The Potential Impacts of State Income Taxes on Timber Income Following the 1986 Tax Reform Act

by

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(ABSTRACT)

State income tax laws and their relationship to the federal income tax were surveyed and changes affecting forest landowners since similar research on this subject (1981-82) are discussed. Several previously favorable provisions were eliminated at the federal level. Although the economic situation and research assumptions have changed, the general indications are that many states have implemented provisions which may be considered generally unfavorable to forest landowners. The 1988 federal and state income tax liabilities for hypothetical forest landowners at three personal income levels, each with and without timber sale revenue, were calculated for 41 states in the U.S. which impose a comprehensive income tax.

In the South, the state percentage of the total income tax liability for the hypothetical landowners who sell timber ranged from 9 to 21, 7 to 17, and 6 to 15 percent for the low, medium and high income levels, respectively. The state percentage ranged from 10 to 31, 9 to 20, and 7 to 16 percent for the low, medium and high income levels, respectively for landowners who did not sell timber. Louisiana was the lowest and North Carolina was the highest for all hypothetical cases. In the West, the state percentage ranged from 13 to 25, 12 to 25, and 10 to 19 percent, for the low, medium and high income levels, respectively, for landowners who sold timber. The state percentage for landowners who did not sell timber ranged from 10 to 34, 15 to 25, and from 12 to 20 percent for the low, medium and high income levels, respectively. Arizona and Colorado consistently were among the lowest and Hawaii was the highest for all the hypothetical cases.

The state percentage in the Northeast, for landowners who sold timber ranged from 8 to 20, 6 to 17, and 5 to 16 percent, for the low, medium and high income levels, respectively. The state percentage for landowners who did not sell timber ranged from 14 to 32, 8 to 21, and 6 to 17 percent, for the low, medium and high income levels, respectively. Pennsylvania was the lowest in all hypothetical cases, Maryland the highest when there was no timber sale, and New York among the highest when there was a timber sale. The state percentage in the Midwest, when there was a timber sale ranged from 9 to 21, 7 to 17, and 6 to 16 percent for the low, medium and high income levels, respectively. The state percentage, when there was no timber sale ranged from 16 to 28, 9 to 21, and 7 to 17 percent for the low, medium and high income levels, respectively. Illinois was the lowest in most of the hypothetical cases, Minnesota the highest in most of the cases, and Wisconsin among the highest when there was no timber sale.

In the South and West, several tax provisions (capital gains exclusions, federal income tax deductions, standard deductions and personal exemptions) were important in providing for a low state tax liability. In the Northeast and Midwest, tax rates, federal income tax deductions and capital gains exclusions were the most important provisions for providing for a low state tax liability.

Spreading timber sale revenue over a two-year period, by using the installment sale method of reporting income, reduced the present value of tax liabilities substantially at the low (from $2,409 to $2,829), medium (from $1,203 to $1,279) and high (from $530 to $616) income levels. In addition, Maryland, North Carolina and Oregon have special forestry provisions in their codes, which could further reduce tax liabilities for timberland owners.

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Chapter 1

Introduction

Taxation is used to secure the bulk of the money to pay federal, state and local government bills (Duerr et al 1982). Taxes are a method for supporting our way of public life, and an important feature of the private firm's environment. Taxes may be considered as coercive levies by government on a firm, but they are part of the economic process, they pay for beneficial public goods and services. Taxpayers take a reduction in income of one kind (taxes) in order to realize an increase income of another kind (public goods). Rising costs of governments are forcing taxes to increase, and thus causing them to be a more noticeable cash outlay for the firm (Duerr et al 1982).

Taxes provided $247.1 billion of the general revenue for state governments in fiscal year 1987 (FY87) (CCH 1988d). Individual income taxes (imposed by 43 states) totalled $76.1 billion, or 31 percent of the total state taxes collected. Individual income taxes were the main source of revenue for 30 states, while sales taxes were the main source in 18 in FY87. Severance taxes were the main source of revenue for Alaska and Wyoming (CCH 1988d). The factors affecting the total amount of state taxes collected include tax rate changes, the imposition of a tax by additional state or local governments, general economic growth, legislative adjustments, legal rulings concerning particular taxes, and major shifts in the method and timing of the collection (CCH 1988c).

More than one-half of the states made tax changes in 1988, however, these changes involved relatively small amounts of revenue, and revenue increases were expected to be only $600 million (CCH 1988e). In addition, by October 1988 no state had enacted major increases in personal income tax rates. Ten states had, however, created or expanded personal income tax breaks in order to reduce taxes. This method of reducing taxes in general was the most common method in 1988 (CCH 1988e).

In a recent survey of the American public, state income taxes were identified as the fairest of all taxes, ranking ahead of state sales taxes, local property taxes, and the federal income tax (ACIR 1987, CCH 1988a). In comparison to previous surveys, this particular survey showed a growing public discontent with state income taxes while federal income taxes were becoming more favorable in the public eye. Respondents also indicated that state governments seemed to provide less for the public's tax dollar than do local or federal governments (CCH 1988a).

State tax funds help provide for schools, highways, public protection and many other public goods (CCH 1987). The differences in service levels among states reflect differences in tax levies. In order to influence the pace and composition of economic development state governments have used tax policy along with regulatory policy, direct expenditures and public persuasion to increase the income and employment of their residents. Most private firms, however, are not interested in whether personal income is increased or decreased, or whether new jobs have been created, as long as a tax incentive reduces costs (Barker 1983).

An increasing number of states are turning to explicit tax incentives and manipulations in their overall tax structure to induce industrial development, or induce firms to relocate to their state (Barker 1983). Tax incentives may be justified if they impel a firm to relocate, equalize interstate tax differentials, or serve as a wage subsidy to offset labor immobility or wage rigidity. Tax incentives have been used to lower the cost of capital and influence capital formation. Tax incentives may also serve to redistribute income to capital from labor and to provide development incentives. Finally, tax incentives may serve as a signal to out of state businesses that the particular state with the incentive is pro-business in terms of regulatory and spending policies. In terms of the personal income tax, analysts theorize that higher tax rates in one particular state may lead to migration of businesses out of that state and to states with lower tax rates. The differential at which interstate migration occurs is purely speculative. Higher tax rates, however, result in a reduction in work effort, personal savings, and new business formation in the state with the higher tax rates (Barker 1983).

The majority of state tax incentives can be utilized by all taxpayers in a state, so that a taxpayer only needs to meet certain criteria, and make the investment to obtain the benefit (Barker 1983). One reason that state tax incentives are repeatedly proposed and passed in state legislatures is the lack of evaluation of their effectiveness. Barker (1983) states that it is impossible for states to predict whether or not taxpayers tend to over-invest or under-invest when making business decisions. Legislators who decide to implement an incentive program on the assessment of an average return violate the marginal decision rule.

Many economists oppose tax incentives due to their alleged inefficiency (Barker 1983). A misallocation of capital may occur if the tax incentives are effective in shifting capital from investments with high rates of return to investments with lower rates of return. Few economists, when focusing on the competition between states for new businesses, conclude that tax incentives under competition will lead to improved allocation of resources, particularly labor. States are considered to benefit from tax incentives if an increase in income arises from an increase in investment or hiring, if reductions occur in welfare or transfer costs, or if a potential increase in tax revenues materializes due to the expanded economic activity. If a tax incentive does not do any of these, the state receives no benefit from the tax incentive, but the private firm does (Barker 1983).

The passage of the Tax reform Act of 1986 (TRA '86) represents the culmination of a sweeping review of the entire federal income tax system (Gardner and Stewart 1987). It has been described as the most extensive revision in the U. S. Tax Code in over 30 years (Condrell et al 1987). In addition, the Internal Revenue Service (IRS) definitions of gross and taxable income provide a model that is difficult for state tax systems to ignore (Barker 1983).

The major effects of TRA '86 involve both direct and indirect effects on taxpayers. The direct effect is the change in the federal income tax liability of each taxpayer. The indirect effect occurs in state income tax liabilities when the state tax code conforms to the federal tax code, or when taxpayer behavior changes as a result of tax reform. The changes made by TRA '86 have important implications for those states that rely on the federal provisions for income tax computation. States that continue to use the federal definition of "income" without adjusting their tax rates would receive a tax windfall due to the broadened base. These states were projected to have increases in income tax collection. Four states, Colorado, Kansas, Louisiana and New Mexico, were expected to have windfalls over 20 percent of their projected tax collections (CCH 1988b).

These projections may not be as high as expected if the state does not allow the federal income tax as a deduction, or if the state does not adopt one or more major federal provisions. States that couple to federal code by way of federal taxable income (i.e. use the federal definition of taxable income) often make adjustments for differences in state and federal deductions and exemptions. These states were projected to have very small changes in tax collections. States that use federal income tax liability as their tax base were projected to have a decline in state tax collections roughly proportional to the decline in federal income tax liability. Those states with limited income taxes projected both declines due to both behavioral changes and shifts in interest income and expenses in response to TRA '86, and increases from adopting the federal definition of long-term capital gains (ACIR 1988, CCH 1988b).

In developing the tax law changes of TRA '86, Congress was guided by "revenue neutrality" (Hoffman et al 1987). The net effect of the changes should neither increase nor decrease the Federal deficit. The lower tax rates (and corresponding broader base), however, did not necessarily mean that the tax liabilities for all classes of taxpayers would remain neutral. In addition, TRA '86 is not revenue neutral in every year. The new tax code is revenue neutral over a five-year period

(1987-1991), and is expected to put the Gramm-Rudmann-Hollings targets for FY88 and FY89 way out of reach (Hawkes 1988). While there is an element of fairness in removing 6 million low income taxpayers from the tax rolls, and eliminating several major tax shelters, no obvious feature of the new code contributes to economic growth. Individual retirement accounts (IRA's) and 401(k) plans, which had provided a stimulus to save when the national savings rate was well below investment needs, have been eliminated (Hawkes 1988). TRA '86 also dealt a blow to investment and productive capital with the repeal of the investment tax credit (ITC) and the lengthening of depreciation schedules (Hawkes 1988). In time the effects on the United States economy of these changes in the tax laws will be realized.

Income taxes, both federal and state, have an important impact on forest management in the United States. Many of the changes that have occurred at the federal level have been adopted by most states. The combined effects (federal and state) are expected to negatively affect the nonindustrial private forest (NIPF) landowner's tax liability due to higher tax rates and limited deductibility of annual costs (Milliken and Bradley 1986). The following study is a partial equilibrium analysis of the effects of state income taxes on NIPF landowners following TRA '86. The results that are illustrated and discussed focus on the effects of federal tax reform and state tax law changes on NIPF landowners, and not on U.S. taxpayers as a whole. The discussion of the current provisions and tax incentives which may positively or negatively affect NIPF landowners, and perhaps influence the intensity of management of their timberland, are assumed to affect NIPF landowners, and possibly other taxpayers with similar characteristics.

Objectives

The first objective of this study is to determine the level of federal, state and combined federal-state income taxes on timber income within the United States, following the passage of TRA '86. The second objective is to determine the difference in the state tax percentage of the total income tax liability between landowners who invest in forest management and have timber sale revenue, and landowners who do not invest in forest management and have no timber sale revenue. The third objective is to resolve the impact of the passive loss rules upon the tax liabilities of forest landowners. The fourth objective is to specify whether there are regional variations in state tax laws or whether there has been a shift of favorable tax provisions to the state level. The fifth and final objective is to specify the importance of special forestry provisions for those states which include them in their tax laws.

A brief, but representative literature review (Chapter 2) provides the setting for the entire study. State tax law changes since the previous research on this subject was published are examined (Chapter 3). The possible shift of favorable tax provisions to the state level, regional variations in state tax laws, and special forestry provisions are discussed in Chapter 3. The hypothetical case and methods of analysis are outlined in Chapter 4. The impacts of state income taxes on an active landowner with timber sale revenue and on a passive landowner with no timber sale revenue are detailed in Chapter 5. An analysis indicating the tax provisions that have the greatest impact on state tax liabilities is provided. Finally, alternative tax planning strategies (Chapter 6) are discussed and the amount of potential tax savings for landowners who elect to use the installment sale method of reporting timber sale revenue is determined. Chapter 7 contains the conclusions and inferences from the detailed study of this subject about the impact on NIPF landowners. The Appendices provide an outline of federal (Appendix A) and state (Appendix B) tax laws.

Chapter 2

Literature Review

The main concern of this study is the income maintenance of nonindustrial private forest (NIPF) landowners. Their holdings, however, have strategic significance to timber supply because they account for 58 percent of the commercial forest land in the United States and produced about one-third of the softwood timber removals in 1977 (Clawson 1979). According to *The South's Fourth Forest* (USDA Forest Service 1988), there is expected to be a large increase in the demand for softwood timber in the United States by the year 2030. An increase in timber output from NIPF holdings could reduce the pressure placed on public forests in meeting the nation's increasing demand for timber (Benfield et al 1988). A consensus of opinion indicates that only a modest increase in the supply of softwood timber is projected (USDA Forest Service 1988), even though the harvest of softwood timber from NIPF holdings is generally less than growth.

By definition, the quantity supplied of softwood timber equals the quantity demanded at market-clearing prices. An increase in softwood timber prices will occur when there is a shortfall in the quantity of softwood timber supplied (Hunter 1982), by the price of softwood timber being bid up until quantity demanded equals the quantity supplied. In other words, an increase in stumpage price may increase the quantity supplied of softwood timber due to timber buyers combing the countryside and flushing a substantial amount of timber out of the woods, at somewhat higher prices (Clawson 1979). Binkley and Vincent (1988) state that there is a consensus among the seven studies they reviewed that prices for softwood timber will increase during the next 30 years, but at a decreasing rate, and at lower rates than in the past. Although higher prices may stimulate important additions to the U. S. timber supply, the amount of additions would not be as large as those additions of timber that NIPF holdings (on sites good enough and tracts large enough to practice intensive forest management) could produce at full potential (Clawson 1979).

There are several disincentives to sustained private forestry, including a degree of risk accompanying long timber rotations, and a lack of liquidity. In addition, the realization of revenues from forestland is not an annual event, and smaller tracts of timber are usually managed less intensely than larger tracts due to "economies of scale" (there is usually a higher cost per acre for intensive management on smaller tracts). In general, NIPF landowners do not have access to market information and lack sufficient technical expertise to effectively manage their timberland (Benfield et al 1988).

The Society of American Foresters (SAF) (1979) argues that each private landowner should be free to determine how, when and why they will use their land. Governments may enact constraints or incentives designed to alter this use, but ultimately the owner should be free to decide what to achieve from the land and whether it will be increased goods or services to society and/or increased income and satisfaction to the owner. The SAF believes that the most effective force behind the betterment of forest management, in the long-run, is the enlightenment of forestland owners to all the alternatives of forestland management (SAF 1979).

Increasing the NIPF landowner's knowledge of forest management opportunities may be effective in increasing the timber supply potential from NIPF land (USDA Forest Service 1988, 1985). A variety of other ways may also be effective in increasing the timber supply potential of NIPF holdings. Public and private programs of protection, technical and financial assistance, and forest industry programs of assistance are a few methods considered to have a positive effect on softwood timber supply on NIPF holdings.

Timber tax incentives can be used to increase a landowner's motivation to invest in forest management through lower tax liabilities and higher rates of return on investments, but such responses are very difficult to document (Klemperer 1987). Chang (1983) concluded that changes in the maximum capital gains tax rate do not cause changes in nonindustrial reforestation investment, although he indicates that "many more analyses still need to be done."

Taxes are a cost of production that affects the return on investment. To the extent that returns are lowered, investment capital at the margin will shift from forestry to other alternatives. This, of course, adversely affects the practice of forestry and the timber supply. While many of these questions are beyond the scope of this inquiry, the study will analyze the effects of federal and state income taxes on timber sale revenue.

The 1986 Tax Reform Act

Income taxes are a significant cost and they have an important impact on the financial return of a forestry investment. The standard deduction and personal exemption amounts were increased with TRA '86, and the income tax base was substantially broadened with the elimination of the preferential treatment of long-term capital gains and many deductions (Boucher and Taylor 1987). Lowering the tax rates and broadening the tax base, however, does not necessarily mean that the tax liabilities for all classes of taxpayers will remain neutral. The federal tax reform is expected to shift the tax burden from one taxpayer group to another rather than generate new income. With this shift in tax liability, some taxpayers will benefit and others will be hurt (Boucher and Taylor

1987). Boucher and Taylor imply that timberland owners as a taxpayer class are worse off after tax reform than before.

Boucher and Taylor (1987) note also that corporations are generally losers under the recent federal tax reform due to an increase in corporate income tax rates, the repeal of the investment tax credit (ITC), the elimination of some deductions and the imposition of a new minimum tax. In the long-run corporations may benefit from increased public purchasing power in society.

Some individual taxpayers will benefit from tax reform due to reduced rates and increased personal exemption and standard deduction amounts. At the state level, however, those same individuals could lose some of the benefit from federal tax reform if they file returns in states which closely follow the federal code, but do not lower their tax rates and do not increase their personal exemption or standard deduction amounts. On the other hand, certain individuals no longer entitled to claim deductions for tax shelters, IRA contributions, and other activities on the federal level, plus individuals who are subject to the higher capital gains tax rates may not benefit from federal tax reform.

State tax windfalls

With the federal income tax base expanded by TRA '86, the tax base of states that are coupled[1] to the federal code is also expanded. This will cause a tax windfall for those state governments, if their tax rates remain unchanged. Fifteen of the 37 states that have an income tax were projected to have returned the windfall to their taxpayers by some method. This was achieved by lowering the tax rates or restoring some of the lost deductions and exclusions that occurred on the federal level (Klott 1988). Approximately 14 states kept the windfall because state income tax rates

[1] States that adopt many of the federal income tax definitions and provisions are considered to have "coupled" to the federal code

did not drop automatically, or because some state legislatures were inactive in this area, implying a net tax increase at the state level. Three states returned part and kept the balance of the windfall. The others either have not decided what to do with the windfall, or do not base their tax system on the federal system (Fetterman 1988).

The response of taxpayers to federal tax reform (and associated state tax reforms) is unpredictable. Similarly, the estimated windfall gains by states from timber sales cannot be accurately predicted because landowners may respond differently when selling timber that is subject to the higher capital gains rates. Boucher and Taylor (1987) note that some taxpayers may "postpone the realization of capital gains until death because of the reduced tax advantage afforded such gains." This particular insight may not directly involve forestry investments because a timber sale cannot be timed to occur at the date of a taxpayer's death. The heirs receive a step-up in the basis, and some timber sales may be postponed indefinitely until legislation is passed to invite a perceived favorable treatment on the liquidation of the capital asset. The step-up helps estates of $600,000 or less, but the marginal tax rate at that level is 37 percent, indicating high valued estates may not benefit from postponement.

Income tax brackets after tax reform

One of the major changes in the Internal Revenue Code (IRC) is the lowering of ordinary income tax rates and the removal of the progressivity of the tax by reducing the number of tax brackets from 14 (pre-TRA '86) to 2 (1988 and after). An individual's income is now subject to a two-tiered rate structure, consisting of 15 and 28 percent brackets. The benefit of having income fall in the 15 percent bracket, however, is phased out by a 5 percent surtax for any amount of income over certain specified limits (Condrell 1986). Exemption deductions are also phased out by extending the imposition of the 5 percent surtax on enough taxable income to eliminate their benefit.

The elimination of many deductions and credits in the new tax laws has broadened the tax base. Higher standard deduction and personal exemption amounts have mitigated somewhat the tax impacts on the broadened base. Tax rates applied to the broadened base have been reduced on the federal level, decreasing individual tax liabilities $120 billion over the five-year period 1987-1991 (Boucher and Taylor 1987).

Capital gains provisions after tax reform

TRA '86 repealed the exclusion from taxable income of 60 percent of a net long-term capital gain. Under previous tax law the top capital gains tax rate was 20 percent, given the 60 percent exclusion of the net long-term capital gain from taxation and a maximum tax rate of 50 percent for ordinary income. During 1987 only, capital gains were taxed at a maximum rate of 28 percent (Hoffman et al 1987). Net long-term capital gains are now taxed at ordinary income rates.

Timber capital gains provisions in the IRC remain unchanged, and are retained in the present code in sections 1221, 1231, 631(a), and 631(b). This allows an opportunity for the capital gains differential to be reestablished at some future date (Condrell 1988). If the requirements are met, income may still be reported as a capital gain, and in certain situations, it may be advantageous for a NIPF landowner to continue to do so (Siegel 1987a). Some advantages in reporting timber sales as capital gains may still exist for self-employed taxpayers, taxpayers with capital losses, and taxpayers with involuntary conversions.

