales are different than timber sales. The typical timber sale is between an owner and a harvester where log sales are typically between the harvester and a mill owner.

While there were few major legislative changes during this period, the industry itself had undergone significant change. What appeared at its beginning in 1980 as a typical cyclical downturn in the timber industry resulted in the basic collapse of the housing market. Deregulation of financial markets made funds scarce and anti inflationary monetary policy

pushed interest rates above 20%. The timber industry began a response of selective mill closures and significant modernization of the mills and plants that survived which continued throughout this period.

The demand for housing recovered in 1983 but prices remained low as increased productivity in the U.S. and Canada overwhelmed the increased demand. Firms in Oregon were not competitive with other firms in the U.S. or with Canadian production. This was partially due to contracts to purchase federal timber at prices, which were pushed well above current market by past expectations, and to Canadian subsidization of lumber exports. A number of actions restored competitiveness. Oregon firms either through deunionization or with union cooperation reduced wage rates by over 20%, Canada imposed a 15% tax on lumber exports, and price roll-backs and contract extensions reduced the cost of federal timber.

In an assessment of Oregon's Forests, 1988, Oregon State Department of Forestry; Michael D. Sullivan of the Northwest Forestry Association concluded:

"In summary, Oregon's lumber, plywood and pulp and paper industries are healthy and strong and their prospects for the coming decade are bright, assuming a relatively stable national economy and an adequate supply of raw materials."

At the end of this period the industry, restructured and lean, faced a national recession and a reduction in timber availability as the BLM and Forest Service began revising harvest policy to include the preservation of forest habitats. There was also much concern that Congress, under the endangered species act, would restrict or prevent timber harvesting from many public forests and, perhaps, from some private forests as well.

VII.

Recent Changes: 1991 to 2000

Highlights

- Ballot Measure 5 (1990)
 - Temporary Legislation in 1991
 - Exemption for Standing Timber in 1993
- Ballot Measure 50 (1997)
 - Eastern and Western Oregon Privilege Taxes
 - Small Tract Option
 - Vetoed Legislation
- Current Programs and Continuing Issues
- Forest Products Harvest Tax

The challenges facing by the timber industry changed during this period. While excess supply of timber dominated the early years, the growing shortage of potentially harvestable timber dominates the last decade. In 1990, the spotted owl and in 1992, the marbled murrelet were listed as threatened species under the federal Endangered Species Act. These listings plus the listings and potential listings of various salmon, trout, and steelhead runs and the increased awareness of the environmental effects of logging resulted in the collapse in timber sale programs on Oregon's national forests and Bureau of Land Management districts and restricted harvests in wilderness and riparian areas. Despite the passage of the Salvage Rider to the 1995 Recissions Act, federal timber harvests in Oregon have declined dramatically, and are well below levels of the past several decades. The table below shows the Oregon harvest by ownership class for 1986 (peak harvest year) and 1997 in millions of board feet.

<u>Ownership</u>	<u>1986</u>		<u>1997</u>		<u>Percent</u>
	<u>Volume</u>	<u>% of Total</u>	<u>Volume</u>	<u>% of Total</u>	
National Forest	3,850	44.0%	523	12.8%	-86.4%
Bureau of Land Management	1,042	11.9%	136	3.3%	-86.9%
State & Other Public	357	4.1%	290	7.1%	-18.8%
Forest Industry	3,066	35.1%	2,653	65.0%	-13.5%
Nonindustrial Private	428	4.9%	480	11.8%	-12.1%
Total Oregon	8,743	100.0%	4,081	100.0%	-53.3%

Ballot Measure 5, passed in November 1990, limited tax and government charges on property to a percent of market value during the tax year. When fully phased in, 1995-96, the limits were ½% for schools and 1% for all other uses.