The previous preferential treatment of long-term capital gains was thought to have stimulated capital formation and lessoned the tax burden caused by bunching of gains. It was believed that the preferential treatment decreased the tax deterrent to forestry investments caused by the "lock-in effect,"[2] and to have partially compensated landowners for the negative impact of inflation on the taxation of capital gains. The Treasury Department, however, contends that a differential in tax rates (between ordinary income and capital gains) can reduce economic efficiency in a society, by causing capital to be allocated to assets with lower before-tax returns than other assets. In a freely competitive market, it is unlikely that much capital actually will be invested in below-average returns (Klemperer 1987).

Passive activity loss rules

There are new passive loss rules which affect the deductibility of forest management and related expenses by NIPF landowners. These provisions limit the ability of taxpayers to use losses and credits from one activity to offset income from other activities. The provisions are designed to curb abusive tax shelters. Legitimate timber investments are not tax shelters in the any sense of the word. They may give the appearance of a tax shelter due to periodic incomes, negative cash flows in the early stages of the investment, and the realization of profits at the rotation age in most cases.

Depending on which category a landowner's particular timber activity fits, the rules for deducting certain management costs, taxes and interest will vary. The change creates tax liability difficulties for landowners who have long-term capital investments with periodic incomes. These landowners may have to become more active in the management of their timberland to sustain the amount of deductions and credits allowed under previous law. Active participation in an activity involves regular, continuous, and substantial involvement in that activity's operations (Condrell 1988).

Individuals, estates, trusts, personal service organizations and closely held C corporations are affected by the passive loss rules. Three categories of timber activities with regards to the rules were

[2] The "lock-in effect" is caused by locking capital in an investment for the duration of a timber rotation before being recovered.

established: timber held as part of a trade or business in which the taxpayer materially participates; timber not held as a trade or business, but for the production of income (i.e. an investment); and timber held as part of a trade or business, or as an investment, in which the taxpayer does not materially participate (FICTVT 1987). The third category is one in which "passive activities" are defined and is technically the only one substantially affected by the new passive loss rules. Losses from a passive activity can be deducted only to the extent of income earned by that or other passive activities. Deductions for management expenses, interest and taxes are limited in any year, under the new tax laws, where timber income is less than the sum of these amounts (Condrell 1988).

The rules for deducting timber management and related costs, taxes and interest will vary depending on the category into which a taxpayer fits. Temporary IRS regulations have established quantitative tests for determining taxpayer status. These tests fit timber activities very poorly due to the nature of most forestry investments, and they are especially restrictive for absentee landowners and those landowners who use consulting foresters. Condrell et al (1987), the USDA Forest Service (1989) and Haney and Siegel (1988) provide a detailed description of the types of timber-related activities that fit into each category.

Other federal income tax provisions pertaining to forestry

Income averaging was repealed by TRA '86. It was no longer considered necessary due to the reduction in tax brackets from 14 to 2 (Hoover 1988). The installment sale method of smoothing income and minimizing tax costs may still be utilized by many timberland owners. Installment sale provisions may be used for timber sales by taxpayers considered to be a trade or business as defined under Section 2032(a) of the IRC. Otherwise, considerable restrictions have been imposed on the use of installment sales by trades or businesses (USDA Forest Service 1989).

The rules pertaining to the amortization of qualified reforestation expenditures and the associated investment tax credit (ITC) did not change under TRA '86. However, the economic impact of these provisions has been reduced somewhat due to the lowering of the tax rates. The USDA Forest Service (1989), Haney and Siegel (1988) and Gunter and Kessler (1987) outline the amortization procedures in detail.

Depletion rules also remain unchanged following TRA '86. An allowance for depletion (deduction of invested capital) is permitted in computing a net gain on a timber sale, and technically occurs only when a landowner treats cutting as a sale under an IRC Section 631(a) election. It is common practice, however, to refer to the recovery of invested timber capital under any method of disposal as depletion. The importance of recovering invested capital becomes relatively more important to taxpayers now that the exclusion of a portion of long-term capital gains is not currently available.

Effects of federal income taxes on forestry investments

Considerable research has been done on the effects of federal income taxes on forestry investments (Condrell et al 1987, FICTVT 1987, Briggs and Condrell 1986, FICTVT Various, USDA Forest Service 1982). Prior to TRA '86, Leuschner and Haney (1985) speculated on the effects of a modified flat tax on forestry investments as well as the loss of capital gains incentives and amortization of reforestation expenditures. They also provide a discussion of the possibility of indexing the basis of capital investments. The idea of indexing the basis for capital gains assets arose in President Reagan's and the Treasury Department's tax reform proposals in 1984. President Reagan's proposal would have involved indexing the basis in lieu of preferential tax treatment of capital gains in 1991. The results of Leuschner and Haney's (1985) study indicate that individuals with sufficient capital to invest in forest management would have been discouraged the most under the proposals.

Leuschner and Haney (1985) concluded that these proposals, if implemented, would bring lower returns on forestry investments and that funds may be shifted to alternative investments which earn higher returns. Lower investment in forestry was expected to result in reductions in the timber supply, thereby increasing the prices for wood and wood products. In addition, less investment in forest management may have negative impacts on recreation, aesthetics and wildlife that come with a managed forest. An unexpected consequence of the proposed tax law changes is that compliance with the IRC is not likely to improve, due to the complexity of the tax laws and the difficulty of understanding the provisions by average taxpayers.

The argument for basis indexing is stronger after the passage of TRA′ 86, since short- and long-term capital gains and ordinary income are taxed at the same marginal rates. Klemperer (1987) suggests indexing the tax-deductible basis to insure that inflation will not cause an extra burden on forestry investments above the burden imposed by the changes in TRA ′86. Without changing the marginal tax rates Klemperer and O′Neil (1987) suggest basis indexing could increase bid prices for certain assets, such as timberland, by more than 10 percent. Investments with short time horizons (such as Christmas trees) will gain more land bidding power than investments with longer horizons (such as sawtimber). Asset value of investments with horizons longer than 30 years will not be affected much by inflation, once inflation has reached 6 percent. Given a fixed inflation rate, and viewed from a tax neutral standpoint, basis indexing seems to be a preferable tax policy due to the wide range of impacts fixed inflation can impose on the after-tax present value of capital assets. Additional recordkeeping requirements would be one disadvantage of the indexing proposals.

It may seem logical for timberland owners to pursue arguments for using basis indexing to remove the highly variable and negative effects of inflation on capital gains returns. Basis indexing could provide a tax reduction for timberland owners and owners of other capital assets. Lobbying for a return of the capital gains differential may again raise the efficiency concerns of the Treasury Department (Klemperer 1987).

Dangerfield and Gunter (1986) predict that the new tax laws will be less favorable to forest landowners than the old tax laws. Landowners may benefit from other aspects of TRA '86 leading to a net gain. By determining individual income tax liabilities for a range of four income levels, combined with a range of four levels of capital gains from timber sales, they show that people with lower adjusted gross incomes are hurt the most by the tax reform. In their analysis people with high levels of adjusted gross income, but low levels of capital gains, actually would have a lower tax liability under the new federal laws. Dangerfield and Gunter (1986) suggest that the benefit from timber sales must be calculated on an individual basis, and that the implications of future price changes should also be considered.

Guertin and Rideout (1987) use fundamentals of forest investment theory to evaluate the effects of federal tax reform on planting density, rotation age, and utilization of marginal lands, for corporate forest landowners. They maximized land expectation value (LEV) for loblolly pine and Douglas-fir on three site classes (low, medium and high) for management regimes that included no thinnings or other intermediate treatments. A higher capital gains tax on timber revenues, combined with a lower value of annual operating cost deductions (caused by the higher tax rates), reduced the LEV in every case. Low sites showed the greatest percentage reduction in LEV, perhaps due to these sites having a low LEV to begin with. They found that the tax reform produced only trivial changes in planting density and optimum rotation age under the assumptions of their model.

Milliken and Bradley (1986) discuss in depth the effects of the passive loss rules on timberland owners. They concluded that timberland owners would expect mixed results under the final tax reform bill. They argue that the increased tax on capital gains will adversely affect the value of timberland and the reduced rates on ordinary income would diminish the value of current deductions. The rates of return on forestry investments that are leveraged will decline since the reduced ordinary income tax rates increase the after-tax cost of borrowing capital. The uncertainty of the passive loss rules may depress timberland values further.

IRS regulations prevent taxpayers from using regularly occurring losses in passive activities to offset active income. Milliken and Bradley (1986) project that many timberland owners will be treated as passive participants in their forestry investments under strict IRS interpretation of the new rules. They further assert that the market for timberland is likely to remain unsettled for 3 to 5 years as investors adjust to the new tax laws. Klemperer (1987) indicates that shifts in forestland use are unlikely, since the most profitable use for most current forestland probably still is the current use, growing timber. The intensity of management will likely decrease if returns are less than alternative opportunities.

Milliken and Bradley (1986) predict a shift in timberland ownership from passive investors to investors who are in the trade or business of selling timber. Individual absentee owners will likely become sellers since they are the most disadvantaged timberland owner group after tax reform. Individuals in an active trade or business are likely to become buyers. They are unsure of the number of individuals who want to be actively involved in the management of their timberland, and how much capital this group may have in order to purchase timberland. Tax-exempt investors may be the most favored buyers, but the rate of return they demand may be too high for profitable forest management, and the infrastructure is not in place for this group to acquire scattered, small tracts of timberland.

Milliken and Bradley (1986) forecast a short-term drop in stumpage prices due to the passive investors disinvesting in timber by selling the timber, but they also see a long-term increase in timber supply. The increase is projected because most of the new timberland owners will probably be in an active trade or business, and may be more aggressive in their efforts to reforest after harvesting timber. Although, it all depends on taxpayer behavior.

Siegel (1987b) discusses capitalization verses expensing of intermediate silvicultural systems under the new federal tax laws. He states that the correct way to handle these costs depends on the nature, timing, and purpose of the practice, the taxpayer's cash flow and tax status, and the other tax options available to the timberland owner. With the passage of TRA '86, many of the code sections remain unchanged as to whether to capitalize or expense silvicultural treatments. The provisions for amortization of reforestation costs and the associated ITC remain intact as well as the requirements for capitalizing stand establishment costs. Management costs and stand improvement costs are ordinary and necessary costs, and can be expensed in the year of occurrence, or, at the taxpayer's option, they can be capitalized as "carrying charges." Siegel (1987b) also discusses the consequences some landowners, who are subject to the passive loss rules, face in terms of the opportunity to expense these intermediate silvicultural stand costs. He asserts that less silvicultural work will be done on NIPF land when these rules are coupled with the higher capital gains tax rates.

Klemperer (1987) states that a tax increase could reduce the intensity of forest management on NIPF land. If precommercial thinning and intensive site preparation do not bring the returns that are available with other investments, a shift from an investment in forestry to investments in other assets may occur, possibly indicating a greater reliance on natural regeneration for private forestland. Klemperer (1987) suggests that selective land use regulations on sensitive sites may be more efficient than tax adjustments due to environmental concerns.

Effects of state income taxes on forestry investments

State income tax impacts on forestry investments vary widely due to differing state income tax laws. Prior to TRA '86, Siegel and Haney (1983) indicated that many states had offered landowners opportunities to minimize the tax imposed on income from forestry investments through capital gains treatment of timber revenues, amortization of reforestation expenses, investment tax credits, and the annual deduction of operating expenses. Some of these benefits have been altered since the previous study because many states closely follow the federal income tax structure imposed under TRA '86.

Duerr et al (1982) assert that state income taxes do not appear to raise special problems for forestland owners. For the most part timber is not specifically mentioned in state income tax codes that recognize capital gains. Further, Duerr et al (1982) indicate that the indirect effect of state income taxes on forest investments is likely to be beneficial. State income taxes on forestry investments provide funds for state aid to local governments, and therefore ease the pressure on local governments in having to generate revenues from property taxes.

McGee et al (1984, 1982) and McGee (1982) have studied the effects of state income taxes on forestry investments in the United States. Their analyses include coverage of the combined effects of the existing federal income tax structure and state income tax structure in 1982. They had also reviewed the major aspects of federal income tax law as it pertained to forestry investments. State income taxes should be important in the investment analysis of forestry investments because McGee et al (1984) indicate that 18 to 30 percent of the total income tax liability was attributed to the state liability. The state income tax provisions were outlined in their study, along with the special forestry provisions that were incorporated into certain state laws. Unfortunately, changes in the tax laws over the past six years due to TRA '86 may have altered many conclusions of this work.

Eisenstadt (1988) notes that state tax planning is now more complicated than it was prior to TRA '86. Many states have enacted new tax legislation in response to TRA' 86. Even in the absence of direct legislation by states in response to TRA' 86, the state income tax burden on income from forestry investments generally changed. Now that the top marginal income tax rate is only 33 percent at the federal level (28% for the very wealthy) state income taxes constitute a larger percentage of the total income taxes paid by most taxpayers.

The state income tax probably ranks below all of the timber-related taxes in terms of the amount of revenue collected (Holley 1988). Holley reports that it is an important consideration in the decision framework of NIPF landowners. States which had taxed 100 percent of net long-term capital gains prior to TRA '86 may gain a competitive advantage in comparison to other states which fully tax capital gains now after previously allowing an exclusion. The considerable difference in state income tax liabilities may give some states a competitive advantage in attracting forestry investors. Holley (1988) asserts that state income taxes are one of many components of an investment cash flow analysis, but the vast differences among state income tax systems cannot be easily accommodated in a region-wide forestry investment study. McKnight (1989) notes that "[f]orest managers....need to know the impact of state income taxes on timber sale returns," and that "[t]his has been a much-neglected topic and one which is especially timely following the major revisions in tax codes."

Chapter 3

State Tax Law Changes

An analysis of changes in the major provisions of state income tax codes over the past six years with an emphasis on TRA '86 follows. The information used in this study was derived from State Codes, income tax forms, correspondence and conversation with State Revenue Department representatives, the *State Tax Guide* (CCH 1988f), and the Bureau of National Affairs (1988). The major provisions include the determination of the state tax base, the proportion of long-term capital gains that are taxable, the status of the amortization deduction for qualified reforestation expenditures, and the adoption of the federal passive loss rules. Adjustments in other provisions of state tax laws are also discussed. These other provisions include the deductibility of federal income taxes, personal exemption and standard deduction amounts, abbreviated tax rate schedules, and maximum effective long-term capital gains tax rates. For the purposes of this Chapter the work by McGee et al (1984, 1982) and McGee (1982) is referred to as the "previous study." Results from my survey and analyses are compared with the previous study. The information from the previous study was obtained from state codes, income tax forms, correspondence and conversation with State Revenue Department representatives, and publications of the Commerce Clearinghouse.

The analysis of state income tax provisions is on a regional basis. Four regions were used in this study to be consistent with the previous study. The South includes the following 14 states: Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia and West Virginia. The West includes the following 13 states: Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington and Wyoming. The Northeast includes the following 12 states: Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Rhode Island and Vermont. Finally, the Midwest includes the remaining 11 states: Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, South Dakota and Wisconsin.

The South

Most southern states have income tax systems that conform closely to the federal system. The federal changes enacted with the passage of TRA '86 flow through automatically to those five states that utilize federal adjusted gross income (AGI) as their tax base (Table 1). According to the previous study, six states in the South used federal AGI as their tax base in 1982. Kentucky does not use the current definition of federal AGI as its tax base, but had used it previously.

The remaining six southern states with a comprehensive income tax do not use federal AGI as their tax base, although some have adopted several components of the new federal law. Alabama utilizes the federal individual retirement account (IRA), business income, and alimony provisions. Arkansas has adopted certain provisions of federal law, including nearly all of those relating to itemized deductions. Mississippi utilizes the federal IRA, itemized deduction, and installment sale provisions. Kentucky and North Carolina use somewhat unique procedures to determine taxable income. Kentucky uses an old definition of federal AGI as its tax base. Kentucky's AGI is calculated in terms of the federal IRC as it existed on December 31, 1985. North Carolina taxes net

Table 1. Key Provisions of State Income Taxes in the South, 1988.a/

	Federal adjusted gross income used as tax base	Proportion of long-term capital gain taxable	Amortization of reforestation costs	Adoption of federal passive activity loss rules	Comments
	(Yes/no)	(%)	(Yes/no)	(Yes/no)	
ALABAMA	NO	100	YES	NO	Casualty losses in excess of $100 deductible in year of loss.
ARKANSAS	NO	100	YES	YESd/	Special capital gains provisions become effective in 1989 (see text, page 24). Taxpayers can claim 100% of capital loss in year of occurrence.
FLORIDA	---	---	---	---	No income tax.
GEORGIA	YES	100	YES	YES	
KENTUCKY	NOb/	40	YES	YESd/	Income averaging permitted.
LOUISIANA	YES	100	YES	YES	
MISSISSIPPI	NO	100	YES	YESd/	Capital losses can be claimed only in year of occurrence.
NORTH CAROLINA	NO	100	YES	NO	Special forestry provisions (see text, page 24). No state ITC.
OKLAHOMA	YES	100	YES	YES	
SOUTH CAROLINA	NOc/	100	YES	YES	
TENNESSEE	---	---	---	---	Tax on interest and dividend income only.
TEXAS	---	---	---	---	No income tax.
VIRGINIA	YES	100	YES	YES	
WEST VIRGINIA	YES	100	YES	YES	

a/ Provisions effective as of September 1988. Sources of this information were: State Codes, income tax forms, correspondence and conversation with State Revenue Department representatives, the State Tax Guide (CCH 1988f), and the Bureau of National Affairs (1988).

b/ Kentucky based its method of computing AGI on the federal income tax provisions that were in effect on December 31, 1985.

c/ The South Carolina tax base is federal taxable income.

d/ Only partially adopted.

income, calculated by subtracting certain specified exclusions from total income. South Carolina continues to utilize federal taxable income as its tax base.

Nine states in the South tax 100 percent of long-term capital gains (Table 1). Four of these states (Alabama, Arkansas, Mississippi, and North Carolina) had fully taxed long-term gains prior to the passage of TRA '86, according to the previous study. The other five changed to conform to current federal law. Kentucky still provides a 60 percent exclusion of net long-term gains, and Arkansas began to phase-in an exclusion in 1989. The exclusion began at 10 percent, will rise to 30 percent in 1990, and to 60 percent for 1991 and beyond.

The treatment of capital losses varies among states. Most states follow the federal capital loss provisions which limit recovery in some situations. In Alabama, however, capital losses in excess of $100 may be offset, without limit, against income in the year of occurrence. Capital losses in Mississippi must be offset against income in the year of occurrence. To the extent that these losses cannot be offset, recovery is lost.

The federal reforestation amortization deduction is automatically passed through to taxpayers in the 5 states that have adopted federal AGI as their tax base, and to taxpayers in South Carolina (Table 1). The other 5 states directly allow a reforestation amortization deduction in calculating either AGI or net income. According to the previous study, all eleven states had allowed an amortization deduction for qualified reforestation expenditures.

Six states in the South have adopted the federal passive loss rules in full; Arkansas, Kentucky and Mississippi have partially adopted them. Two states, Alabama and North Carolina, have not adopted the federal rules (Table 1).

North Carolina is the only southern state whose income tax code contains special forestry provisions. Taxpayers in North Carolina may report timber income in the year of receipt, or they may elect to report one-third of it in the year of receipt, and one-third in each of the next two tax years.

Reforestation expenditures may be currently deducted in full, or may be amortized over 60 months. Also, federal and state forestry cost-share payments received by North Carolina landowners can be excluded from income for state purposes.

The previous study discussed deductions, exemptions and rates that applied in 1982. Since that time, some changes have occurred. Four states in the South still allow a deduction for federal income taxes paid (Table 2), as compared to 5 reported by the previous study. Three of the four permit a complete deduction, but Oklahoma allows it only to the extent that it relates to income subject to state taxation. The deduction is prorated on the ratio of Oklahoma AGI to federal AGI. South Carolina has eliminated the deduction it previously allowed.

Personal exemption deductions have remained constant in five states (Alabama, Georgia, Mississippi, North Carolina and Oklahoma), as compared to those reported by the previous study. The 1988 amounts are shown in Table 2. Increases have occurred in Virginia (to $800 from $600) and West Virginia (to $2,000 from $600). Two states, Arkansas and Kentucky, still use personal exemption tax credits, each in the amount of $20 per exemption, although Arkansas' has decreased (to $20 from $35) since the previous study. South Carolina's personal exemption and standard deduction amounts are passed through to the state return via the federal taxable income base. Louisiana's combined standard deduction and personal exemption has been lowered to $9,000 from $12,000.

Standard deduction amounts in six states (Alabama, Arkansas, Kentucky, Mississippi, North Carolina and Oklahoma) have remained the same since the previous study. The 1988 standard deduction amounts are shown in Table 2. Two states, Georgia (to $3,000 from $2,000) and Virginia (to $2,700 from $2,000), raised their standard deduction amounts. West Virginia eliminated both standard and itemized deductions in 1987 legislation.

The tax rate schedules for ordinary income have remained the same in six states (Alabama, Arkansas, Georgia, Kentucky, Louisiana and North Carolina). Minor changes have occurred in the

Table 2. State Income Tax Deductions, Exemptions and Rates in the South.a/

State	Federal income tax deductible	Personal exemption	Standard deduction b/	Abbreviated tax rate schedule b/					Maximum effective long-term capital gains tax rate
				Steps	From	Of the first	To	Of the amount over	
	(Yes/no)	($)	($)	(#)	(%)	($)	(%)	($)	(%)
ALABAMA	YES	1,500	4,000c/	3	2.0	1,000	5.0	6,000	5.0
ARKANSAS	NO	20d/	1,000e/	6	1.0	2,999	7.0	24,999	7.0
FLORIDA	---	-----	-----	-	---	-----	---	------	---
GEORGIA	NO	1,500	3,000	6	1.0	1,000	6.0	10,000	6.0
KENTUCKY	YES	20d/	650	5	2.0	3,000	6.0	7,999	2.4
LOUISIANA	YES	9,000f/	COMBINEDg/	3	2.0	10,000	6.0	50,000	6.0
MISSISSIPPI	NO	9,500	3,400	3	3.0	5,000	5.0	10,000	5.0
NORTH CAROLINA	NO	1,100h/	550i/	5	3.0	2,000	7.0	10,000	7.0
OKLAHOMA	YES	1,000	2,000j/	7	0.5	2,000	6.0	15,000	6.0
SOUTH CAROLINA	NO	creditk/	-----	5	3.0	4,000	7.0	10,000	7.0
TENNESSEE	---	-----	-----	-	---	-----	---	------	---
TEXAS	---	-----	-----	-	---	-----	---	------	---
VIRGINIA	NO	800	2,700	4	2.0	3,000	5.75	15,000	5.75
WEST VIRGINIA	NO	2,000	-----l/	5	3.0	10,000	6.5	60,000	6.5

a/ Provisions effective as of September 1988. The sources of this information were: State Codes, income tax forms, correspondence and conversation with State Revenue Department representatives, the State Tax Guide (CCH 1988f), and the Bureau of National Affairs (1988).
b/ The standard deduction and tax rate schedules are for married taxpayers filing a joint return.
c/ If AGI is less than $20,000, the deduction is 20 percent of AGI.
d/ A tax credit of $20 is utilized rather than a personal exemption.
e/ If gross income is less than $10,000, the deduction is 10 percent of gross income.
f/ The personal exemption for husband and wife together. For single taxpayers the personal exemption is $6,000.
g/ Louisiana uses a combined personal exemption/standard deduction.
h/ The combined personal exemption for a married couple living together is $3,300.
i/ The maximum deduction is $550; for many taxpayers it may be less.
j/ The deduction actually equals the larger of 15 percent of AGI or $1,000, not to exceed $2,000.
k/ A credit is utilized in lieu of a personal exemption. For married filing a joint return, it is 0.7 percent of the lesser of $30,000 or the qualified earned income of that spouse with the lower qualified earned income for the tax year.
l/ The standard deduction was eliminated by the 1987 state tax legislation.

other five. Details of the 1988 rates and schedules are shown in Table 2. Mississippi added one step to its tax schedule (to 3 from 2) and increased its maximum ordinary income tax rate to 5 percent (on income over $10,000) from 4 percent (on income over $5,000). Oklahoma reduced the number of steps in its tax schedule (to 7 from 18) and lowered its maximum ordinary income tax rate to 6 percent (on income over $15,000) from 17 percent (on income over $94,000). South Carolina reduced the number of steps in its tax schedule (to 5 from 6) and increased its lowest tax rate to 3 percent (on income under $4,000) from 2 percent (on income under $2,000). Virginia increased the threshold to which its maximum ordinary income tax rate (5.75 percent) is applied to income over $15,000 (previously income over $12,000). Finally, West Virginia reduced the number of steps in its tax schedule to 5 from 24. The lowest ordinary income tax rate in West Virginia was increased to 3 percent (on income under $10,000) from 2.1 percent (on income under $4,000) and the maximum ordinary income tax rate was decreased to 6.5 percent (on income over $60,000) from 9.6 percent (on income over $400,000).

The maximum effective long-term capital gains tax rate (Table 2) is the product of the percentage of a long-term gain that is taxable times the maximum ordinary income tax rate. The maximum effective long-term gain rate has remained the same in four states (Alabama, Arkansas, Kentucky and North Carolina) since the previous study. In six states, however, it has risen. In Georgia (to 6 percent from 2.4 percent), Louisiana (to 6 percent from 2.4 percent), and Virginia (to 5.75 percent from 2.3 percent) the increase was due to the elimination of the long-term capital gains exclusion. An increase in South Carolina (to 7 percent from 3.5 percent) was due to a loss of a 50 percent long-term gain exclusion, and in West Virginia (to 6.5 percent from 3.8 percent) due to the loss of a 60 percent exclusion. In Mississippi, where long-term gains were already 100 percent taxable, the maximum ordinary income tax rate has been increased, thus effectively raising the maximum long-term gains rate to 5 percent from 4 percent.

The maximum effective long-term capital gains tax rate has been lowered only in Oklahoma (to 6 percent from 6.8 percent). Although the long-term gains exclusion was eliminated in that state, making all of a long-term gain taxable at ordinary income tax rates, the maximum ordinary income tax rate was reduced to 6 percent from 17 percent.

The West

The changes in the more important aspects of state tax laws in the West are examined as they pertain to NIPF landowners. Their interactions with federal tax laws are included. These changes have occurred partly in response to TRA '86, and partly due to periodic adjustments in state income tax laws since the previous study.

Five states in the West use federal AGI as their tax base (Table 3). Eight states previously had used federal AGI. Two states, Colorado and Idaho, changed their tax base to federal taxable income from federal AGI. Hawaii and Oregon adopted other methods for computing state AGI. They had previously used federal AGI as their tax base. Finally, California adopted federal AGI as its tax base, where it had previously used another method.

Eight states in the West tax 100 percent of net long-term capital gains (Table 3). Previously, all eight states had some form of capital gains differential in their tax laws. Idaho still utilizes a capital gains differential, which excludes 60 percent of net capital gains income from taxation. Montana allows a 40 percent exclusion of capital gains income reported from installment sales that began prior to January 1, 1987.

All nine states in the West with a personal income tax allow a deduction for the amortization of qualified reforestation expenditures (Table 3). The amortization deduction is passed automatically to taxpayers in those six states which use as their tax base either federal AGI or federal taxable income. The other three states allow the deduction in calculating state AGI. According to the previous study, Hawaii did not allow an amortization deduction for qualified reforestation expenditures.

Table 3. Key provisions of State Income Taxes in the West, 1988.a/

	Federal adjusted gross income used as tax base	Proportion of long-term capital gain taxable	Amortization of reforestation costs	Adoption of federal passive activity loss rules	Comments
	(Yes/ no)	(%)	(Yes/ no)	(Yes/ no)	
ALASKA	---	---	---	---	No income tax.
ARIZONA	YES	100	YES	YES	
CALIFORNIA	YES	100	YES	YES	
COLORADO	NOb/	100	YES	YES	
HAWAII	NO	100	YES	YES	
IDAHO	NOb/	40	YES	YES	
MONTANA	NO	100	YES	YES	Allows a 40% exclusion of capital gains reported from installment sales which began prior to January 1, 1987.
NEVADA	---	---	---	---	No income tax.
NEW MEXICO	YES	100	YES	YES	
OREGON	NO	100	YES	YES	Reforestation tax credit.
UTAH	YES	100	YES	YES	
WASHINGTON	---	---	---	---	No income tax.
WYOMING	---	---	---	---	No income tax.

a/ Provisions effective as of September 1988. The sources of this information were: State Codes, income tax forms, correspondence and conversation with State Revenue Department representatives, the State Tax Guide (1988f), and the Bureau of National Affairs (1988).

b/ The tax base is federal taxable income.

Special forestry provisions exist in the tax code in Oregon, where a reforestation tax credit is available to taxpayers who develop under-productive forestland into a commercial forest. The total credit, for those taxpayers who are eligible, is equal to 30 percent of the cost of developing the forest. One-half of the credit can be claimed in the year in which a preliminary certificate is issued (the year the trees are planted) by a state forester. After the forest is established, in accordance with the specifications of the state forester, the remaining 15 percent of the tax credit plus 30 percent of any additional establishment costs can be claimed. The previous study indicated the total credit only equalled 10 percent of these costs.

The passive loss rules of the federal tax code have been adopted by every state in the West with a comprehensive personal income tax (Table 3).

Several other adjustments in deductions, exemptions and rates have occurred since the previous study. Four states in the West allow a deduction for federal income tax liability (Table 4), compared to five states that allowed the deduction in the previous study. Arizona and Montana allow the full deduction of federal income tax liability. Arizona also allows an additional special deduction of 63 percent of the federal income tax liability up to a maximum of $20,000. Oregon allows the deduction up to a maximum of $3,000. Utah allows a deduction of one-third of the federal income tax liability on the state return. Colorado repealed its deduction for federal income tax liability.

The 1988 personal exemption amounts for the western states are shown in Table 4. Personal exemption amounts have increased in seven states in the West since the previous study. Increases have occurred in Arizona (to $2,125 from $1,729), Hawaii (to $1,040 from $1,000), Montana (to $1,140 from $750), New Mexico (to $1,140 from $750) and Utah (to $1,463 from $750). In addition, Colorado (previously $1,203) and Idaho (previously $1,000) have increased these amounts by passing the federal amount ($1,950) to their taxpayers via their tax base (federal taxable income). Oregon has switched to allowing a personal exemption tax credit ($89) instead of allowing a personal exemption deduction (previously $1,000). Idaho ($15) and Hawaii ($1) allow a personal ex-

Table 4. State Income Tax Deductions, Exemptions and Rates in the West, 1988.a/

State	Federal income tax deductible	Personal exemption	Standard deduction b/	Abbreviated tax rate schedule b/: Steps	From	Of the first	To	Of the amount over	Maximum effective capital gains tax rate
	(Yes/no)	($)	($)	(#)	(%)	($)	(%)	($)	(%)
ALASKA	---	-----	-----	-	---	-----	---	------	---
ARIZONA	YES c/	2,125 d/	2,125 d/	7	2.0 d/	2,366	8.0 d/	14,196	8.0
CALIFORNIA	NO	52 e/	3,932 d/	6	1.0 d/	7,300	9.3 d/	47,900	9.3
COLORADO	NO	----- f/	----- f/	1	5.0	Federal	taxable	income	5.0
HAWAII	NO	1,040 g/	1,700	8	2.25	2,400	10.0	40,400	7.25 h/
IDAHO	NO	----- f/ i/	----- f/	8	2.0	2,000	8.2	40,000	3.3
MONTANA	YES	1,140 d/	4,280 d/ j/	10	2.2 d/ k/	1,400	12.1 d/ k/	48,100	12.1
NEVADA	---	-----	-----	-	---	-----	---	------	---
NEW MEXICO	NO	2,000	4,000	7	2.4	8,000	8.5	64,000	8.5
OREGON	YES l/	89 d/ m/	3,000	3	5.0	4,000	9.0	10,000	9.0
UTAH	YES n/	1,463	5,000	6	2.75	1,500	7.75	7,500	7.75
WASHINGTON	---	-----	-----	-	---	-----	---	------	---
WYOMING	---	-----	-----	-	---	-----	---	------	---

a/ Provisions effective as of September, 1988. The sources of this information were: State Codes, income tax forms, correspondence and conversation with State Revenue Department representatives, the State Tax Guide (CCH 1988f), and the Bureau of National Affairs (1988).
b/ The standard deduction and tax rate schedules are for married taxpayers filing a joint return.
c/ A special deduction of 63% of the federal income tax liability, to a maximum of $20,000, whichever is greater, is allowed in 1988 in addition to the regular full deduction of federal income tax liability.
d/ Annually adjusted for inflation.
e/ California allows a $52 tax credit per exemption.
f/ These amounts are passed through to taxpayers via the federal return.
g/ Hawaii allows an additional $1 credit for general income tax per exemption.
h/ Hawaii taxes capital gains at a maximum rate of 7.25%.
i/ An additional $15 tax credit (grocery credit) per exemption is allowed.
j/ The standard deduction is 20% of Montana AGI, to a maximum of $4,280.
k/ A surtax of 10% on Montana tax rates is in effect through 1989.
l/ The federal income tax liability is allowed as a deduction up to a maximum of $3,000.
m/ Oregon allows an $89 tax credit per exemption.
n/ Utah allows a deduction for 1/3 of the federal income tax paid.

emption tax credits in addition to personal exemption deductions. California's personal exemption amount has remained constant since the previous study.

The 1988 standard deduction amounts are shown in Table 4. Increases have occurred in six states since the previous study. The standard deduction amounts have increased as follows: Arizona (to $2,125 from $1,729), California (to $3,932 from $3,060), Montana (to $4,280 (maximum) from $3,520), New Mexico (to $4,000 from $3,400), Oregon (to $3,000 from $1,500) and Utah (to $5,000 from $2,000). The Montana standard deduction equals 20 percent of state AGI, up to a maximum of $4,280. Hawaii has decreased the standard deduction amount to $1,700 (from $3,400) since the previous study. Standard deductions in Colorado and Idaho are passed through to the state level through their tax base (federal taxable income).

Tax rate schedules have changed in every western state except Utah; however, the changes that have occurred since the previous study are relatively minor. Some states only annually adjusting for inflation. Details of the 1988 schedules and rates are shown in Table 4. Arizona increased the threshold to which its lowest tax rate (2 percent) is applied (to $2,366 from $2,000), and the threshold to which its maximum ordinary income tax rate (8 percent) is applied (to $14,196 from $12,000). California reduced the number of steps in its schedule (to 6 from 11) and lowered its maximum tax rate to 9.3 percent (on income over $47,900) from 11 percent (on income over $48,400). Colorado adopted a flat income tax rate (5 percent) on federal taxable income with modifications that replaced an 11 step schedule.

Hawaii reduced the number of steps in its schedule (to 8 from 12). Hawaii also increased its lowest tax rate (to 2.25 percent on income under $2,400, from 0.0 percent on income under $1,000) and lowered its maximum tax rate (to 10 percent on income over $40,400, from 11 percent on income over $61,000). Idaho increased the number of steps in its schedule (to 8 from 6) and increased the maximum tax rate to 8.2 percent (on income over $40,000) from 7.5 percent (on income over $10,000).

Montana increased both its lowest ordinary income tax rate (to 2.2 percent on income under $1,400, from 2 percent on income under $1,100) and its maximum ordinary income tax rate (12.1 percent on income over $48,100, from 11 percent on income over $41,000). The Montana tax rates include a 10 percent surtax on the state tax liability which is in effect through 1989. New Mexico reduced the number of steps in its schedule (to 7 from 19) and increased both its lowest tax rate (to 2.4 percent on income under $8,000, from 0.5 percent on income under $2,000) and its maximum tax rate (to 8.5 percent on income over $64,000, from 6 percent on income over $200,000). Finally, Oregon reduced the number of steps in its schedule (to 3 from 7) and increased its lowest ordinary income tax rate (to 5 percent on income under $4,000, from 4.2 percent on income under $1,000) and reduced its maximum ordinary income tax rate (to 9 percent from 10.8 percent).

The maximum effective long-term capital gains tax rates for 1988 are shown in Table 4. The rate increased in every state in the West since the previous study. The most dramatic increases came in Montana (to 12.1 percent from 4.4 percent) and New Mexico (to 8.5 percent from 2.4 percent), where both the capital gains differentials were lost, and the maximum ordinary income tax rates were increased. The maximum ordinary income tax rate decreased in four states, but the loss of the capital gains differential resulted in an increase in the maximum effective long-term capital gains tax rate. The increases came in California (to 9.3 percent from 7.2 percent), Colorado (to 5 percent from 3.2 percent), Hawaii (to 7.25 percent from 4.4 percent) and Oregon (to 9 percent from 4.3 percent). Utah (to 7.75 percent from 3.1 percent) and Arizona (to 8 percent from 3.2 percent) show an increase in the maximum effective capital gains tax rate due to the loss of the capital gains exclusion. The maximum effective capital gains rate increased the least in Idaho (to 3 percent from 3.3 percent) due solely to an increase in the maximum ordinary income tax rate.

The Northeast

The key provisions of state income tax codes in the Northeast, as of September 1988, are shown in Table 5. Five states use federal AGI as their tax base, compared to 8 in the previous study. Rhode Island and Vermont switched to using federal income tax liability as their tax base, from federal AGI. Massachusetts now uses another method for computing state taxable income instead of federal AGI. New Jersey and Pennsylvania still use other methods for determining state taxable income. Connecticut imposes a tax on capital gains and dividend income only.

Six states (Delaware, Maine, New York, Ohio, Rhode Island and Vermont) have followed the federal lead in taxing 100 percent of long-term capital gains (Table 5), where previously each had allowed for a 60 percent exclusion. Maryland currently taxes 60 percent (previously 40 percent) and Massachusetts currently taxes 50 percent (previously 40 percent) of net long-term capital gains. Connecticut (40 percent), New Jersey (100 percent) and Pennsylvania (100 percent) tax the same proportion of capital gains in 1988 as they did in 1982.

Nine states in the Northeast allow an amortization deduction of qualified reforestation expenditures (Table 5). However, Massachusetts allows the deduction only if the taxpayer is classified as being in an active trade or business. Massachusetts is the only state that did not allow the deduction previously. Connecticut and Pennsylvania do not allow an amortization deduction of qualified reforestation expenditures.

Eight states in the Northeast have adopted the passive loss rules, either in partial or full conformity to the federal IRC (Table 5). Massachusetts, New Jersey and Pennsylvania have not adopted the new rules. Maryland has a special forestry provision which allows a modification subtraction from state AGI for reforestation and timber stand improvement (TSI) expenditures (Table 5).

Table 5. Key provisions of State Income Taxes in the Northeast, 1988.[a]

	Federal adjusted gross income used as tax base	Proportion of long-term capital gain taxable	Amortization of reforestation costs	Adoption of passive activity loss rules	Comments
	(Yes/no)	(%)	(Yes/no)	(Yes/no)	
CONNECTICUT	NO	40	NO	YES	Tax on capital gains and dividend income only.
DELAWARE	YES	100	YES	YES	
MAINE	YES	100	YES	YES	
MARYLAND	YES	60	YES	YES	Allows a modification subtraction from AGI for reforestation and TSI expenditures.
MASSACHUSETTS	NO	50	YES[b]	NO	
NEW HAMPSHIRE	---	---	---	---	Tax on interest and dividend income only.
NEW JERSEY	NO	100	YES	NO	
NEW YORK	YES	100	YES	YES	
OHIO	YES	100	YES	YES	
PENNSYLVANIA	NO	100	NO	NO	
RHODE ISLAND	NO[c]	100	YES	YES	
VERMONT	NO[c]	100	YES	YES	

a/ Provisions effective as of September, 1988. The sources of this information were: State Codes, income tax forms, correspondence and conversation with State Revenue Department representatives, the State Tax Guide (CCH 1988f), and the Bureau of National Affairs (1988).
b/ Amortization is available only if the taxpayer is in an active trade or business in Massachusetts.
c/ Tax base is federal income tax liability.

Other adjustments in deductions, exemptions and rates in the Northeast have occurred since the previous study (Table 6). The federal income tax liability is deductible only in Delaware as was the case in the previous study. The deduction is limited to $600 for joint returns and $300 for all others.

The 1988 personal exemption deductions allowed on the state level are shown in Table 6. Since the previous study increases have occurred in Delaware (to $1,250 from $600), Maryland (to $1,000 from $800) and New York (to $900 from $800). The personal exemption amount has decreased in Massachusetts (to $4,400 from a maximum of $4,800). Personal exemption deductions have remained constant in Connecticut, New Jersey and Ohio. Ohio also allows an extra $350 deduction or a $20 tax credit per exemption. Maine has altered its tax code to allow the use of a $40 tax credit per exemption (previously a $1,000 deduction). Rhode Island and Vermont pass the federal amounts to their taxpayers through their tax base (federal income tax liability). Previously neither state had allowed the deduction. Pennsylvania continues to not allow the deduction.