Because of the uncertainties: whether the forest taxes were subject to Measure 5 and if so how value should be determined, and the likelihood of substantial revenue loss; the Legislature temporarily redefined the following, as taxes on the privilege of harvesting timber:

- The Forest Products Harvest Tax (\$ per 1,000 board feet harvested)
- Eastern and Western Oregon Severance Taxes (% of harvest value)
- The additional Severance Tax on Reforestation Lands (% of harvest value)

The Legislature also reduced the privilege tax rates (formerly severance tax rates) and the additional tax rates on reforestation land to extend tax relief to the forest industry comparable to property tax relief under Measure 5, generally. The following temporary rates were established (note that rates change during the calendar year):

<u>Timber Harvest Period</u>	<u>EAST</u>	<u>West</u>		
	<u>Privilege</u>	<u>Additional</u>	<u>Privilege</u>	<u>Additional</u>
January 1, 1991 to June 30, 1991	5.00	4.25	6.50	2.75
July 1, 1991 to June 30, 1992	4.35	3.65	5.85	2.45
July 1, 1992 to June 30, 1993	3.90	3.30	5.30	2.20
July 1, 1993 to December 31, 1993	3.50	2.90	4.70	1.90

These changes exempted these forest taxes from Measure 5, and were sunset January 1, 1994. Thus, the 1993 Legislature would begin its deliberations with the pre 1991 law in effect and the Legislature required an interim study of timber taxes for this purpose. By 1993, reforestation lands would be assessed at 80% of forest land value.

In the process of dealing with school funding under Measure 5, the Legislature spent the offset guarantee account. The deposits to the account required for 1991-92 were set aside in a suspense account. The account balance on June 30, 1991 was distributed in July 1991 and the balance on June 30, 1992, together with the balance in the suspense account, was distributed in July 1992. This added roughly \$17 million to the school funding package. The Offset Guarantee Account was repealed by the 1993 Legislature. The Legislature also provided for appropriation from the Timber Tax Account to the Department of Forestry for the cost of administering the small tract option tax.

The 1991 Legislature made further changes to the Oregon Forest Land Protection Fund. The harvest tax, acreage fees, improved lot surcharge, and minimum assessments were increased and the State Forester was given authority to make further increases, as necessary, to maintain an increased minimum fund balance of \$15 million. The 1993 Legislature suspended these taxes and fees in the calendar year following a determination that the Fund balance exceeded \$15 million. The Fund was also allowed to borrow from the General Fund and the maximum local share of the State Forester's fire protection costs was increased to 60% for the 1991-93 biennium. This maximum local share was reduced to 55% in 1993 and returned to the permanent 50% level in 1999.

The 1991 Legislature passed SB 1125 in response to increasing environmental concerns. It made numerous changes to the Forest Practices Act increasing the regulatory authority of the State Forester and requiring cooperative efforts by the State Forester, DEQ, and ODF&W to achieve water quality standards and restore wildlife habitats. It also required a

study of the cumulative effects of past, present, and foreseeable future forest practices on the environment.

Other actions by the 1991 Legislature prohibited export of logs from state and locally owned forest land, extended the 1989 provisions affecting intensively managed hardwoods in Western Oregon to Eastern Oregon, and allowed contiguous tax lots under common ownership to be aggregated in determining fire district assessments.

The Timber Taxation Subcommittee of the 1991-92 Joint Interim Committee on Revenue and School Finance reviewed the issues involved in timber taxation and the economics of timber production. The Subcommittee developed six proposals for legislative consideration. The first three continued the privilege taxes as taxes in lieu of property tax on the value of standing timber but provided for reduced rates based on three rationales. The first reduced the privilege tax rates proportionately with the reductions in the Measure 5 limits (2.7% East and 3.5% West). The second reduced the privilege taxes proportionately with actual reduction in property tax rates on timberland (2.17% East and 2.82% West). The third imposed the Measure 5 limits (1.5%) as privilege tax rates. Under these proposals, forestland was subject to property tax at its indexed 1977 value. The last three proposals were based on Oregon Forest Industry Council (OFIC) proposals. These proposals were based on the theory that standing timber should be treated like an agricultural crop and exempt from property tax and that the productivity value of forestland should be taxed at the 1.5% rate allowed by Measure 5. To support this, OFIC contracted for appraisals of forestland value in Eastern Oregon and by site class in Western Oregon and provided a method for indexing these values. The proposals differed in how the tax was to be collected. The first repealed the severance tax and assessed forestland at 100% of the proposed specially assessed values. The second assessed forestland at 20% of the proposed values and constructed privilege tax rates intended to raise the remaining 80% of the tax (1.8% East and 3.2% West). The third proposal exempted forest land from property tax and imposed privilege tax rates intended to raise the same amount of revenue as a 1.5% tax on forest land value (2.25% East and 3.93% West). Under these proposals, the privilege tax rate reductions were phased in between 1993-94 and 1995-96 and the phase out of the additional tax on reforestation lands was completed in 1995-96. Both OFIC and the Subcommittee recommended the second industry option (80 – 20) for a number of reasons (see Research Report 2-93).