The 1988 standard deduction amounts for the states in the Northeast are detailed in Table 6. Standard deduction amounts have increased in Delaware (to $1,600 from $1,000), Maryland (to $4,000 (maximum) from $3,000) and New York (to $8,500 from $2,500) from the previous study. Maine now allows its taxpayers a $100 standard deduction tax credit for joint returns, where it had previously allowed a $2,800 deduction. Rhode Island and Vermont pass the federal standard deduction amount to their taxpayers through their tax base (federal income tax liability). The other five states in the Northeast continue to not allow a standard deduction.

Abbreviated tax rate schedules for the states in the Northeast are detailed in Table 6. Tax rates and schedules have remained the same in Connecticut, Maryland and Massachusetts since the previous study. Maryland, however, now imposes a county surtax equal to 50 percent of the state income tax liability in all but four counties. Delaware reduced the number of steps in its tax schedule (to 8 from 15) and lowered the maximum ordinary income tax rate to 7.7 percent (on income over $40,000) from 13.5 percent (on income over $50,000). Maine increased the amount of income subject to its lowest tax rate (1.0 percent) to $4,500 from $4,000.

Table 6. State Income Tax Deductions, Exemptions and Rates in the Northeast, 1988.a/

State	Federal income tax deductible	Personal exemption	Standard deductionb/	Abbreviated tax rate schedule: Steps	From	Of the first	To	Of the amount over	Maximum effective long-term capital gains tax rate
	(Yes/ no)	($)	($)	(#)	(%)	($)	(%)	($)	(%)
CONNECTICUT	NO	100	-----	1	7.0	Net capital gains income			2.8
DELAWARE	YESc/	1,250	1,600	8	0.0	2,000	7.7	40,000	7.7
MAINE	NO	40d/	100e/	8	1.0	4,500	10.0	50,000	10.0
MARYLAND	NO	1,000	4,000f/	4	2.0g/	1,000	5.0g/	3,000	3.0g/
MASSACHUSETTS	NO	4,400h/	-----	1	5.0i/	-----	---	------	---
				1	10.0i/	-----	---	------	5.0
NEW HAMPSHIRE	--	-----	-----	-	---	-----	---	------	---
NEW JERSEY	NO	1,000	-----	3	2.0	20,000	3.5	50,000	3.5
NEW YORK	NO	900	8,500	7	3.0	6,000	8.375	34,000	8.375
OHIO	NO	650j/	-----	8	0.743	5,000	6.9	100,000	6.9
PENNSYLVANIA	NO	-----	-----	1	2.1	All taxable income			2.1
RHODE ISLAND	NO	-----k/	-----k/	1	22.96	Federal income tax			7.6
VERMONT	NO	-----k/	-----k/	1	23.0	Federal income tax			7.6

a/ Provisions effective as of September, 1988. The sources of this information were: State Codes, income tax forms, correspondence and conversation with State Revenue Department representatives, the State Tax Guide (CCH 1988f), and the Bureau of National Affairs (1988).
b/ The standard deduction amounts are for married taxpayers filing a joint return.
c/ Limited to $600 for joint returns and $300 for all others.
d/ Maine allows a $40 tax credit per exemption.
e/ Maine allows a $100 standard deduction tax credit for married taxpayers filing a joint return.
f/ The standard deduction is 15 percent of Maryland AGI up to a maximum of $4,000, but not less than $2,000.
g/ Plus a county tax of 50 percent of the state income tax liability (applicable to all but four Maryland counties.
h/ The Massachusetts personal exemption is allowed against earned income and annuities only.
i/ Massachusetts taxable income is divided into two categories: income taxed at 5 percent (earned income and annuities) and income taxed at 10 percent (interest, dividends and capital gains).
j/ Taxpayers can elect to choose either an additional $350 per exemption, or a $20 tax credit per exemption.
k/ These amounts are the federal amounts, passed through to taxpayers via the federal return.

New Jersey added one step to its tax schedule and increased the maximum tax rate to 3.5 percent (on income over $50,000) from 2.5 percent (on income over $20,000). New York reduced the number of steps in its tax schedule (to 7 from 13) and lowered the maximum tax rate to 8.375 percent (on income over $34,000) from 14 percent (on income over $23,000). Ohio increased its maximum tax rate to 6.9 percent (from 5 percent) on income over $100,000. Pennsylvania reduced its flat tax rate on all taxable income to 2.1 percent from 2.2 percent. Rhode Island increased its flat tax rate to 22.96 percent of federal income tax liability, from 21.9 percent, and Vermont lowered its flat tax rate to 23 percent of federal income tax liability, from 24 percent.

The maximum effective long-term capital gains tax rate (Table 6) increased in every state in the Northeast except Pennsylvania (the rate fell to 2.1 percent from 2.2 percent) and Connecticut (the rate remained the same). Rates increased in Maine (to 10 percent from 4 percent), Maryland (to 4.5 percent from 2 percent) and Massachusetts (to 10 percent from 4 percent) due solely to an increase in the amount of capital gains subject to taxation. The maximum effective long-term capital gains tax rate increased in New Jersey (to 3.5 percent from 2.5 percent) due solely to an increase in its maximum ordinary income tax rate.

The maximum effective long-term capital gains tax rate increased in Delaware (to 7.7 percent from 5.4 percent), New York (to 8.375 percent from 5.6 percent) and Vermont (to 7.6 percent from 4.8 percent) due to an increase in the amount of capital gains subject to taxation, although maximum ordinary income tax rates were lowered in these states. Increases in the maximum effective rate attributable to both an increase in maximum ordinary income tax rate and the amount of capital gains subject to taxation occurred in Ohio (to 6.9 percent from 2.5 percent) and Rhode Island (to 7.6 percent from 4.4 percent).

The Midwest

The key provisions of state income taxes in the Midwest, as of September 1988, are shown in Table 7. Eight states in the Midwest currently use federal AGI as their tax base. Minnesota and North Dakota have switched to using federal taxable income (from federal AGI) as their tax base since the previous study.

Eight states in the Midwest tax 100 percent of long-term capital gains (Table 7). Seven of these eight states had previously taxed only 40 percent of long-term capital gains, Minnesota had previously taxed 50 percent. Iowa currently taxes only 40 percent of long-term capital gains, but limits the maximum deduction to $17,500. Wisconsin taxpayers are allowed a 60 percent long-term capital gains deduction (previously 20 percent).

All Midwest states allow an amortization deduction for qualified reforestation expenditures (Table 7), as in the previous study. Every state in the Midwest has adopted the federal passive loss rules concerning the deductibility of certain management costs, taxes and interest in conjunction with their timberland ownership (Table 7).

Other provisions of state income taxes in the Midwest (deductions, exemptions and rates) are illustrated in Table 8. Iowa, Missouri and North Dakota allow a deduction for federal income tax liability. Kansas and Minnesota, which had previously allowed the deduction, have repealed this provision.

Personal exemption amounts for 1988 are also shown in Table 8. An increase in the state personal exemption amount has occurred in Indiana (to $1,000 from $500), Iowa (to a $40 tax credit from $38), Michigan (to $1,800 from $1,500) and Wisconsin (to a $50 tax credit from $40). Personal exemption amounts have remained the same in Illinois, Kansas and Missouri since the previous study.

Table 7. Key provisions of State Income Taxes in the Midwest, 1988.a/

	Federal adjusted gross income used as tax base	Proportion of long-term capital gain taxable	Amortization of reforestation costs	Adoption of passive activity loss rules	Comments
	(Yes/no)	(%)	(Yes/no)	(Yes/no)	
ILLINOIS	YES	100	YES	YES	
INDIANA	YES	100	YES	YES	
IOWA	YES	40b/	YES	YES	
KANSAS	YES	100	YES	YES	
MICHIGAN	YES	100	YES	YES	
MINNESOTA	NOc/	100	YES	YES	
MISSOURI	YES	100	YES	YES	
NEBRASKA	YES	100	YES	YES	
NORTH DAKOTA	NOc/	100	YES	YES	
SOUTH DAKOTA	---	---	---	---	No income tax.
WISCONSIN	YES	40	YES	YES	

a/ Provisions effective as of September, 1988. The sources of this information were: State Codes, income tax forms, correspondence and conversation with State Revenue Department representatives, the State Tax Guide (1988f), and the Bureau of National Affairs (1988).

b/ Iowa allows a 60 percent capital gains deduction, up to a maximum of $17,500.

c/ Tax base is federal taxable income.

Table 8. State Income Tax Deductions, Exemptions and Rates in the Midwest, 1988.a/

State	Federal income tax deductible	Personal exemption	Standard deduction b/	Abbreviated tax rate schedule: Steps	From	Of the first	To	Of the amount over	Maximum effective long-term capital gains tax rate
	(Yes/ no)	($)	($)	(#)	(%)	($)	(%)	($)	(%)
ILLINOIS	NO	1,000	-----	1	2.5	All taxable net income			2.5
INDIANA	NO	1,000	-----	1	3.4	All adjusted gross income			3.4
IOWA	YES	40c/	3,030	9	0.4	1,000	9.98	45,000	9.98d/
KANSAS	NO	1,000	5,000	8	2.0	4,000	9.0	50,000	9.0
MICHIGAN	NO	1,800	-----	1	4.6	All taxable income			4.6
MINNESOTA	NO	-----e/	-----e/	2	6.0	19,000	8.0f/	19,000	8.0f/
MISSOURI	YES	1,200	5,000	10	1.5	1,000	6.0	9,000	6.0
NEBRASKA	NO	1,130	5,000	4	2.0	3,000	5.9	45,000	5.9
NORTH DAKOTA	YES	-----e/	-----e/	8	2.67	3,000	12.0	50,000	12.0
SOUTH DAKOTA	--	-----	-----	-	---	-----	---	------	---
WISCONSIN	NO	50g/	-----h/	3	4.9	10,000	6.93	20,000	2.8

a/ Provisions effective as of September, 1988. The sources of this information were: State Codes, income tax forms, correspondence and conversation with State Revenue Department representatives, the State Tax Guide (CCH 1988f), and the Bureau of National Affairs (1988).
b/ The standard deduction amounts are for married taxpayers filing a joint return.
c/ Iowa allows a $40 personal exemption tax credit for joint returns.
d/ The maximum effective long-term capital gains rate may be less than this amount, depending on the amount of timber sale income excluded from taxation, see Table 7.
e/ These amounts are passed through to taxpayers via the federal return.
f/ Plus a surtax of 10 percent of any additional tax paid under IRC Sec. 1(g): phase-out of personal exemptions and the 15 percent tax bracket.
g/ Taxpayers may also qualify for a joint filing credit.
h/ Standard deduction for 1988 and thereafter is $8,900 less 19.778 percent of (Wisconsin AGI - $10,000), but not less than $0.

Minnesota, which previously allowed a $134 tax credit per exemption, now passes its personal exemption amount to its taxpayers through the tax base (federal taxable income). North Dakota also passes its personal exemption amount through to taxpayers via federal taxable income, where it had previously allowed a $2,300 deduction. Nebraska currently allows a $1,130 personal exemption deduction, where it had previously allowed a $56 tax credit per exemption.

Standard deduction amounts for 1988 have increased in six states since the previous study (Table 8). These increases have occurred in Iowa (to $3,030 from $3,000), Kansas (to $5,000 from $2,800), Missouri (to $5,000 from $3,400) and Nebraska (to $5,000 from none). Minnesota (which previously allowed a $2,250 deduction) and North Dakota (which previously allowed a $3,400 deduction) now have the federal standard deduction amount ($5,000) passed to their taxpayers via their tax base (federal taxable income).

Although Indiana had previously allowed a $500 standard deduction for joint returns, it does not allow a standard deduction. Illinois and Michigan still do not allow a standard deduction on the state level. Wisconsin's standard deduction is $8,900 less 19.778 percent of (state AGI - $10,000), but not less than $0. Taxpayers filing a joint return with state AGI over $55,000 effectively have no standard deduction available to them. Previously Wisconsin allowed a flat $3,400 standard deduction amount for joint returns.

The abbreviated tax rate schedules for the states in the Midwest are illustrated in Table 8. Four states (Illinois, Kansas, Michigan and Missouri) have not changed their schedule or rates since the previous study. Indiana, which imposes a flat tax rate on all AGI, increased its tax rate to 3.4 percent from 1.9 percent. North Dakota added two steps to its schedule and increased its maximum tax rate on ordinary income to 12 percent (on income over $50,000) from 7.5 percent (on income over $30,000). Nebraska levies a four step schedule beginning with 2 percent (on income under $3,000) and leading to 5.9 percent (on income over 45,000). It replaces Nebraska's flat state income tax rate which was 17 percent of the federal income tax liability before credits.

Iowa reduced the number of steps in its schedule (to 9 from 13) and reduced the maximum ordinary income tax rate to 9.98 percent (on income over $45,000) from 13 percent (on income over $76,725). Minnesota reduced the number of steps in its schedule (to 2 from 12) and lowered the maximum tax rate to 8 percent (on income over $19,000) from 16 percent (on income over $36,632). Finally, Wisconsin reduced the number of steps in its schedule (to 3 from 8) and lowered the maximum ordinary income tax rate to 6.93 percent (on income over $20,000) from 10 percent (on income over $51,600).

The maximum effective long-term capital gains tax rate decreased in only one state in the Midwest since the previous study. Wisconsin reduced its maximum effective rate to 2.8 percent from 8 percent (Table 8) due to a reduction in the maximum ordinary income tax rate and a larger capital gains exclusion. The maximum effective rate has remained constant in Indiana due to the flat rate tax and the amount of taxable net long-term capital gains remaining constant. In Minnesota the capital gains exclusion was eliminated and the maximum ordinary income tax rate was reduced to maintain the same maximum effective long-term capital gains tax rate as was previously reported (8 percent). The actual effective rate may be higher than the reported rate due to a 10 percent surtax on any income tax that is derived from the 33 percent federal marginal tax bracket.

An increase in the maximum effective long-term capital gains tax rate has occurred in Kansas (to 9 percent from 3.6 percent), Michigan (to 4.6 percent from 1.8 percent) and Missouri (to 6 percent from 2.4 percent) due solely to the loss of the capital gains differential. Increases have occurred in Indiana (to 3.4 percent from 0.8 percent) and North Dakota (to 12 percent from 3 percent) due to the loss of the capital gains differential and an increase in the maximum ordinary income tax rate.

A reduction in the maximum ordinary income tax rate, combined with a limited capital gains differential, has produced an increase in the maximum effective long-term capital gains tax rate in Iowa {to 9.98 percent (maximum) from 5.2 percent}. The actual effective rate may be less than that shown (9.98 percent) depending on how much the limited capital gains deduction impacts the marginal tax rate on a capital gain. With the change in Nebraska's tax schedule from a flat tax imposed on federal income tax liability (which included a 60 percent capital gains exclusion) to a progressive tax schedule (which includes no exclusion), the maximum effective long-term capital gains tax rate has increased to 5.9 percent from 3.4 percent.

Discussion

The number of federal provisions deemed favorable to timberland owners have been reduced. One of the most important, the capital gains exclusion, was also lost in 27 states which had previously allowed such an exclusion. Only 8 states still allow some type of long-term capital gain exclusion. Two of these states are in the South, one is in the West, three are in the Northeast and two are in the Midwest.

Reforestation amortization provisions have been continued on the federal level. The status of these provisions on the state level has also remained fairly constant with most states allowing an amortization deduction for qualified reforestation expenditures. However, most states have adopted the federal passive loss rules concerning the deductibility of certain management costs, taxes and interest, which increases tax liabilities for landowners who are considered passive forestland managers.

The federal maximum effective long-term capital gains tax rate increased with the passage of TRA '86 due to the loss of the capital gains exclusion, even though maximum effective ordinary income tax rates were lowered. The maximum effective long-term capital gains rate has increased in 31 states, has remained constant in 7 states and has decreased in 3 states. In general, capital gains are now taxed at higher rates at both the federal and state levels with no region showing a marked decrease in the rate among states.

Federal standard deduction and personal exemption amounts (Chapter 2) have increased since the new federal laws were enacted. Standard deduction and personal exemption amounts at the state level have increased in 17 states while remaining the same in 7 states. Eight states do not allow a standard deduction, the others have either decreased these amounts or switched to using a tax credit instead of a deduction or vice versa. Personal exemption amounts have increased in 17 states and have remained constant in 8 states since the previous study. The remaining states either do not allow a personal exemption or have switched to using some other method for allowing a personal exemption. On a regional basis, increases in both standard deduction and personal exemption amounts have generally occurred in the West, Northeast and Midwest. The states in the South have generally remained constant with regard to the amounts allowed for both provisions.

The broadening of the federal tax base has also broadened the base for states which follow the Federal Code closely. Tax rates and schedules have been altered in most of the states since the previous study, but remain the same in 14 states. In many states, schedules have shown a reduction in the number of steps, and in several instances complete changes in the method of taxation have occurred. As an aside, states in all four regions generally use progressive tax schedules, with flat tax rates being more common in the Northeast and Midwest than in the South and West.

Special forestry provisions are viable options qualified forest landowners may take advantage of to reduce state tax liabilities. North Carolina has special provisions for reporting timber sale revenue and for deducting reforestation costs, where Oregon allows a tax credit for qualified reforestation costs. Maryland also has special forestry provisions applicable to reforestation and TSI expenditures.

In conclusion, capital gains are now taxed at higher rates at the federal level and in most states. Ordinary income is being taxed at lower rates on the federal level, but on the state level the results are mixed. Some states still allow a capital gains deduction and/or relatively low ordinary income tax rates that provide low state tax liabilities for all taxpayers. By comparison, other states have followed the federal lead without lowering their tax rates or providing relief through other tax provisions.

Chapter 4

Hypothetical Case and Methods of Analysis

In order to analyze the effects of recent changes in federal and state income tax laws on timber income in the U.S., the 1988 tax liability for a hypothetical landowner case will be calculated. The general assumptions of the hypothetical case will be discussed here, followed by the specific assumptions about timberland ownership in each region. The goal of the analyses in Chapters 5 and 6 is to focus on the state income tax impact of a timber sale. This goal is met by holding the federal income tax constant across all states, for a given personal income level (for the active case, a personal income level and one timber sale level). It is also assumed that the landowner's itemized deductions equal the standard deduction amount, and that the landowners elect to use the standard deduction in the analysis. To facilitate the comparisons, site preparation costs and depletion deductions are held constant for all states, although such costs may vary widely even within a small geographic area, and the possibility of depletion deductions being equal is quite remote.

Active and passive management analysis

For the Income Tax Impact analysis (Chapter 5) the combined 1988 federal-state income tax liability for a hypothetical landowner case will be calculated. The hypothetical taxpayers are a landowner and his wife, both 55 years old, who have no other dependents for tax purposes. Excluding revenue from the sale of timber, three alternative levels of personal income were assumed: a low income level ($25,000), a medium income level ($60,000) and a high income level ($110,000).

In the active case, the landowners were assumed at all three income levels to have timber management as a primary objective. It was assumed that they invested in forest management practices in order to increase timber yield and had a timber sale in 1988. The landowners made estimated federal and state income tax payments at the time of the sale based on the sale receipts. The expenses of the sale (cruise, marketing, supervision) were assumed to equal 10 percent of the timber sale proceeds. It was further assumed that the land was reforested in 1989, the year following harvest. Therefore, the amortization deduction for qualified reforestation expenditures and the associated ITC did not enter into income tax calculations for the year of timber sale, 1988. Annual expenses related to the ownership of the property were $1,000 ($2 per acre x 500 acres) for property taxes and $1,500 ($3 per acre x 500 acres) forest management costs. It was assumed that the landowners were actively involved in the management of their timberland. Therefore, these annual costs were allowed as current deductions on the landowner's tax return. No incentive payments were received by the taxpayers.

In the passive case, the landowners were assumed at all three income levels to have management objectives for which timber production was incidental and no investment was made in forest management practices. No investment in forest management practices means that either there will be a lower and uncertain amount of wood harvested at irregular intervals, or that the landowners expect a different output or mix of outputs (e.g., recreation, wildlife and water) from their forestland.

Therefore, little or no timber is harvested in 1988, and there is no timber sale revenue. In addition, the landowners were assumed to be classified as being "passive" with regard to the management of their timberland. The annual management costs and property taxes, therefore, were not allowed as current deductions but were capitalized instead.

The South

For the hypothetical case in the South, the landowners were assumed to have purchased 500 acres of pine timberland for $532 per acre in 1978.[3] The tract contained several even-aged stands with ages ranging from 10 to 30 years. The purchase price was allocated between land ($125,000 or $250/acre) and timber ($141,000 or $282/acre). The initial quantity of merchantable timber on the tract was 3,300 thousand board feet (MBF).

In July 1988, the landowners sold 381 MBF of timber from 48 acres. The yields were assumed to be representative of a reasonable private non-corporate pine management regime typically found in the South on planted old fields or pasture. They received $135 per MBF (Timber-Mart South 1988) for 336 MBF of pine sawtimber and $105 per MBF for 45 MBF of pine Chip-N-Saw. Total sale receipts were $50,000, which were received in a lump-sum sale.

A depletion allowance was determined at the time of harvest based on the entire tract being stocked with an adjusted volume of 5,225 MBF (yield estimates derived from PCWTHIN (Burk et al 1984)) accounting for growth of 1,925 MBF since the purchase date. The timber account showed a cost basis of $141,000. The depletion unit for the sale was calculated to be $26.99 per MBF ($141,000/5,225 MBF). Total depletion for the sale was $10,283 ($26.99/MBF x 381 MBF).

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[3] The purchase price is an exact figure in each region in order for the depletion deduction to remain constant (refer back to page 48 for an explanation).

The West

The landowners were assumed to have purchased 500 acres of timberland for $741 per acre in 1978. Douglas-fir management is used as an example of a forestry investment in this region although the limited range of the species must be acknowledged. The tract contained several even-aged stands of Douglas-fir timber ranging in age from 5 to 50 years. The purchase price was allocated to land ($100,000 or $200 per acre) and timber ($270,000 or $541 per acre). At the time of purchase the quantity of merchantable timber on the entire tract was 5,500 MBF.

In July 1988, the landowners sold 20 acres, or 333 MBF of timber. The yields were assumed to be an average level of production from a medium site Douglas-fir plantation. A stumpage price assumed to be $150 per MBF (Standiford 1988) yielded total sale receipts of $50,000 ($150 x 333 MBF). These were received in a lump-sum sale.

A depletion allowance was determined at the time of the sale based on the entire tract being stocked with an adjusted volume of 8,760 MBF of Douglas-fir sawtimber (yield estimates were derived from DFSIM (USDA Forest Service 1986)), which accounted for 3,260 MBF growth since the purchase date. The depletion unit was calculated to be $30.88 ($270,000/8,760 MBF). Total depletion for the sale was $10,283 ($30.88/MBF x 333 MBF).

The Northeast

The hypothetical case for the Northeast assumes that the landowners purchased 500 acres of white pine forestland in 1978 for $620 per acre. The tract contained several even-aged stands with ages ranging from 5 to 40 years. Allocation of the purchase price was to land ($125,000 or $250 per acre) and timber ($185,085 or $370 per acre). The initial quantity of sawtimber on the entire tract was 3,750 MBF.

In July 1988, the landowners sold 375 MBF of sawtimber from 25 acres in a lump-sum sale. The stumpage price for the sawtimber was assumed to be $133 per MBF. Timber sale proceeds were $50,000 (375 MBF x $135/MBF). A depletion allowance was determined at the time of harvest, based on the entire tract containing an adjusted volume of 6,750 MBF of white pine sawtimber. Growth since the purchase date was 3,000 MBF (yield estimates derived from Lancaster and Leak 1978). The depletion unit was calculated to be $27.42 ($185,085/6,750 MBF). Total depletion for the sale was $10,283 ($27.42 x 375 MBF).

The Midwest

For the Midwest, the hypothetical landowners were assumed to have purchased 500 aces of red pine forestland for $471 per acre. The limited range of red pine is acknowledged and used only as an example of a forestry investment in this region. The entire tract of red pine contained several age classes ranging from 5 to 30 years. The purchase price was allocated to timber ($135,630 or $271 per acre) and land ($100,000 or $200 per acre). The quantity of merchantable timber on the tract at the purchase date was 1,500 MBF.

In July 1988, the hypothetical landowners received $50,000 from a lump-sum timber sale. The sale was on 60 acres and included 417 MBF of red pine sawtimber. At the time of the sale the entire tract was stocked with an adjusted volume of 5,500 MBF of sawtimber, accounting for a growth of 4,000 MBF since the purchase date (yield estimates from Hahn and Stelman 1984). The depletion allowance was calculated to be $24.66 ($135,630/5,500 MBF). Total depletion for the sale was $10,283 ($24.66 x 417 MBF).

Alternative tax planning analysis

For the Alternative Tax Planning analysis (Chapter 6), the combined federal-state income tax liability for two tax years (1988 and 1989) will be calculated. The same personal income levels and amount of timber sale revenue will be used in this analysis as was used in the Income Tax Impact analysis (Chapter 5). In this analysis, however, it is only the active case that is analyzed. It was previously assumed that the passive case harvested little or no timber in 1988, and had no timber income to report in that tax year. The active landowners elect to use the installment sale method of reporting timber income in order to spread timber sale revenue over two years. Half of the timber sale revenue ($25,000) was received in August 1988, and half ($25,000) in January 1989.[4] On receipt of the payments, the landowners made estimated federal and state income tax payments based on those payments.

With the exception of the reforestation amortization and credit, the 1989 return was assumed to be the same as the 1988 return. Amortization of qualified reforestation expenses begins in 1989, when site preparation costs are incurred. The taxpayers also elect an ITC in that year. Total qualified reforestation expenditures were $8,160. The ITC ($816) equalled 10 percent of the qualified expenses. The amount subject to amortization ($7,752) was calculated by reducing the qualified expenditures by 50 percent of the ITC claimed ($8,160 -(.50 x $816)). The allowable one-fourteenth of the qualified reforestation expenditures ($554 or $7,752/14) was deducted for federal AGI in 1989 (Gunter and Kessler 1987).

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4 If installment sale payments are received more than 6 months apart, the deferred amount must include an applicable amount of interest.

Methods of evaluation

The methods of evaluating the results of the Income Tax Impact analyses (Chapter 5) on timber sales are: (1) to determine the exact income tax liability (federal, state and combined federal-state) for the cases in which the landowners invest in forest management and have a timber sale (active timberland managers), and the cases in which the landowners do not invest in forest management and have no timber sale (passive timberland managers), and (2) to determine the state portion (percentage) of the total income tax liability. Each of these results are confined to the limitations of the models. In addition, the reasons for the variation in the results among the states will be discussed.

The methods of evaluating the results of the Alternative Tax Planning analyses (Chapter 6) on timber sales are: (1) to determine the present value of the combined federal-state income tax liability over a two-year period, with and without use of the installment sale method for reporting timber sale revenue, and (2) to determine the state portion of the total tax liability when using the installment sale. A 10 percent discount rate will be used, representing the rate of return that the landowner may realize from a comparable investment assuming annual earning opportunities.

Chapter 5

Income Tax Impacts on the Hypothetical Case

Initially, the federal income tax liability will be detailed for the hypothetical case without state income taxes included in the analysis. These results will be used as a benchmark in order to compare state income tax liabilities. The combined federal-state income tax liabilities will be examined on a regional basis. The percent of the total income tax liability levied by each state on the hypothetical case will be indicated and some of the results will be explained.

Federal income tax consequences

The 1988 federal income tax liability for the hypothetical landowners with an investment in forest management and timber sale revenue for all three income levels are summarized in Table 9a. Timber sale revenue ($50,000) is reduced by sale expenses ($5,000) and depletion ($10,283) to produce a net taxable gain of $34,717. Revenue from the sale of timber may still be reported as a

Table 9a. Federal Income Tax Liability for the Case Example Timber Sale Under Three Income Level Assumptions, with an Investment in Forest Management, and Timber Sale Revenue, 1988.a/

		Income level Low	Medium	High
		($)	($)	($)
Personal income		25,000	60,000	110,000
Revenue from timber sale	$50,000			
Less deductions				
Expense of sale	(5,000)			
Depletion	(10,283)			
Net gain on sale	34,717			
Taxable gain on sale		34,717	34,717	34,717
Less deductions				
Property tax	(1,000)			
Management costs	(1,500)			
Total deductions		(2,500)	(2,500)	(2,500)
Adjusted gross income		57,217	92,217	142,217
Standard deduction		(5,000)	(5,000)	(5,000)
Personal exemption		(3,900)	(3,900)	(3,900)
Taxable income		48,317	83,317	133,317
Net federal income tax		9,661	20,032	36,532

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner," a computer software package designed by the Bureau of National Affairs (1988).

long-term capital gain if certain requirements are met, but it is now taxed the same as ordinary income.

The taxable gain on the timber sale plus personal income, less deductions for property taxes of $1,000 ($2 per acre x 500 acres) and management costs of $1,500 ($3 per acre x 500 acres) equal adjusted gross income (AGI). The standard deduction for married taxpayers filing a joint return is $5,000. The personal exemption amount is $3,900 ($1,950 x 2 exemptions). Subtracting these deductions from AGI produces federal taxable income.

Taxable income at the low income level was $48,317 and the net federal income tax was $9,661. At this income level $18,567 ($48,317-29,750) was taxed at the 28 percent marginal tax rate. Taxable income at the medium income level was $83,317 with net federal tax computed to be $20,032. This amount includes a 5 percent surtax on the last $11,417 ($83,317-71,900) of income. Taxable income at the high income level was $133,317. The net tax was $36,532 with the 5 percent surtax applying to $61,417 ($133,317-71,900).

In the hypothetical case in which the landowners did not invest in forest management and had no timber sale revenue, net federal taxable income is computed by subtracting from personal income the standard deduction and personal exemption amounts (Table 9b). Taxable income at the low income level was $16,100, with the net federal income tax amounting to $2,415. Taxable income at the medium income level was $51,100, producing a net federal income tax of $10,441. For the high income level net taxable income was $101,100, and the net federal income tax was $25,901.

Table 9b. Federal Income Tax Liability for the Case Example Under Three Income Levels, without an Investment in Forest Management, and no Timber Sale Revenue, 1988.a/

	Income Level		
	Low	Medium	High
	($)	($)	($)
Personal Income	25,000	60,000	110,000
Adjusted Gross Income	25,000	60,000	110,000
Standard Deduction	(5,000)	(5,000)	(5,000)
Personal Exemption	(3,900)	(3,900)	(3,900)
Taxable Income	16,100	51,100	101,100
Net Federal Income Tax	2,415	10,441	25,901

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner," a computer software package designed by the Bureau of National Affairs (1988).

Federal-state income tax consequences

State income tax codes differ in many ways. This was discussed in Chapter 3; therefore. the amount of income subject to taxation in each state will vary greatly. In addition, the results of this analysis cannot be directly compared to previously reported research findings on this subject (McGee et al 1984, 1982; McGee 1982). Since that work was completed both federal and many state income tax laws have changed. Some assumptions in this study also differ from the previous study reflecting changing economic and institutional conditions.

Since 1985 state income taxes have been allowed as a deduction on the federal tax return. The effective state tax rate applicable to either ordinary income or capital gains is the applicable state tax rate x (1 - the applicable federal tax rate). State income taxes were not deducted on the federal tax return in this analysis. The state income tax liability was, however, reduced by a factor of (1 - applicable federal tax rate) (Davis and Johnson 1987). It is assumed that the federal government is subsidizing state governments in this respect. If state income taxes had been deducted on the federal return the benchmark federal tax liability would have been lost due to the variation in state tax liabilities. Even though there is a cross-deduction problem in the analysis, state income taxes are reduced to indicate the effective state income tax while retaining the benchmark federal tax. Regional results of the 1988 federal-state income tax analysis was calculated for the hypothetical landowners on a regional basis at all three income levels.

The South

At the low income level with no timber sale revenue,[5] state taxable income ranged from $12,100 in Mississippi to $24,000 in Arkansas (Table 10).[6] At the low income level with timber sale revenue, state taxable income ranged from $28,943 in Kentucky to $56,217 in Arkansas. At the medium income level and no timber sale revenue, state taxable income ranged from $42,559 in Alabama to $59,000 in Arkansas (Table 11). At the medium income level with timber sale revenue, it ranged from $54,580 in Kentucky to $91,217 in Arkansas. At the high income level and no timber sale revenue, state taxable income ranged from $77,099 in Alabama to $109,000 in Arkansas (Table 12). With timber sale revenue, it varied between $88,906 in Kentucky to $141,217 in Arkansas.

At the low income level and no timber sale revenue, the state portion of the total income tax liability ranged from 10 percent in Louisiana to 31 percent in North Carolina (Table 10). At the low income level with timber sale revenue, the state portion ranged from 9 percent in Louisiana to 21 percent in North Carolina. The state portion of total income tax liability at the medium income level and no timber sale revenue ranged from 9 percent in Louisiana to 20 percent in North Carolina (Table 11). With timber sale revenue, the range was from 7 percent in Louisiana to 17 percent in North Carolina. At the high income level and no timber sale revenue the state portion of total income tax liability ranged from 7 percent in Louisiana to 16 percent in North Carolina (Table 12). With timber sale revenue the range was from 6 percent in Louisiana to 15 percent in North Carolina.

Sole proprietors whose timber holdings are considered a business and taxpayers who earn less than the maximum social security withholding threshold can avoid paying federal self employment

[5] "No timber sale revenue" refers to the passive case in which the landowners do not invest in forest management. "With timber sale revenue" refers to the active case in which the landowners invest in forest management, and have a timber sale in 1988.

[6] The following discussion concerns those states with a comprehensive income tax: Florida, Tennessee and Texas are excluded.

Table 10. Combined Federal-State Income Tax for the Hypothetical Landowner at the Low Income Level in the South, 1988.a/

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable incomeb/	Total income tax (state plus federal)c/	State portion	State taxable incomeb/	Total income tax (state plus federal)c/	State portion
	($)	($)	(%)	($)	($)	(%)
ALABAMA	15,585	2,984	19	40,556	11,064	13
ARKANSAS	24,000	3,248	26	56,217	11,983	19
FLORIDA	------	2,415	0	------	9,661	0
GEORGIA	19,000	3,163	24	51,217	11,686	17
KENTUCKY	21,285	3,296	27	28,943	10,933	12
LOUISIANA	22,585	2,690	10	47,556	10,613	9
MISSISSIPPI	12,100	2,802	14	44,317	11,148	13
NORTH CAROLINA	21,150	3,487	31	53,367	12,192	21
OKLAHOMA	21,000	3,053	21	53,217	11,593	17
SOUTH CAROLINA	16,100	3,039	21	48,317	11,743	18
TENNESSEE	------	2,415	0	------	9,661	0
TEXAS	------	2,415	0	------	9,661	0
VIRGINIA	20,700	3,221	25	52,917	11,677	17
WEST VIRGINIA	21,000	3,044	21	53,217	11,366	15

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ Gross income before any deductions is $25,000 and $75,000, respectively.

c/ Combined federal-state income tax liability: federal share is $2,415 and $9,661, respectively.

Table 11. Combined Federal-State Income Tax for the Hypothetical Landowner at the Medium Income Level in the South, 1988.a/

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable incomeb/	Total income tax (state plus federal)c/	State portion	State taxable incomeb/	Total income tax (state plus federal)c/	State portion
	($)	($)	(%)	($)	($)	(%)
ALABAMA	42,559	11,916	12	65,185	22,321	10
ARKANSAS	59,000	12,903	19	91,217	23,834	16
FLORIDA	------	10,441	0	------	20,032	0
GEORGIA	54,000	12,587	17	86,217	23,324	14
KENTUCKY	48,259	12,353	15	54,580	22,217	10
LOUISIANA	49,559	11,450	9	72,185	21,578	7
MISSISSIPPI	47,100	12,029	13	79,317	22,589	11
NORTH CAROLINA	56,150	13,113	20	88,367	24,029	17
OKLAHOMA	56,000	12,493	16	88,217	23,237	14
SOUTH CAROLINA	51,100	12,664	18	83,317	23,611	15
TENNESSEE	------	10,441	0	------	20,032	0
TEXAS	------	10,441	0	------	20,032	0
VIRGINIA	55,700	12,572	17	87,917	23,257	14
WEST VIRGINIA	56,000	12,266	15	88,217	23,120	13

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ Gross income before any deductions is $60,000 and $110,000, respectively.

c/ Combined federal-state income tax liability: federal share is $10,441 and $20,032, respectively.

Table 12. Combined Federal-State Income Tax for the Hypothetical Landowner at the High Income Level in the South, 1988.a/

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable incomeb/	Total income tax (state plus federal)c/	State portion	State taxable incomeb/	Total income tax (state plus federal)c/	State portion
	($)	($)	(%)	($)	($)	(%)
ALABAMA	77,099	28,430	9	98,685	39,784	8
ARKANSAS	109,000	30,537	15	141,217	42,679	14
FLORIDA	------	25,901	0	------	36,532	0
GEORGIA	104,000	29,908	13	136,217	41,834	13
KENTUCKY	82,799	29,069	11	88,906	39,945	9
LOUISIANA	84,099	27,766	7	105,685	39,052	6
MISSISSIPPI	97,100	29,053	11	129,317	40,764	10
NORTH CAROLINA	106,150	30,732	16	138,367	42,874	15
OKLAHOMA	106,000	29,821	13	138,217	41,747	12
SOUTH CAROLINA	101,100	30,314	15	133,317	42,456	14
TENNESSEE	------	25,901	0	------	36,532	0
TEXAS	------	25,901	0	------	36,532	0
VIRGINIA	105,700	29,810	13	137,917	41,683	12
WEST VIRGINIA	106,000	29,764	13	138,217	41,798	13

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ Gross income before any deductions is $110,000 and $160,000, respectively.

c/ Combined federal-state income tax liability: federal share is $25,901 and $36,532, respectively.

tax on timber sale income by reporting it as a capital gain. Kentucky is the only state still using a long-term capital gains exclusion. The state portion of total income tax liability was one of the lowest at all three income levels when and timber sale revenue was reported as a capital gain in Kentucky.

Tax rates determine tax liability once state taxable income is computed. The state portion of total income tax liability was lowest in Louisiana at all three income levels for the hypothetical case. Although Louisiana's maximum ordinary income tax rate is as high as that in most other southern states, it is generally imposed on a higher income threshold ($50,000) than that used by other states ($10,000 to $15,000). Louisiana also allows a deduction for the federal income tax liability.

Standard deductions and personal exemptions reduce the amount of income subject to taxation. Several states utilize personal exemption credits rather than the more common deductions. The tax credits, however, do not appear to be an advantage for our hypothetical situations. The state portion of the total income tax liability in Arkansas and Kentucky, which utilize personal exemption credits, is generally in the middle to upper range among the southern states. This is not the case, however, when the capital gains differential is utilized in Kentucky. Those states with the highest combination of standard deduction and personal exemption amounts (Alabama, Louisiana and Mississippi) had the lowest state portions of total income tax liability in most of the hypothetical cases. In addition, Alabama allows a deduction for federal income taxes, and Alabama and Mississippi have the lowest maximum ordinary income tax rates in the South.

Four southern states (Alabama, Kentucky, Louisiana and Oklahoma) allow a deduction for federal income taxes. This provision has helped produce a low state income tax in Alabama and Louisiana, as previously discussed. Kentucky and Oklahoma generally fall in the middle to upper and middle ranges, respectively, in most of the cases. The state portion of the total income tax liability would have been even higher had the provision not been allowed.

North Carolina ranked the highest in terms of state percentages in every hypothetical case. In North Carolina 100 percent of net long-term capital gains are taxable, and there is no deduction for federal income taxes. Personal exemption and standard deduction amounts are relatively low as compared to other southern states. In addition, North Carolina has the highest maximum ordinary income tax rate (along with Arkansas and South Carolina) in the South. Landowners with timber sales may incur a substantial tax savings by taking advantage of the previously discussed special forestry provisions available in North Carolina.

The West

The amount of state taxable income varies greatly among the western states. At the low income level and no timber sale revenue, state taxable income ranged from $14,832 in Arizona to $21,220 in Hawaii (Table 13).[7] At the low income level with timber sale revenue, state taxable income ranged from $26,153 in Idaho to $53,437 in Hawaii. At the medium income level and no timber sale revenue, state taxable income ranged from $37,751 in Arizona to $56,220 in Hawaii (Table 14). At the medium income level with timber sale revenue, state taxable income ranged from $55,931 in Arizona to $88,437 in Hawaii. At the high income level and no timber sale revenue, state taxable income ranged from $65,248 in Arizona to $106,220 in Hawaii (Table 15). Finally, at the high income level with timber sale revenue, state taxable income ranged from $84,448 in Arizona to $138,437 in Hawaii.

The state portion of the total income tax liability at the low income level and no timber sale revenue, ranged from 10 percent in California to 34 percent in Hawaii (Table 13). At the low income level with timber sale revenue, the state portion ranged from 13 percent in Idaho to 25 percent in Hawaii. At the medium income level and no timber sale revenue the state portion ranged from

[7] The following discussion concerns those states with a comprehensive income tax: Alaska, Nevada, Washington and Wyoming are excluded.