The 1993 Legislature passed HB 2438, which basically adopted the 80-20 OFIC proposal as recommended by the Interim Committee. The major provisions of HB 2438 included:

- Forest Land
 - Continues prior system of indexed forestland values through 1994-95.
 - Places specially assessed forestland values for Eastern Oregon and for 8 site classes in Western Oregon in statute. These are base values before indexing and are effectively 1994-95 values but first used in 1995-96.
 - Indexed values beginning in 1995-96 by 50% of the change in the Log Purchase Value Index.
 - Converts Log Purchase Value Index to a 7 year moving average (4 year phase-in).
 - Limits assessed value beginning in 1995-96 to 20% of specially assessed value.
- Privilege Taxes

- Reduced tax rates and eliminated the additional tax on reforestation lands.

The privilege tax rates and the additional tax rate imposed on reforestation lands are shown in the table below:

<u>Timber Harvest Period</u>	<u>EAST</u>		<u>West</u>	
	<u>Privilege</u>	<u>Additional</u>	<u>Privilege</u>	<u>Additional</u>
June 30, 1993 to December 31, 1993	3.50	2.90	4.70	1.90
Calendar Year 1994	3.30	2.31	4.40	1.35
Calendar Year 1995	2.90	1.88	3.80	1.02
Calendar Year 1996 and later years	1.80	0.00	3.20	0.00

The Legislature adopted OFIC's theory of taxation in a series of legislative findings and policy statements. The major differences from the Interim Committee recommendation were to structure the phase-down so that privilege tax rates were constant for each calendar year and to delay the full implementation by about 18 months. The Legislature directed the Department to evaluate the adopted forest land values by February 1, 1995 and to report its findings to the 1995 Legislature. It required that the Department to review forestland values in 2000 and every 6 years thereafter.

The 1993 Legislature funded Department of Forestry administrative expenses for the Small Tract Option and the Reforestation Tax Credit from the Western Oregon Timber Tax Account. This continued this funding source for the Small Tract Option and added the Reforestation Tax Credit.

The 1995 Legislature made minor changes to timber tax law while the 1993 legislation took effect. It clarified that hardwood harvests were exempt from Forest Products Harvest taxes, rebating taxes owed or refunding taxes paid back to 1990 in the West and 1992 in the East. It exempted machinery and equipment used solely in connection with logging from property tax. It also revised log purchase reporting requirements. The 1989 legislation required both sellers and purchasers in western Oregon to report on each transaction. 1993 legislation required that reports include the Department of Forestry Notification of Operations permit number but allowed large sellers to report directly to the Department of Revenue rather than providing the required information to purchasers. The 1995 Legislature clarified that purchasers must report and that sellers must provide purchasers with the required information unless they elect to report separately. It also extended this requirement to eastern Oregon.

The voters passed Measure 47 in November 1996. To clarify the Measure, the 1997 Legislature referred Measure 50, preserving the intent of Measure 47 but making it workable. Measure 50 and the enabling legislation in SB 1215 reduced property taxes and limited their future growth by creating a maximum assessed value for property and creating permanent operating tax rates for all taxing districts. Each property's 1997-98 maximum assessed value was based at 90% of its 1995-96 assessed value, and thereafter annual growth was limited to 3% per year after 1997-98.

The table below shows how forestland values were affected by Measure 50. In the table, assessed values for 1995-96 are truncated after cents to assure that the values are less than 20% of the statutory values. Some counties will show lower values, if they used the Department's certified values (whole dollars). For 1997-98 assessed value is the lesser of the 20% column (assessed value before Measure 50) or maximum assessed value (shown in the last column). Measure 50 reduced assessed value by about 18.3% in western Oregon and 25% in eastern Oregon. But if you compare the reduction to the full value of forestland, the reduction is about 3.7% in western Oregon and 5% in eastern Oregon. This is lower than the reduction for property generally because the privilege taxes were unaffected by Measure 50.

Site Class	1995-96 Value			1997-98 Value		
	Indexed	Statutory	Assessed	Indexed	20%	Maximum
West	Statutory	Assessed	Statutory	20%	Assessed	
FA	\$782.42	\$156.48	\$862.06	\$172.41	\$140.83	
FB	672.66	134.53	741.13	148.22	121.08	
FC	430.33	86.06	474.13	94.82	77.45	
FD	324.92	64.98	357.99	71.59	58.48	
FE	185.82	37.16	204.74	40.94	33.44	
FF	45.64	9.12	50.29	10.05	8.21	
FG	7.61	1.52	8.38	1.67	1.37	
FX	1.09	0.21	1.20	0.23	0.19	
East	47.91	9.58	57.33	11.46	8.62	

The industry sought to share more equally in the property tax reductions under Measure 50 and to reduce the industry's exposure (some felt that the privilege taxes were outside both Measure 5 and Measure 50 and were legitimate sources for funding special programs in a period of tight fiscal restraint). In response to these concerns, the 1997 Legislature passed HB 3734, which allowed forestland owners to elect to have their forestland assessed at full value under Measure 50 together with an exemption from privilege taxes.

HB 3734 was vetoed by the Governor, who noted that the bill did not become effective until the following biennium and that it is critically important that any major change in tax policy receive a through debate inside the larger context of economic and equity issues. Thus, the 80 – 20 program remained in tact, however, the assessed value of forestland was limited to its maximum assessed value under Measure 50.

The 1997 Legislature continued funding for administration of the small tract option and the reforestation tax credit from the Western Oregon Timber Tax Account, provided funding for assistance to eastern Oregon non-industrial private landowners from the Eastern Oregon Timber Tax Account, and made changes to the small tract option. It increased the maximum acreage limit under the small tract option to 5,000 acres, repealed the law disqualifying forestland when stand age reached 90 years, and changed the method of valuing forestland under the small tract option from productivity values to the indexed

statutory forestland values by assigning Department of Revenue site classes. The effects of this change and Measure 50 on the small tract option are shown in the table below:

Forestry <u>Site Class</u>	<u>Productivity Value</u>		Maximum	Indexed	
	<u>1995-96</u>	<u>1997-98</u>	<u>Assessed Value</u>	<u>Revenue</u>	<u>Statutory</u>
I	1,156	895	1,040.40	FA	862.06
II	760	579	684.00	FC	474.13
III	527	400	474.30	FD	357.99
IV	252	187	226.80	FF	50.29
V	66	45	59.40	FG	8.38

Maximum assessed values of forest land under the Small Tract Option were about 30% higher than the 1997-98 productivity values determined by the Department of Forestry, primarily because of the decline in productivity value between 1995-96 and 1997-98. The conversion to Department of Revenue site classes and their associated indexed statutory values did reduce assessed values.

The 1999 Legislature addressed the timber tax issue early, passing HB 2452 in March. This bill set the stage for a reconsideration of the issues in HB 3734 (1997) which was vetoed by the Governor. It, primarily, exempted harvests from privilege taxes, if the timber was harvested from land other than forestland (land not eligible for the 20% assessment ratio). The Governor vetoed this bill on April 7th and the House failed to override the Governor's veto. The Governor's veto message cited several reasons for the veto, including the revenue impact on schools, and stated his interest in pursuing the issue of equitable timber taxation.

The House Committee on Revenue and School Finance began hearings on HB 3575 in April, the Legislature passed the bill in July, and the Governor signed it in September. HB 3575 imposes a new system for taxing forestland, which phases in through 2003. Forestland value and maximum assessed value, under Measure 50, are determined as if the land had been assessed at 100% of its indexed statutory value in 1995. This occurs in two steps. It goes to 75% in 2000 and to 100% in 2003. Harvests from lands in this program pay reduced privilege taxes for 2000 through 2002 and are exempt from the privilege taxes beginning January 1, 2003. The method of indexing forestland values, 50% of the change in a 7 year moving average (West) and a 5 year moving average (East), was preserved; but the base was changed from the Log Purchase Value Index to the Average Pacific Northwest Coast Lumber Price Index. Harvests from land, assessed as other than forestland for at least 5 years are exempt from privilege taxes.