Table 13. Combined Federal-State Income Tax for the Hypothetical Landowner at the Low Income Level in the West, 1988.a/

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable income b/	Total income tax (federal plus state) c/	State portion	State taxable income b/	Total income tax (federal plus state) c/	State portion
	($)	($)	(%)	($)	($)	(%)
ALASKA	------	2,415	0	------	9,661	0
ARIZONA	14,832	2,985	19	36,120	11,370	15
CALIFORNIA	21,068	2,670	10	53,285	11,388	15
COLORADO	16,100	3,099	22	48,317	11,401	15
HAWAII	21,220	3,650	34	53,437	12,967	25
IDAHO	16,200	3,171	24	26,153	11,076	13
MONTANA	18,061	3,352	28	40,996	12,172	21
NEVADA	------	2,415	0	------	9,661	0
NEW MEXICO	17,000	2,877	16	49,217	11,468	16
OREGON	19,585	3,524	31	51,217	12,650	24
UTAH	16,276	3,251	26	46,102	11,947	19
WASHINGTON	------	2,415	0	------	9,661	0
WYOMING	------	2,415	0	------	9,661	0

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ Gross income before any deductions is $25,000 and $75,000, respectively.

c/ Combined federal-state income tax liability: federal share is $2,415 and $9,661, respectively.

Table 14. Combined Federal-State Income Tax for the Hypothetical Landowner at the Medium Income Level in the West, 1988.[a]

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable income[b]	Total income tax (federal plus state)[c]	State portion	State taxable income[b]	Total income tax (federal plus state)[c]	State portion
	($)	($)	(%)	($)	($)	(%)
ALASKA	------	10,441	0	------	20,032	0
ARIZONA	37,751	12,244	15	55,931	22,882	12
CALIFORNIA	56,068	12,354	15	88,285	23,820	16
COLORADO	51,100	12,281	15	83,317	22,823	12
HAWAII	56,220	13,947	25	88,437	25,453	21
IDAHO	51,200	13,078	20	61,153	23,258	14
MONTANA	45,039	13,272	21	65,625	24,618	19
NEVADA	------	10,441	0	------	20,032	0
NEW MEXICO	52,000	12,402	16	84,217	23,627	15
OREGON	54,000	13,610	23	86,217	24,924	20
UTAH	48,628	12,860	19	77,680	23,714	16
WASHINGTON	------	10,441	0	------	20,032	0
WYOMING	------	10,441	0	------	20,032	0

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ Gross income before any deductions is $60,000 and $110,000, respectively.

c/ Combined federal-state income tax liability: federal share is $10,441 and $20,032, respectively.

Table 15. Combined Federal-State Income Tax for the Hypothetical Landowner at the High Income Level in the West, 1988.a/

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable incomeb/	Total income tax (federal plus state)c/	State portion	State taxable incomeb/	Total income tax (federal plus state)c/	State portion
	($)	($)	(%)	($)	($)	(%)
ALASKA	------	25,901	0	------	36,532	0
ARIZONA	65,248	29,288	12	84,448	40,713	10
CALIFORNIA	106,068	30,797	16	138,235	43,435	16
COLORADO	101,100	29,288	12	133,317	40,998	11
HAWAII	106,220	32,513	20	138,437	45,303	19
IDAHO	101,200	31.102	17	111,152	42,281	14
MONTANA	79,579	31,299	17	99,125	43,515	16
NEVADA	------	25,901	0	------	36,532	0
NEW MEXICO	102,000	30,509	15	134,217	42,975	15
OREGON	104,000	31,865	19	136,217	44,439	18
UTAH	93,527	30,363	15	122,235	42,409	14
WASHINGTON	------	25,901	0	------	36,532	0
WYOMING	------	25,901	0	------	36,532	0

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ Gross income before any deductions is $110,000 and $160,000, respectively.

c/ Combined federal-state income tax liability: federal share is $25,901 and $36,532, respectively.

15 percent in Arizona, California and Colorado to 25 percent in Hawaii (Table 14). At the medium income level with timber sale revenue the state portion ranged from 12 percent in Arizona and Colorado to 21 percent in Hawaii. The state portion of the total income tax liability at the high income level and no timber sale revenue ranged from 12 percent in Arizona and Colorado to 20 percent in Hawaii (Table 15). At the high income level with timber sale revenue the state portion ranged from 10 percent in Arizona to 19 percent in Hawaii.

Long-term capital gains differentials can exclude from income taxation a certain portion of capital gains revenue. Idaho is currently the only state in the West allowing a long-term capital gains exclusion. The state portion of the total income tax liability for the Idaho hypothetical case ranked among the lowest in the West at all three income levels when timber sale revenue was reported as a capital gain.

The amount of state income tax liability depends on the progressivity of the tax rate schedule and the percentage of the maximum ordinary income tax rate. The ideal situation from the taxpayer's standpoint would be to impose the maximum ordinary income tax rate on a relatively high amount of income (slowly progress to the maximum rate) and have this maximum ordinary income tax rate be relatively low. Arizona, Idaho and New Mexico have maximum ordinary income tax rates which are relatively low compared to the other western states. These three states also had a state portion of total income tax liability which was consistently among the lowest five in the West in all of the hypothetical cases. Colorado also was consistently among the states with the lowest state portion of total income tax liability. This was possibly due to the imposition of a flat 5 percent tax on federal income tax liability with modifications.

A combination of the long-term capital gains differential, favorable tax schedules, rates, and personal exemption and standard deduction amounts may produce a low state tax liability. In most states no single tax provision results in the lowest tax levy. For example, when compared to other states in the West, Utah allows no capital gains differential, but has relatively high standard deduction ($5,000) and personal exemption ($1,463) amounts and a relatively low maximum ordinary income tax rate (7.75 percent). However, the Utah income tax liability ranked in the medium range in all of the hypothetical cases in the West, possibly due to the fast progressivity of its tax rate schedule. The maximum ordinary income tax rate in Utah is applied to all income over $7,500.

The deductibility of federal income taxes may further reduce the amount of state taxable income. Arizona, with regular and special deductions for the federal income tax liability, ranked the lowest in the amount of state income taxes paid in almost every case. In addition, Arizona also has the lowest maximum ordinary income tax rate. Although Montana permits a full deduction for federal income tax liability, it ranked among the highest in the amount of total income taxes paid in all cases, because it also has the highest maximum ordinary income tax rate. Thus, a few preferential income tax provisions may or may not provide low tax levies for taxpayers in states where these provisions exist. It should be noted that all taxpayers benefit from the federal income tax liability deduction, whether or not they invest in forest management.

Special forestry provisions can provide added incentives for timber landowners who wish to invest in forest management. Special provisions such as the reforestation investment tax credit (ITC) offered to qualified Oregon landowners can substantially reduce the amount of state income tax liability.

The Northeast

At the low income level and no timber sale revenue, state taxable income ranged from $14,500 in New York to $25,000 in Maine and Pennsylvania (Table 16).[8] At the low income level with timber sale revenue, state taxable income ranged from $37,330 in Maryland to $57,217 in Maine and Pennsylvania. State taxable income at the medium income level and no timber sale revenue,

[8] The following discussion concerns those states with a comprehensive income tax: Connecticut and New Hampshire are excluded.

Table 16. Combined Federal-State Income Tax for the Hypothetical Landowner at the Low Income Level in the Northeast, 1988.a/

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable incomeb/	Total income tax (federal plus state)c/	State portion	State taxable incomeb/	Total income tax (federal plus state)c/	State portion
	($)	($)	(%)	($)	($)	(%)
CONNECTICUT	------	2,415	0	13,687d/	10,475	8
DELAWARE	20,900	3,269	26	53,117	12,106	20
MAINE	25,000	2,976	19	57,217	11,920	19
MARYLAND	19,250	3,567	32	37,330	11,613	17
MASSACHUSETTS	20,600	3,291	27	18,100e/	11,563	16
NEW HAMPSHIRE	------	2,415	0	------	9,661	0
NEW JERSEY	23,000	2,819	14	55,217	10,621	9
NEW YORK	14,500	2,894	17	46,717	11,851	18
OHIO	23,700	2,900	17	55,917	11,191	14
PENNSYLVANIA	25,000	2,861	16	57,217	10,526	8
RHODE ISLAND	2,415f/	2,886	16	9,661f/	11,258	14
VERMONT	2,415f/	2,887	16	9,661f/	11,261	14

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ Gross income before any deductions is $25,000 and $75,000, respectively.

c/ Combined federal-state income tax liability: federal share is $2,415 and $9,661, respectively.

d/ Connecticut imposes a tax on net capital gains income in this case.

e/ The amount shown is 5 percent income (earned income), 10 percent income (net capital gains income) is $17,358.

f/ The state tax is imposed as a percentage of the federal income tax liability with modifications.

ranged from $49,500 in New York to $60,000 in Maine and Pennsylvania (Table 17). At the medium income level and timber sale revenue, it ranged from $77,330 in Maryland to $92,217 in Maine and Pennsylvania. At the high income level and no timber sale revenue, state taxable income ranged from $99,500 in New York to $110,000 in Maine and Pennsylvania (Table 18). At the high income level and timber sale revenue, state taxable income ranged from $122,330 in Maryland to $142,217 in Maine and Pennsylvania.

The state portion of the total income tax liability at the low income level and no timber sale revenue ranged from 14 percent in New Jersey to 32 percent in Maryland (Table 16). At the low income level with timber sale revenue, the state portion ranged from 8 percent in Pennsylvania to 20 percent in Delaware. At the medium income level and no timber sale revenue, the state portion of the total income tax liability ranged from 8 percent in Pennsylvania to 21 percent in Maryland (Table 17). The state portion at the medium income level and timber sale revenue ranged from 6 percent in Pennsylvania to 17 percent in Delaware, Maine and New York. The state portion at the high income level and no timber sale revenue ranged from 6 percent in Pennsylvania to 17 percent in Maryland (Table 18). The state portion at the high income level and timber sale revenue ranged from 5 percent in Pennsylvania to 16 percent in New York.

The states which consistently had the lowest income tax liability in the Northeast (Pennsylvania, New Jersey and Ohio) fully tax long-term capital gains and do not allow standard deductions for their taxpayers. In addition, Pennsylvania does not allow a personal exemption in calculating the state income tax. Tax rates and schedules are the major factor causing each of these three states to rank the lowest in terms of total income tax liability. Pennsylvania (2.1 percent) and New Jersey (3.5 percent) have the lowest maximum ordinary income tax rates and maximum effective capital gains tax rates in the Northeast. Pennsylvania has a flat income tax rate and New Jersey has a progressive tax schedule with only 3 steps, the maximum rate being applied to income over $50,000.

Ohio also has a progressive tax schedule. However, Ohio's tax schedule slowly progresses to its maximum ordinary income tax rate of 6.9 percent on all income over $100,000. This is the highest

Table 17. Combined Federal-State Income Tax for the Hypothetical Landowner at the Medium Income Level in the Northeast, 1988.a/

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable incomeb/	Total income tax (federal plus state)c/	State portion	State taxable incomeb/	Total income tax (federal plus state)c/	State portion
	($)	($)	(%)	($)	($)	(%)
CONNECTICUT	------	10,441	0	13,687d/	20,846	4
DELAWARE	55,900	13,040	20	88,117	24,113	17
MAINE	60,000	12,860	19	92,217	24,010	17
MARYLAND	54,000	13,292	21	77,330	23,607	15
MASSACHUSETTS	55,600	12,443	16	53,100e/	22,974	13
NEW HAMPSHIRE	------	10,441	0	------	20,032	0
NEW JERSEY	58,000	11,471	9	90,217	21,746	8
NEW YORK	49,500	12,798	18	81,717	24,033	17
OHIO	58,700	12,075	14	90,217	22,729	12
PENNSYLVANIA	60,000	11,348	8	92,217	21,330	6
RHODE ISLAND	10,441f/	12,166	14	20,032f/	23,113	13
VERMONT	10,441f/	12,170	14	20,032f/	23,118	13

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ Gross income before any deductions is $60,000 and $110,000, respectively.

c/ Combined federal-state income tax liability: federal share is $10,441 and $20,032, respectively.

d/ Connecticut imposes a tax on net capital gains income in this case.

e/ The amount shown is 5 percent income (earned income), 10 percent income (net capital gains income) is $17,358.

f/ The state tax is imposed as a percentage of the federal income tax liability with modifications.

Table 18. Combined Federal-State Income Tax for the Hypothetical Landowner at the High Income Level in the Northeast, 1988.a/

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable incomeb/	Total income tax (federal plus state)c/	State portion	State taxable incomeb/	Total income tax (federal plus state)c/	State portion
	($)	($)	(%)	($)	($)	(%)
CONNECTICUT	------	25,901	0	13,687d/	37,174	2
DELAWARE	105,900	30,899	16	138,117	43,168	15
MAINE	110,000	30,832	16	142,217	43,190	15
MARYLAND	104,000	31,067	17	122,330	42,620	14
MASSACHUSETTS	105,600	29,439	12	103,100e/	41,149	11
NEW HAMPSHIRE	------	25,901	0	------	36,532	0
NEW JERSEY	108,000	28,032	8	140,217	39,418	7
NEW YORK	99,500	30,901	16	131,717	43,339	16
OHIO	108,000	29,357	12	140,217	41,477	12
PENNSYLVANIA	110,000	27,449	6	142,217	38,533	5
RHODE ISLAND	25,901f/	29,885	13	36,532f/	42,152	13
VERMONT	25,901f/	29,892	13	36,532f/	42,161	13

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).
b/ Gross income before any deductions is $110,000 and $160,000, respectively.
c/ Combined federal-state income tax liability: federal share is $25,901 and $36,532, respectively.
d/ Connecticut imposes a tax on net capital gains income in this case.
e/ The amount shown is 5 percent income (earned income), 10 percent income (net capital gains income) is $17,358.
f/ The state tax is imposed as a percentage of the federal income tax liability with modifications.

threshold in the Northeast to which a maximum ordinary income tax rate is applied. Ohio's maximum rate is considered to fall in the mid-range of Northeastern states. In addition, the maximum effective long-term capital gains tax rate in Ohio is considered to fall in the mid-range of all these states.

Northeastern states which have long-term capital gains exclusions in their tax codes (Maryland and Massachusetts) provide tax savings for taxpayers who can utilize this provision, such as NIPF landowners with timber sale revenue in half of the cases. However, other aspects of these two states tax codes caused the tax liabilities to fall in the mid- to upper-range of state income tax liabilities in the region. In fact, Maryland has the highest state income tax liability in all cases where there no timber sale revenue is reported. This result is due primarily to a 50 percent county surtax being imposed in all but four Maryland counties. Massachusetts allows the highest personal exemption amount in the Northeast (a $4,400 maximum), but also imposes the highest tax rate. Capital gains are taxed at a flat 10 percent.

Three states (Delaware, Maine and New York) ranked among the highest in the Northeast in terms of state income taxes imposed on the hypothetical cases. While each allows a personal exemption deduction (or tax credit) and a standard deduction, both their maximum ordinary income tax rates and their maximum effective long-term capital gains tax rates are among the highest in the Northeast. New York does, however, allow the highest standard deduction ($8,500) for married taxpayers filing a joint return.

The Midwest

At the low income level and no timber sale revenue, state taxable income ranged from $13,685 in North Dakota to $23,000 in Illinois and Indiana (Table 19).[9] At the low income level and timber sale revenue, state taxable income ranged from $27,026 in Iowa to $55,217 in Illinois and Indiana. State taxable income ranged from $40,659 in North Dakota to $60,000 in Wisconsin at the medium income level and no timber sale revenue (Table 20). At the medium income level and timber sale revenue, state taxable income ranged from $51,655 in Iowa to $90,217 in Illinois and Indiana. At the high income level and no timber sale revenue, state taxable income ranged from $75,199 in North Dakota to $110,000 in Wisconsin (Table 21). At the high income level and timber sale revenue, state taxable income ranged from $85,155 in Iowa to $140,217 in Illinois and Indiana.

The state portion of the total income tax liability at the low income level and no timber sale revenue ranged from 16 percent in Nebraska to 28 percent in Wisconsin (Table 19). At the low income level and timber sale revenue, the state portion ranged from 9 percent in Illinois to 21 percent in Minnesota. At the medium income level and no timber sale revenue the state portion of the total income tax liability ranged from 9 percent in Illinois to 21 percent in Wisconsin (Table 20). At the medium income level and timber sale revenue the state portion ranged from 7 percent in Illinois to 17 percent in Minnesota and North Dakota. At the high income level and no timber sale revenue the state portion ranged from 7 percent in Illinois to 17 percent in Minnesota (Table 21). At the high income level and timber sale revenue the state portion ranged from 6 percent in Illinois to 16 percent in Minnesota.

Capital gains differentials exist in the tax codes of two states in the Midwest, Iowa and Wisconsin. In the cases where timber sale revenue was reported as a capital gain, Iowa's state portion of the total income tax liability ranked among the lowest in the Midwest at the low and medium income levels. A combination of the capital gains differential and a deduction for the federal income tax liability contributed to these results. Iowa's state portion of the total income tax liability ranked among the highest in the Midwest in the cases where timber sale revenue was not received, even though the deduction for federal income taxes was utilized.

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9 The following discussion concerns those states with a comprehensive income tax: South Dakota is excluded.

Table 19. Combined Federal-State Income Tax for the Hypothetical Landowner at the Low Income Level in the Midwest, 1988.a/

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable incomeb/	Total income tax (federal plus state)c/	State portion	State taxable incomeb/	Total income tax (federal plus state)c/	State portion
	($)	($)	(%)	($)	($)	(%)
ILLINOIS	23,000	2,904	17	55,217	10,655	9
INDIANA	23,000	3,080	22	55,217	11,012	12
IOWA	19,555	3,275	26	27,026	10,999	12
KANSAS	16,100	2,969	19	48,317	11,164	13
MICHIGAN	21,400	3,251	26	53,617	11,437	16
MINNESOTA	16,100	3,236	25	48,317	12,170	21
MISSOURI	14,385	2,957	18	39,356	11,199	14
NEBRASKA	17,740	2,860	16	49,957	11,094	13
NORTH DAKOTA	13,685	3,009	20	38,656	11,756	18
SOUTH DAKOTA	------	2,415	0	------	9,661	0
WISCONSIN	19,067	3,336	28	32,706	11,120	13

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ Gross income before any deductions is $25,000 and $75,000, respectively.

c/ Combined federal-state income tax liability: federal share is $2,415 and $9,661, respectively.

Table 20. Combined Federal-State Income Tax for the Hypothetical Landowner at the Medium Income Level in the Midwest, 1988.a/

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable income b/	Total income tax (federal plus state) c/	State portion	State taxable income b/	Total income tax (federal plus state) c/	State portion
	($)	($)	(%)	($)	($)	(%)
ILLINOIS	58,000	11,485	9	90,217	21,543	7
INDIANA	58,000	11,861	12	90,217	22,087	9
IOWA	46,529	12,797	18	51,655	22,756	12
KANSAS	51,100	12,076	14	83,317	22,697	12
MICHIGAN	56,400	12,309	15	88,617	22,763	12
MINNESOTA	51,100	13,111	20	83,317	24,269	17
MISSOURI	41,359	12,066	13	63,985	22,634	11
NEBRASKA	52,740	11,992	13	84,957	22,749	12
NORTH DAKOTA	40,659	12,690	18	63,285	24,147	17
SOUTH DAKOTA	------	10,441	0	------	20,032	0
WISCONSIN	60,000	13,261	21	71,387	23,420	14

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ Gross income before any deductions is $60,000 and $110,000, respectively.

c/ Combined federal-state income tax liability: federal share is $10,441 and $20,032, respectively.

Table 21. Combined Federal-State Income Tax for the Hypothetical Landowner at the High Income Level in the Midwest, 1988.a/

	Without forest management investment and no timber sale			With forest management investment and timber sale		
	State taxable income b/	Total income tax (federal plus state) c/	State portion	State taxable income b/	Total income tax (federal plus state) c/	State portion
	($)	($)	(%)	($)	($)	(%)
ILLINOIS	108,000	27,710	7	140,217	38,880	6
INDIANA	108,000	28,361	9	140,217	39,726	8
IOWA	81,069	30,403	15	85,155	41,306	12
KANSAS	101,100	29,198	11	133,317	40,973	11
MICHIGAN	106,400	29,180	11	138,617	40,804	10
MINNESOTA	101,100	31,151	17	133,317	43,617	16
MISSOURI	75,899	28,862	10	97,485	40,300	9
NEBRASKA	102,740	29,321	12	134,957	41,225	11
NORTH DAKOTA	75,199	30,687	16	96,785	43,054	15
SOUTH DAKOTA	------	25,901	0	------	36,532	0
WISCONSIN	110,000	30,847	16	121,387	42,007	13

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ Gross income before any deductions is $110,000 and $160,000, respectively.

c/ Combined federal-state income tax liability: federal share is $25,901 and $36,532, respectively.

In almost every case, Wisconsin's state portion of the total income tax liability was among the highest in the Midwest. The Wisconsin standard deduction, tax schedule and rates contributed to this result. There is effectively no standard deduction allowable for married taxpayers filing a joint return with income over $55,000. Also, the maximum ordinary income tax rate (6.93 percent, which is considered to fall in the mid-range in the Midwest) is applied to income at a relatively low threshold of $20,000. Finally, the lowest ordinary income tax rate in the Wisconsin tax schedule is the second highest of similar rates in the Midwest.

The two states which utilize federal taxable income as their tax base, Minnesota and North Dakota, ranked among the highest in terms of state income tax liabilities in almost every case in the study. Tax rates caused these results. Minnesota's lowest ordinary income tax rate (6 percent) in its progressive schedule is the highest among similar first-step rates in the Midwest. In addition, Minnesota imposes a 10 percent surtax on any tax derived from the 33 percent federal marginal tax bracket. North Dakota has the highest maximum ordinary income tax rate in the Midwest (12 percent), along with the highest maximum effective long-term capital gains tax rate (12 percent). These mitigate the effect of allowing a deduction for the federal income tax liability.

The two states in the Midwest which were consistently among the lowest in terms of state income tax liabilities were Illinois and Indiana. Neither state allows a deduction for the federal income tax liability or a standard deduction. Both states fully tax long-term capital gains. Illinois (2.5 percent) and Indiana (3.4 percent) impose flat tax rates that are, however, the lowest maximum ordinary income tax rates in the Midwest. Both states also have relatively low maximum effective long-term capital gains tax rates. The other state in the Midwest which allows a deduction for federal income tax liability, Missouri (Iowa and North Dakota have already been discussed), also ranked among the lowest in terms of state tax liabilities in most cases of the study. This result, however, is due to a combination of the federal income tax liability deduction, relatively high standard deduction ($5,000) and personal exemption ($1,200) amounts, and a maximum ordinary income tax rate which falls in the mid-range of the states in the Northeast.

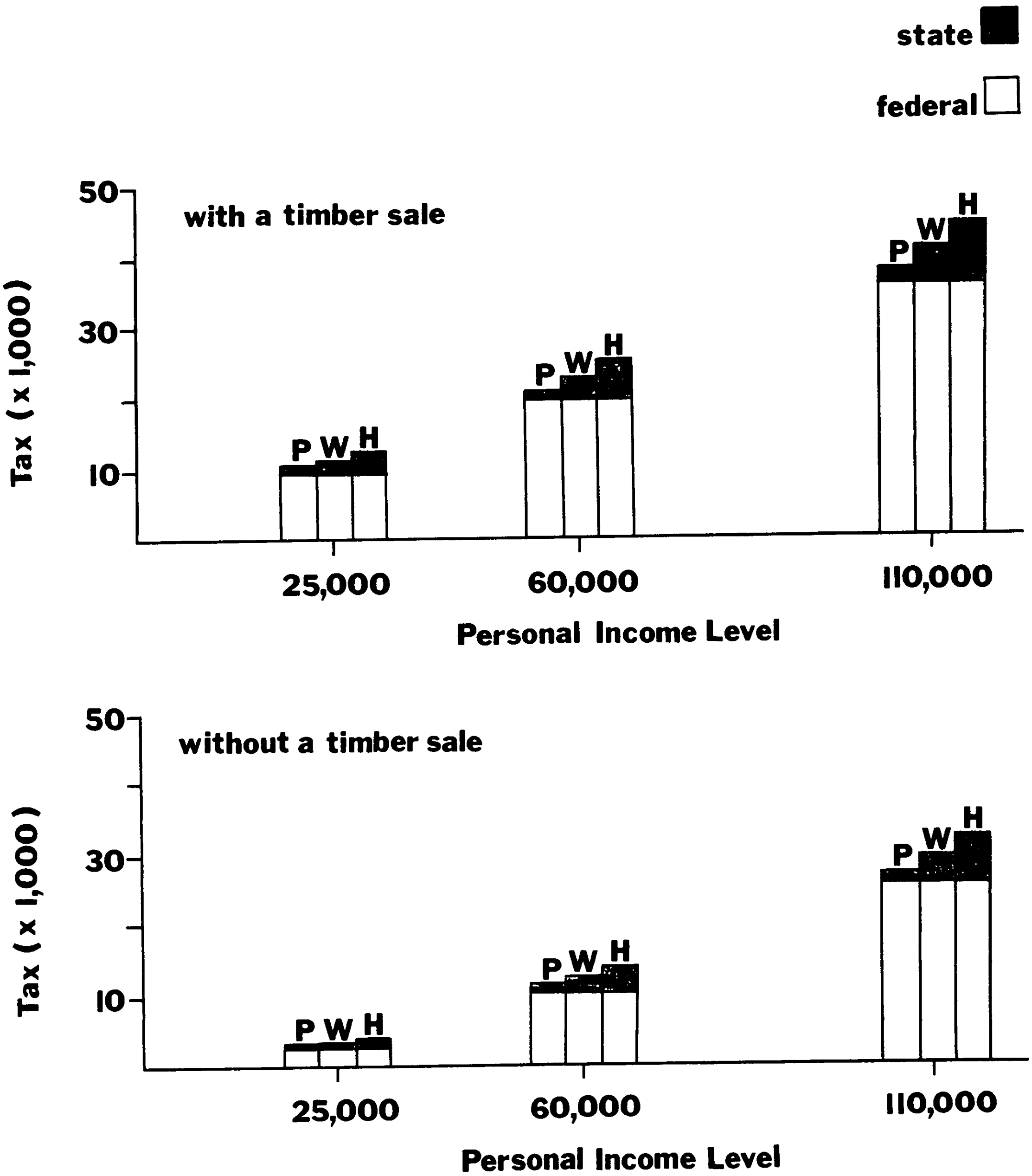
Discussion

The results show that the state portion of the total income tax liability, with an investment in forest management and timber sale revenue, is generally lower than the state portion when there is no investment in forest management and no timber sale revenue. This holds for all three income levels. In the previous study, the opposite was generally true. Absolute tax liabilities are higher, of course, when timber sale revenue is added to a personal income level. Changes in both federal and state income tax laws undoubtedly contributed to the different findings, as well as the use of different assumptions. The exclusion for a portion of long-term capital gains was eliminated at the federal level and by most states. At the same time maximum federal rates were lowered and maximum ordinary income tax rates remained relatively constant at the state level.

Figures 1 and 2 illustrate the state percentage of the total income tax liability for three states: Pennsylvania (which had the lowest state percentage in the U.S.), West Virginia (which ranked in the mid-range) and Hawaii (which had the highest state percentage). Figure 3 illustrates the differential in tax levies between cases in which there is a timber sale (active case) and in which there is no timber sale (passive case) for the same three states. State percentages of the total income tax liability generally decrease with an increase in taxable income, due to the federal income tax reaching its maximum rate at a very high income threshold as compared to most states. In cases in which there is timber sale revenue, there is an additional amount of taxable income derived from the timber sale, therefore there is a greater amount of taxable income when timber sale revenue is reported (as compared to when there is no timber sale) and generally a lower state percentage of total tax liability.

The model assumes that taxpayers who invest in forest management receive a tax savings, because they actively participate in forest management for the purposes of the passive loss rules. Annual management costs and property taxes are allowed as current deductions. They are disal-

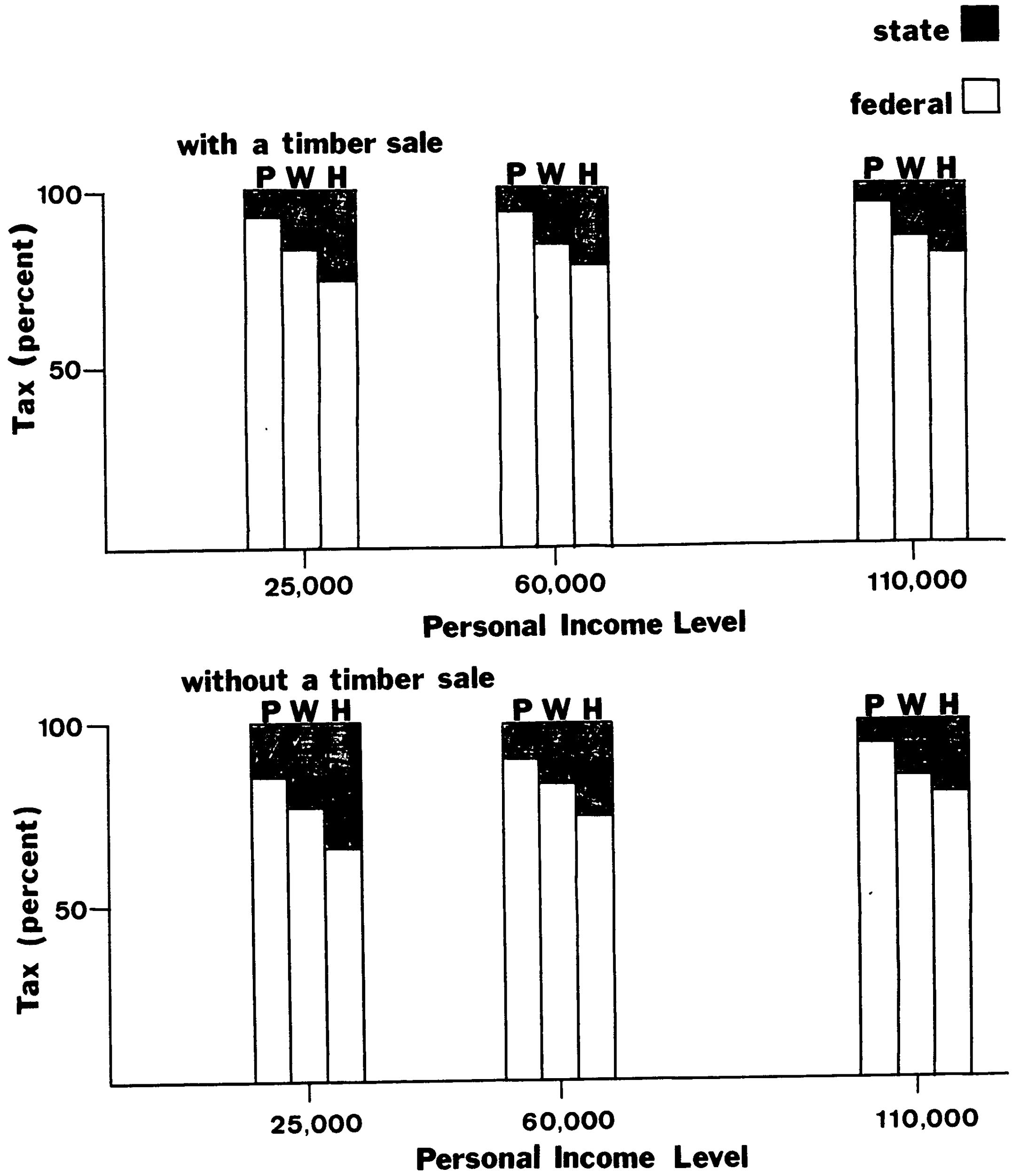
Figure 1. Total Income Tax Liabilities (Federal and State) for Pennsylvania, West Virginia and Hawaii, at Three Income Levels, with and without a Timber Sale, 1988.a/b/



a/ These calculations were made with the Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ The states illustrated are Pennsylvania (P), West Virginia (W) and Hawaii (H).

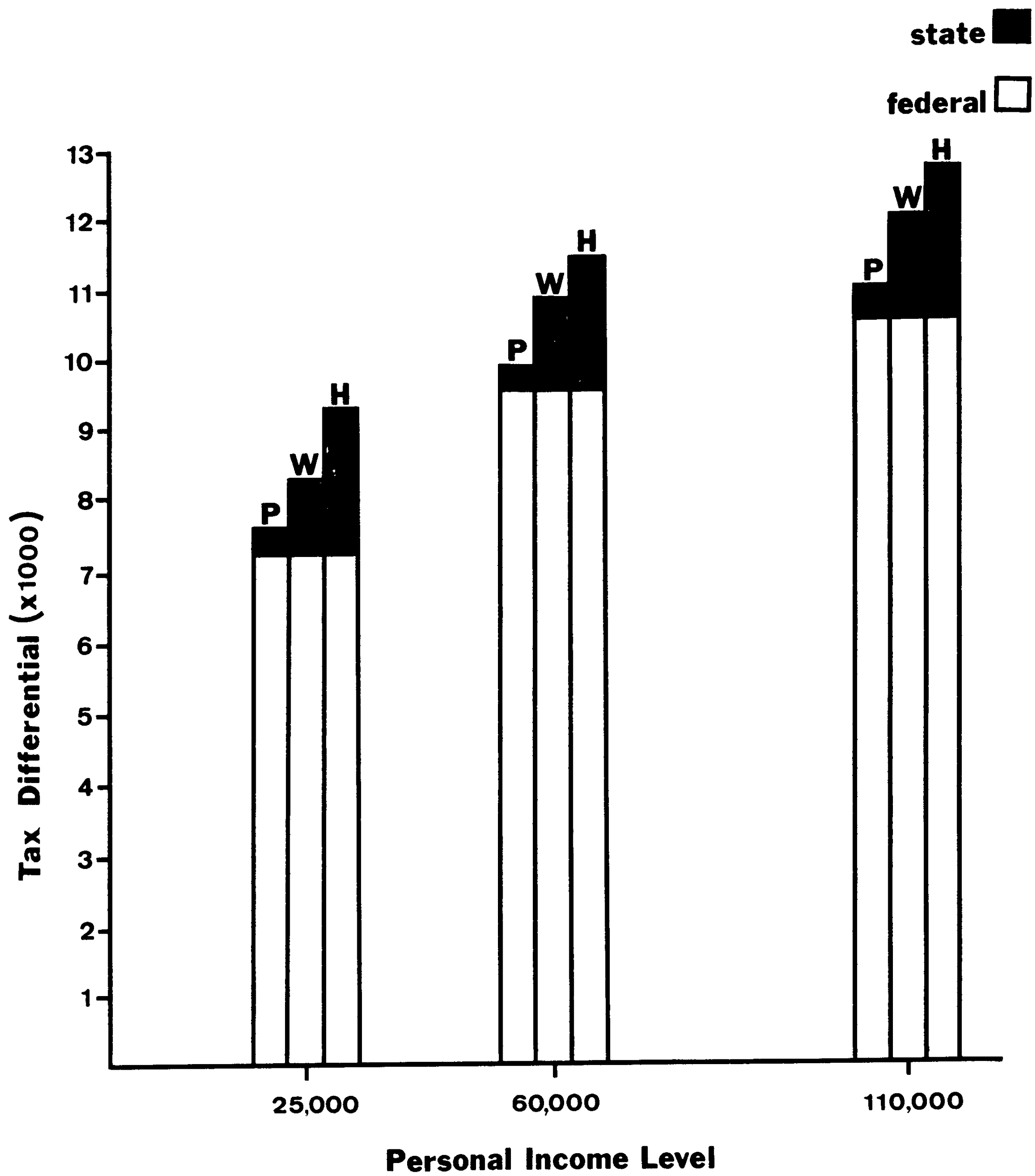
Figure 2. Percentage of Total Income Tax Liabilities (Federal and State) for Pennsylvania, West Virginia and Hawaii, at Three Income Levels, with and without a Timber Sale, 1988.a/b/



a/ These calculations were made with the Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ The states illustrated are Pennsylvania (P), West Virginia (W) and Hawaii (H).

Figure 3. Differential in Tax Levies between the Active Case (with a Timber Sale) and the Passive Case (with no Timber Sale) for Pennsylvania, West Virginia and Hawaii, at Three Income Levels. a/b/



a/ These calculations were made with the Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

b/ The states illustrated are Pennsylvania (P), West Virginia (W) and Hawaii (H).

lowed (capitalized) in the cases when taxpayers who are passive participants and do not invest in forest management. In reality, landowners who do not invest in forest management could also be considered active participants, should they meet the temporary rules of the IRC. The landowners may have the profit motive required for material participation and deductibility of expenses without having a timber sale every year.

The findings of the income tax analysis indicate that no specific tax provision consistently contributes to a lower state percentage of total income tax liability. However, states which allow a deduction for federal income tax liability or a deduction for a percentage of net long-term capital gains (or both) generally have lower state tax percentages for taxpayers who invest in forest management and have timber sale revenue than states which do not allow these provisions. The deduction for federal income tax liability applies to all taxpayers, and providing a substantial tax savings on the state level for taxpayers who do not invest in forest management as well as for those who do. Tax rates and schedules were responsible for low state tax liabilities in the West, Northeast and Midwest. Relatively large dollar amounts allowed for standard deductions and personal exemptions created a low state tax percentage in the South. The federal income tax liability deduction was important in the West and Midwest, and a capital gains deduction substantially reduced tax liabilities for hypothetical cases in states which allow this provision.

The use of a specific tax base (e.g., federal adjusted gross income, federal taxable income) does not assure a lower state portion of the total income tax liability. States that follow the federal Code closely, however, make the state tax calculation easier for their taxpayers, as compared to states which utilize a completely different method for computing income taxes than the federal method.

There are no real regional advantages in state income taxation. The availability of favorable tax provisions (i.e. capital gains deduction, federal income tax deduction) is scattered and not concentrated in any one region. Each region had states which consistently imposed relatively low tax levies on each of the hypothetical cases, and states which consistently imposed relatively high tax levies. The individuality of each state tax code is responsible for these results. The West, however, contains the most states that do not impose an income tax. Average tax rates for the states with a comprehensive income tax in the West (Table 22), however, are higher than the other three regions.

Table 22. Maximum Effective State Long-term Capital Gains Tax Rates, and Maximum Ordinary Income Tax Rates.a/

State	Maximum effective long-term capital gains tax rate (state)	Maximum effective ordinary income tax rate (state)	State	Maximum effective long-term capital gains tax rate (state)	Maximum effective ordinary income tax rate (state)
	(%)	(%)		(%)	(%)
The South			The West		
Alabama	5.0	5.0	Alaska	---	---
Arkansas	7.0	7.0	Arizona	8.0	8.0
Florida	---	---	California	9.3	9.3
Georgia	6.0	6.0	Colorado	5.0	5.0
Kentucky	2.4	6.0	Hawaii	7.25	10.0
Louisiana	6.0	6.0	Idaho	3.3	8.2
Mississippi	5.0	5.0	Montana	12.1	12.1
North Carolina	7.0	7.0	Nevada	---	---
Oklahoma	6.0	6.0	New Mexico	8.5	8.5
South Carolina	7.0	7.0	Oregon	9.0	9.0
Tennessee	---	---	Utah	7.75	7.75
Texas	---	---	Washington	---	---
Virginia	5.75	5.75	Wyoming	---	---
West Virginia	6.5	6.5			
mean	5.79	6.11	mean	6.59	6.94
median	6.00	6.00	median	6.90	6.97
The Northeast			The Midwest		
Connecticut	2.8	---	Illinois	2.5	2.5
Delaware	7.7	7.7	Indiana	3.4	3.4
Maine	10.0	10.0	Iowa	9.98 b/	9.98
Maryland	3.0	5.0	Kansas	9.0	9.0
Massachusetts	5.0	5.0	Michigan	4.6	4.6
New Hampshire	---	---	Minnesota	8.0	8.0
New Jersey	3.5	3.5	Missouri	6.0	6.0
New York	8.375	8.375	Nebraska	5.9	5.9
Ohio	6.9	6.9	North Dakota	12.0	12.0
Pennsylvania	2.1	2.1	South Dakota	---	---
Rhode Island	7.6	7.6	Wisconsin	2.8	6.93
Vermont	7.6	7.6			
mean	5.87	6.38	mean	6.42	6.83
median	5.95	7.60	median	5.95	6.47

a/ Rates effective as of September 1988. The sources of this information were: state tax codes, income tax forms, the State Tax Guide (CCH 1988f), and the Bureau of National Affairs (1988).

b/ The maximum effective capital gains tax rate in Iowa will be lower than the rate shown, depending upon how much the limited deduction ($17,500) impacts the effective rate.

Chapter 6

Alternative Tax Planning

Timber sale revenues are usually periodic because most NIPF are unregulated, and there are economies of scale in increasing sale size and reforestation effort (to a point). Tax savings may result if taxpayers can smooth the flow of income over time and reduce the amount of income subject to the higher federal and state marginal tax rates. Taxpayers at low income levels should attempt to minimize the amount of income in the 28 percent tax bracket on their federal return. Those with income in the medium and high levels should minimize the amount of income in the 33 percent bracket (28% plus a 5% surcharge). Depending on the progressivity of state income tax schedules, a tax savings may result on the state level as well. To accomplish this goal, taxpayers can reduce the amount of periodic timber sale revenue reported in a particular tax year by harvesting timber at more frequent intervals and in smaller amounts. This strategy will often result in additional management costs incurred by the landowners, which must be balanced against potential tax savings.