The Department of Revenue is required to identify forestland in ownership of 5,000 acres or over (large ownerships) and less than 5,000 acres (small ownerships) as of January 1, 2000. Large ownerships are under the new system beginning in 2000 for privilege taxes and in 2000-01 for property tax. Small ownerships remain under the 80 – 20 system unless the owner elects to be taxed under the new system. In 2003 for privilege taxes and 2003-04 for property taxes, all forest land is brought under the new program, but small owners

may elect to be taxed under the 80 – 20 system or whatever alternative program is provided by the 2001 Legislature.

The system for distributing privilege taxes to local taxing districts is simplified and unified for both eastern and western Oregon. During the phase in of the new program, privilege tax payments must be identified between ownerships under the new system and ownerships remaining under the 80 – 20 system. Of the amounts paid under the new system, 93% goes to the State School Fund and 7% goes to the Community College Support Fund. These amounts are determined as of May 15th of each fiscal year and transferred by May 31st, so the districts receive the revenue in the same fiscal year that the payments are made. The amounts paid under the 80 – 20 system, as of May 15th of each fiscal year, are divided, with 65% distributed in the same way as payments under the new system and 35% held in the Timber Tax Accounts for distribution to the counties in the following August. Distributions of Eastern Oregon Privilege Taxes are in proportion to each county's forestland value as a share of total forestland value in eastern Oregon in the prior year. Distributions of Western Oregon Privilege Taxes are in proportion to each county's forestland value as a share of total forestland value in western Oregon in the prior year. These distributions begin in August of 2001 (no distribution in 2000).

These distributions continue to be offset against county levies (reductions to the county's permanent operating tax rates). This distribution system means that actual county privilege tax revenues will be known for the fiscal year, thus there is no need for the reserve account in western Oregon or for counties to hold receipts in excess of offsets. Thus, the Western Oregon Timber Tax Reserve Account is repealed and the balance in the Account on August 31, 2000 is distributed: 30% to counties based on forestland value, 65.1% to the State School Fund, and 4.9% to the Community College Support Fund. Any privilege tax receipts on hand with the county treasurers on August 31, 2000 are distributed as offsets to the appropriate taxing districts. The short-term bonding authority granted when revenues are less than offsets, is repealed and the additions to district bonding capacities based on privilege taxes is repealed.

The method of valuing timber harvests in western Oregon is changed to require the Department to determine Immediate Harvest Value rather than Stumpage Value. This standardizes valuation procedures in eastern and western Oregon and allows the Department additional discretion in designating valuation areas, which should simplify the process. The 1999 Legislature also exempted western Juniper from eastern Oregon privilege tax and from the Forest Products Harvest Tax and required a study of issues related to its management.

The new program, as implemented by the 1999 Legislature, will base 2003 assessed and maximum assessed values on 100% of the indexed statutory values for forestland. In 2003 all forestland is brought under the new program but small landowners may elect to continue under the 80 – 20 program. There was concern that the 2003 assessed values may exceed market value and result in a large number of value appeals. There was also concern that the 80 – 20 program is not the best alternative for small owners. So the legislature required the Department of Revenue to organize interim working groups to:

- Review forestland values in statute and real market values for highest and best use forestlands
- To recommend an economical, administratively efficient, and cost-effective small forestland landowner deferred forest tax optional program

- To recommend methods and procedures by which forestland owners may appeal determinations of forestland real market value.

These working groups are scheduled to report to the 2001 Legislature. If the working group on real market values is not able to reach agreement, they are required to go through a dispute resolution process.

This period saw rapid growth in Forest Products Harvest Taxes, both because of additional rates to fund new programs and because of the declining tax base. Forest Products Harvest Taxes are levied per 1,000 board feet of timber harvested from both public and private forestland. The total harvest reached a high of 8.7 billion board feet in 1986 and has declined to about 3.7 billion board feet. As the table below shows, the decline was mostly in U.S. Forest Service and BLM harvests (86%) with private harvests down about 20%

Year	Timber Harvest (million bf)			Percent of 1986
	Private	Public	Total	
1985	3,756	4,371	8,127	93.0%
1986	3,851	4,892	8,743	100.0%
1987	3,649	4,566	8,215	94.0%
1988	3,679	4,936	8,615	98.5%
1989	4,057	4,363	8,420	96.3%
1990	3,501	2,718	6,219	71.1%
1991	3,525	2,546	6,071	69.4%
1992	3,856	1,850	5,706	65.3%
1993	3,609	1,685	5,294	60.5%
1994	3,571	645	4,216	48.2%
1995	3,638	680	4,318	49.4%
1996	3,120	812	3,932	45.0%
1997	3,400	694	4,094	46.8%
1998	2,848	702	3,550	40.6%
1999	3,098	702	3,800	46.5%
2000	2,988	702	3,700	42.3%

At the beginning of this period, the only Forest Products Harvest Tax (FPHT) rates were 21¢ for forest research, 30¢ for fire suppression, and 16¢ to the Department of Forestry to cover roughly 40% of the cost of administering the Forest Practices Act. The 1991 Legislature added 100% of the cost of the industrial fire prevention program as costs to be funded with FPHT rates. This continued through 1995, thereafter funding was from the General Fund. It also created the Oregon Forest Resources Institute, set a 31¢ rate for 1991-92 and authorized the governing Board of the Institute to set the future rate not to exceed 75¢, though it gave the Board authority to index this maximum rate according to the Consumer Price Index. The 1991 Legislature also passed SB 1125 expanding the Forest Practices and imposing a 13¢ FPHT rate for 1991-91 and 1992-93. The 1991 Legislature set the rate for fire suppression at 50¢, but authorized the State Forester to increase the rate, if necessary, to maintain a balance of \$15 million in the Forest Land Protection fund.

The 1993 Legislature consolidated the rates for the Forest Practices Act, Industrial Fire Prevention and most of the SB 1125 requirements into one rate to fund the portions of these programs covered by FPHT. It imposed a separate 4¢ to fund continued study of the cumulative effects of past, present and foreseeable future forest practices as required by SB 1125. This study was done jointly by the Department of Forestry, the Department of Environmental Quality, and the Department of Fish and Wildlife. It also extended the 1994-95 rates through 12/31/95, converting from rates imposed by fiscal year to rates imposed

by calendar year. The 1993 Legislature left the 50¢ rate for fire suppression in statute, but suspended it, if the balance in the Forest Land Protection Fund was estimated to exceed \$15 million.

The 1997 Legislature passed SB 3700 dealing with watershed enhancement and salmon reclamation. Funding for these programs included a \$1.75 FPHT rate. This tax rate was automatically repealed, if any of a number of conditions relating to the listing of salmon as an endangered species occurred. Salmon were listed and the tax was in effect for only 11 months during 1998. The 1999 Legislature imposed a 15¢ FPHT rate to fund Department of Forestry assistance to nonindustrial private landowners. The current expectation is that the rate for fire suppression in 2001 will be zero, since the Fund is estimated to exceed \$15 million.

The table below shows a summary of the FPHT rates.

<u>Year</u>	<u>Research</u>	<u>Fire</u>	<u>Dept. of Forestry</u>	<u>Resource Institute</u>	<u>Salmon</u>	<u>Total</u>
		<u>Suppres.</u>				
1985-86	.21	0	.10			.31
1986-87	.21	.15	.10			.46
1987-88	.21	.15	.10			.46
1988-89	.21	.15	.10			.46
1989-90	.21	.30	.16			.67
1990-91	.21	.30	.16			.67
1991-92	.30	.50	.53	.31		1.64
1992-93	.30	.66	.53	.31		1.80
6 Months	.40	.66	.77	.31		2.14
1994	.40	.66	.77	.31		2.14
1995	.40	.50	.77	.31		1.98
1996	.50	.50	.60	.51		2.11
1997	.50	.50	.60	.51		2.11
1998	.55	.50	.70	.51	1.75	4.01
1999	.55	.50	.70	.79		2.54
2000	.67	.50	1.23	.79		3.19
2001	.67		1.23	.79		2.69

During the 10 years from 1990 to 2000, the total FPHT rate rose from 67¢ to \$3.19 (476%), which is roughly 17% per year. During this same period the volume harvested declined by 48.9%. Thus the total revenue raised by the tax increased about 290% or 11.1% per year. Most of the increase was to fund new or expanded programs. For forest research, the rate more than tripled and revenue increased by 95%, or about 7% per year. The rate for fire suppression increased by 67% while revenue increased about 2% (this varies depending on the balance in the OFLPF). The rate shown for the Department of Forestry covers different programs at different times as noted above. Thus the 769% rate increase provided an increase in revenue of 470% to fund both existing and new programs. While the Oregon Forest Resource Institute did not exist in 1990, its current rate is 25% of the total rate.