A similar reduction in the amount of periodic revenue realized from timber sales can be obtained if the taxpayers elect to receive timber sale revenue through the installment sale method of reporting. Taxpayers who wish to elect the installment sale method must meet the requirements in Section 453 of the IRC. In general, there must be a sale of property which cannot be considered inventory of the taxpayer at the end of the tax year. The property must also not be traded on an established securities market or on any other established market. Finally, a portion of the net gain must be something other than ordinary income recapture as stated under Section 1245 or Section 1250 of the IRC (Hoffman et al 1987). Interest must be included on a payment deferred more than 6 months from the initial payment or interest is imputed on the deferred payment at the applicable federal rate. The deferred payment in the hypothetical case is received less than 6 months after the initial payment and no interest is included (or involved) to simplify the arguments.

The hypothetical landowners who elect to use the installment sale in this study received half of the timber sale revenue in 1988 and half in 1989. The present value of the combined 1988 and 1989 total tax liabilities is (1988 total tax liability + (1989 total tax liability/1.1)). A 10 percent discount rate is used (see Chapter 4) to calculate the present value of the tax savings. When the hypothetical landowners did not elect the installment sale, all of the timber sale revenue was reported in 1988. The present value of the combined 1988 and 1989 total tax liabilities when the installment sale was not elected was calculated and compared to the situation when the installment sale was elected. Taxes levied in 1988 are not discounted since 1988 was the current year of the study. Taxes levied in 1989 are discounted one year by the 10 percent rate.

To illustrate the use of the installment sale, four cases (each utilizing the same three income levels) were analyzed. Each case represented one of the four categories of state tax bases: federal AGI, federal taxable income, federal income tax liability, and other methods for determining the state tax base. The combined Federal-Georgia case represents states which use federal AGI as their tax base. The combined Federal-Minnesota case represents states which use federal taxable income as their tax base. The Federal-Vermont case represents states which impose an income tax as a percentage of the federal income tax liability. Finally, the Federal-Oregon case represents states which use other methods for determining state taxable income. Each case was chosen to represent the mid-range of maximum ordinary income tax rates for each category. A secondary consideration for choosing each state was due to the importance of forestry in the state's economy.

Federal-Georgia case

Low income level

1988 Tax Return

For 1988 federal and Georgia AGI at the low income level ($39,858) is calculated by adding personal income ($25,000) to the taxable gain on the timber sale ($17,358), and subtracting total deductions ($2,500) (Table 23). After subtracting the standard deduction ($5,000) and personal exemption ($3,900) amounts from federal AGI, federal taxable income was $30,958. The net federal income tax at the low income level was calculated to be $4,801. Taxable income for Georgia purposes, after subtracting the personal exemption ($3,000) and standard deduction ($3,000) amounts from state AGI was $33,858. The net state income tax was $1,275.

The combined federal-state tax liability for 1988 was $6,076 ($4,801 + 1,275). The state portion of the total income tax liability was 21 percent. Using the installment sale method of reporting timber sale revenue, only $1,208 ($30,958-29,750) was taxed at the 28 percent federal marginal tax rate. If the hypothetical landowners had not elected to use the installment sale method of reporting timber sale revenue, $18,567 ($48,317-29,750) would have been taxed at the 28 percent federal rate in 1988.

1989 Tax Return

For 1989 federal and Georgia AGI was $39,305 at the low income level. Federal taxable income was $30,305. Only $555 was taxed at the 28 percent federal marginal tax rate in 1989. The federal income tax liability before tax credits was $4,618. The net federal income tax liability, after subtracting the federal ITC for qualified reforestation expenditures ($816), was $3,802. Georgia taxable

Table 23. Federal and Georgia Alternative Tax Planning Computations for the Case Example Timber Sale at the Low Income Level, 1988 and 1989.a/

	Using installment sale 1988	1989	NPV b/	No installment sale 1988	1989	NPV b/
	($)	($)	($)	($)	($)	($)
Personal income	$25,000	$25,000		$25,000	25,000	
Revenue from timber sale	25,000	25,000		$50,000		
Less deductions						
Expense of sale	(2,500)	(2,500)		(5,000)		
Depletion	(5,142)	(5,141)		(10,283)		
Amortization	(0)	(554)		(0)	(554)	
Net gain on sale	17,358	16,805		34,717	(554)	
Taxable gain on sale	17,358	16,805		34,717	(554)	
Less deductions						
Property taxes	(1,000)	(1,000)		(1,000)	(1,000)	
Management expenses	(1,500)	(1,500)		(1,500)	(1,500)	
Total deductions	(2,500)	(2,500)		(2,500)	(2,500)	
Adjusted gross income	39,858	39,305		57,217	21,946	
Standard deduction	(5,000)	(5,000)		(5,000)	(5,000)	
Personal exemption	(3,900)	(4,000)		(3,900)	(4,000)	
Federal taxable income	30,958	30,305		48,317	12,946	
Federal tax liability	4,801	4,618		9,661	1,942	
Less ITC	(0)	(816)		(0)	(816)	
Net federal tax	4,801	3,802		9,661	1,126	
Net state tax c/	1,275	1,251		2,025	592	
Total tax liability						
1988:	6,076		$6,076	11,686		$11,686
1989:		5,053	4,594		1,718	1,562
Total:			10,670			13,248

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner," a computer package designed by the Bureau of National Affairs (1988).
b/ Net present value using a 10 percent discount rate.
c/ State taxable income is $33,858, $33,305, $51,217 and $15,946, respectively.

income was $33,305. The net state income tax was calculated to be $1,251. The combined federal-state income tax liability was $5,053 ($3,802 + 1,251). The state portion of the tax liability was 25 percent. The present value of the combined tax was $4,594.

1988 and 1989 Tax Returns

A tax savings of $2,578 ($13,248-10,670) results by electing to use the installment sale for this hypothetical case at the low income level. The state savings is $151. The present value of the combined income tax liability for 1988 and 1989 using the installment sale was $10,670 ($6,076 + 4,594), of which the Georgia portion of the total tax liability was 23 percent. The combined income tax liability for 1988 and 1989 would have been $13,248 ($11,686 for 1988 + $1,562 for 1989) had the hypothetical taxpayers not elected to use the installment sale.

Medium and high income levels

Similar calculations were made for the medium and high income levels. By electing to use the installment sale, the landowner's present value of the total income tax liability for 1988 and 1989 was $31,898 ($17,195 for 1988 + $14,703 for 1989) at the medium income level, and $66,638 ($35,408 for 1988 + $31,320 for 1989) at the high income level. The present value of the total income tax liability for 1988 and 1989 would have been $33,101 ($23,324 for 1988 + $9,777 for 1989) at the medium income level and $67,223 ($41,834 for 1988 + $25,389 for 1989) at the high income level if the installment sale election had not been made.

By using the installment sale election, the hypothetical taxpayers saved $1,203 ($33,101-31,898) at the medium income level and $585 ($67,223-66,638) at the high income level. The state savings was $192 at the medium income level, and $64 at the high income level. The state portion of the total income tax liability, when electing to use the installment sale, was 16 percent at the medium income level and 14 percent at the high income level.

Federal-Minnesota case

Low income level

1988 Tax Return

Federal taxable income is used as the tax base in Minnesota and in four other states in the U.S. Federal taxable income at all three income levels was calculated in the same manner as in the Federal-Georgia case. Taxable income for 1988 at the low income level was $30,958 on the federal return (Table 24). The net federal income tax was $4,801. Minnesota uses federal taxable income with modifications as its tax base. Since there are no modifications to make in the hypothetical case, state taxable income for 1988 was also $30,958. The net state income tax was $1,510. The combined federal-state income tax liability for 1988 was $6,311 ($4,801 + 1,510) with the state portion of the total income tax liability accounting for 16 percent.

1989 Tax Return

For 1989 federal and Minnesota taxable income was $30,305 at the low income level. The net federal income tax liability after subtracting the reforestation ITC was $3,802. The net state income tax liability was $1,472. The combined federal-state income tax liability was $5,274 ($3,802 + 1,472) with the state portion accounting for 28 percent. The present value of the combined tax was $4,794.

1988 and 1989 Tax Returns

A tax savings of $2,689 ($13,794-11,105) results by electing to use the installment sale. The state savings was $261. The present value of the combined income tax liability over the two years (1988 and 1989), using the installment sale method of reporting timber sale revenue, was $11,105

Table 24. Federal and Minnesota Alternative Tax Planning Computations for the Case Example Timber Sale at the Low Income Level, 1988 and 1989.a/

	Using installment sale			No installment sale		
	1988	1989	NPV b/	1988	1989	NPV b/
	($)	($)	($)	($)	($)	($)
Personal income	$25,000	$25,000		$25,000	25,000	
Revenue from timber sale	25,000	25,000		$50,000		
Less deductions						
Expense of sale	(2,500)	(2,500)		(5,000)		
Depletion	(5,142)	(5,141)		(10,283)		
Amortization	(0)	(554)		(0)	(554)	
Net gain on sale	17,358	16,805		34,717	(554)	
Taxable gain on sale	17,358	16,805		34,717	(554)	
Less deductions						
Property taxes	(1,000)	(1,000)		(1,000)	(1,000)	
Management expenses	(1,500)	(1,500)		(1,500)	(1,500)	
Total deductions	(2,500)	(2,500)		(2,500)	(2,500)	
Adjusted gross income	39,858	39,305		57,217	21,946	
Standard deduction	(5,000)	(5,000)		(5,000)	(5,000)	
Personal exemption	(3,900)	(4,000)		(3,900)	(4,000)	
Federal taxable income	30,958	30,305		48,317	12,946	
Federal tax liability	4,801	4,618		9,661	1,942	
Less ITC	(0)	(816)		(0)	(816)	
Net federal tax	4,801	3,802		9,661	1,126	
Net state tax c/	1,510	1,472		2,509	660	
Total tax liability						
1988:	6,311		$6,311	12,170		$12,170
1989:		5,274	4,794		1,786	1,624
Total:			11,105			13,794

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner," a computer package designed by the Bureau of National Affairs (1988).

b/ Net present value using a 10 percent discount rate.

c/ State taxable income is: $30,958, $30,305, $48,317 and $12,946, respectively.

(\$6,311+4,794). The total income tax liability would have been \$13,794 (\$12,170 for 1988 + \$1,624 for 1989) at the low income level, if the taxpayers had reported all of their timber sale revenue in 1988.

Medium income level

Tax savings at the medium income level was \$1,279 (\$34,477-33,198) by electing to use the installment sale. The state burden by using the installment sale was \$272, due to the fast progressivity of the state tax rates. The present value of the total income tax liability for 1988 and 1989 was \$33,198 (\$17,882 for 1988 + \$15,316 for 1989) when the installment sale method was elected by the hypothetical taxpayers. The total income tax liability would have been \$34,477 (\$24,269 for 1988 + \$10,208 for 1989) if all of the timber sale revenue was reported in 1988, and the installment sale not used.

High income level

There is a tax savings of \$612 (\$70,085-69,473) if the hypothetical timberland owners spread the timber sale revenue over two tax years by electing to use the installment sale. The state savings was \$91. At the high income level, the present value of the total income tax liability for 1988 and 1989, using the installment sale, was \$69,473 (\$36,900 for 1988 + \$32,573 for 1989). The present value of the total income tax liability would have been \$70,085 (\$43,617 for 1988 + \$26,468 for 1989) had all of the timber sale revenue been reported in 1988.

Federal-Vermont case

Vermont uses the federal income tax liability with modifications as its tax base. Two modifications are a deduction for military pay of full-time active duty personnel and a deduction of the first $1,000 of net long-term capital gains over net short-term capital losses. However, for the hypothetical case there are no modifications to make for the hypothetical case in determining the state tax base, and the tax base is strictly the federal income tax liability for each income level. Calculations that were made for the federal income tax liability in the Federal-Georgia case also apply for the Federal-Vermont case.

Low income level

1988 and 1989 Tax Returns

At the low income level, the net federal income tax liability for 1988 was $4,801 (Table 25). The Vermont income tax liability was $795. The combined federal-state income tax liability for 1988 was $5,596 with the state portion accounting for 14 percent. The net federal income tax liability for 1989 was $3,802. The Vermont income tax liability was $685. The present value of the combined federal-state income tax liability for 1989 was $4,079 with the state portion accounting for 15 percent.

The hypothetical landowners save $2,829 ($12,504-9,675) at the low income level by electing the installment sale method. The state savings was $401. The present value of the combined federal-state income tax liability for 1988 and 1989 was $9,675 ($5,596 + 4,079), using the installment sale method of reporting timber sale revenue. The state portion of the total income tax liability using the installment sale was 15 percent. If the installment sale had not been elected, the present value

Table 25. Federal and Vermont Alternative Tax Planning Computations for the Case Example Timber Sale at the Low Income Level, 1988 and 1989.a/

	Using installment sale 1988	1989	NPV b/	No installment sale 1988	1989	NPV b/
	($)	($)	($)	($)	($)	($)
Personal income	$25,000	$25,000		$25,000	25,000	
Revenue from timber sale	25,000	25,000		$50,000		
Less deductions						
Expense of sale	(2,500)	(2,500)		(5,000)		
Depletion	(5,142)	(5,141)		(10,283)		
Amortization	(0)	(554)		(0)	(554)	
Net gain on sale	17,358	16,805		34,717	(554)	
Taxable gain on sale	17,358	16,805		34,717	(554)	
Less deductions						
Property taxes	(1,000)	(1,000)		(1,000)	(1,000)	
Management expenses	(1,500)	(1,500)		(1,500)	(1,500)	
Total deductions	(2,500)	(2,500)		(2,500)	(2,500)	
Adjusted gross income	39,858	39,305		57,217	21,946	
Standard deduction	(5,000)	(5,000)		(5,000)	(5,000)	
Personal exemption	(3,900)	(4,000)		(3,900)	(4,000)	
Federal taxable income	30,958	30,305		48,317	12,946	
Federal tax liability	4,801	4,618		9,661	1,942	
Less ITC	(0)	(816)		(0)	(816)	
Net federal tax	4,801	3,802		9,661	1,126	
Net state tax c/	795	685		1,601	240	
Total tax liability						
1988:	5,596		$5,596	11,262		$11,262
1989:		4,487	4,079		1,366	1,242
Total:			9,675			12,504

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner," a computer package designed by the Bureau of National Affairs (1988).

b/ Net present value using a 10 percent discount rate.

c/ Net state tax is a percentage of the federal tax liability: 23 percent in 1988, 25 percent in 1989.

of the combined federal-state income tax liability would have been $12,504 ($11,262 for 1988 + $1,242 for 1989).

Medium income level

At the medium income level and using the installment sale method of reporting timber sale revenue, the net federal income tax was $14,601, and the net state income tax was $2,250 for 1988. The combined federal-state income tax liability for 1988 was $16,851 ($14,601 + 2,250). The state portion of the total income tax liability was 13 percent. The 1989 net federal income tax liability was $13,602, and the net state income tax liability was $2,279. The combined federal-state income tax liability was $15,881 ($13,602 + 2,279) with the state portion accounting for 14 percent. The present value of the combined 1989 tax was $14,437. The present value of the combined federal-state income tax liability for 1988 and 1989, at the medium income level using the installment sale, was $31,288 ($16,851 + 14,437). The state portion of the total income tax liability for 1988 and 1989 using the installment sale was 14 percent.

The hypothetical landowners save only $1,208 ($32,496-31,288) by electing to use the installment sale for reporting their timber sale revenue. The state savings was $195. At the medium income level the present value of the combined federal-state income tax liability for 1988 and 1989 would have been $32,496 ($23,119 for 1988 + $9,377 for 1989) had the taxpayers not elected to use the installment sale.

High income level

Federal income tax liability for 1988 at the high income level, when electing to use the installment sale, was $30,804. The net state income tax liability for 1988 was $4,747, or 13 percent of the total income tax liability for 1988 ($35,551). For 1989, the federal income tax liability was $29,772. The state income tax liability was $4,987, or 14 percent of the total income tax liability for 1989 ($34,759). The present value of the 1989 combined tax was $31,599. The present value of the combined federal-state income tax liability for 1988 and 1989, using the installment sale method of reporting timber sale revenue, was $67,150 ($35,551+31,599). The state portion over the two-year period was 14 percent.

At the high income level, the hypothetical landowners would save $530 ($67,680-67,150) in income taxes if they elect to use the installment sale. The state savings was $9. Had the installment sale not been elected, the present value of the combined federal-state income tax liability would have been $67,680 ($42,161 for 1988 + $25,519 for 1989). By spreading the timber sale revenue over two years, more income is reported in 1989 when Vermont imposes a 25 percent tax on the federal income tax liability, rather than the 23 percent tax imposed in 1988.

Federal-Oregon case

Federal taxable income for the Federal-Oregon case was calculated with the same method used in the Federal-Georgia case. Although Oregon does not use federal AGI as its tax base, the simplicity of the hypothetical model allowed the same method to be used.

Low income level

1988 Tax Return

The net federal income tax liability at the low income level was $4,801. Oregon taxable income

($33,858) was produced by subtracting from state AGI ($39,858) a deduction for federal income tax liability ($3,000) and the state standard deduction ($3,000) (Table 26). The net state income tax liability was $1,864. The combined federal-state income tax liability was $6,665 ($4,801 + 1,864). The state portion of the total income tax liability accounted for 28 percent.

1989 Tax Return

For 1989 federal taxable income at the low income level was also calculated as in the Georgia-federal case. The net federal income tax was $3,802. Oregon taxable income ($33,305) was state AGI less the federal income tax liability deduction ($3,000) and the standard deduction ($3,000). The net state tax liability was $947. The combined federal-state income tax liability for 1989 was $4,749 with the state portion accounting for 20 percent. The present value of the combined tax was $4,317.

1988 and 1989 Tax Returns

Electing the installment sale saved $2,414 ($13,396-10,982). The state savings was $135. For 1988 and 1989 the present value of the combined federal-state income tax liability was $10,982 ($6,665+4,317). The state portion of the two-year total accounted for 25 percent. Had all of the timber sale revenue been reported in 1988 and the installment sale not elected, the present value of the combined federal-state income tax liability would have been $13,396 ($12,443 for 1988 + $953 for 1989).

Medium income level

For 1988 the total income tax liability was $18,446 ($14,601 for federal + $3,845 for state) with the state portion accounting for 21 percent. For 1989 the combined federal-state income tax liability was $16,594 ($13,602 for federal + $2,992 for state) with the state portion accounting for

Table 26. Federal and Oregon Alternative Tax Planning Computations for the Case Example Timber Sale at the Low Income Level, 1988 and 1989.a/

	Using installment sale 1988	1989	NPV b/	No installment sale 1988	1989	NPV b/
	($)	($)	($)	($)	($)	($)
Personal income	$25,000	$25,000		$25,000	25,000	
Revenue from timber sale	25,000	25,000		$50,000		
Less deductions						
Expense of sale	(2,500)	(2,500)		(5,000)		
Depletion	(5,142)	(5,141)		(10,283)		
Amortization	(0)	(554)		(0)	(554)	
Net gain on sale	17,358	16,805		34,717	(554)	
Taxable gain on sale	17,358	16,805		34,717	(554)	
Less deductions						
Property taxes	(1,000)	(1,000)		(1,000)	(1,000)	
Management expenses	(1,500)	(1,500)		(1,500)	(1,500)	
Total deductions	(2,500)	(2,500)		(2,500)	(2,500)	
Adjusted gross income	39,858	39,305		57,217	21,946	
Standard deduction	(5,000)	(5,000)		(5,000)	(5,000)	
Personal exemption	(3,900)	(4,000)		(3,900)	(4,000)	
Federal taxable income	30,958	30,305		48,317	12,946	
Federal tax liability	4,801	4,618		9,661	1,942	
Less ITC	(0)	(816)		(0)	(816)	
Net federal tax	4,801	3,802		9,661	1,126	
Net state tax c/	1,864	947		2,782	(78)	
Total tax liability						
1988:	6,665		$6,665	12,443		$12,443
1989:		4,749	4,317		1,048	953
Total:			10,982			13,396

a/ These calculations were made with the "Income Tax Spreadsheet -- with Fifty State Planner," a computer package designed by the Bureau of National Affairs (1988).
b/ Net present value using a 10 percent discount rate.
c/ State taxable income is: $33,858, $33,305, $51,217 and $17,820, respectively. in 1989.

18 percent. The present value of the combined 1989 tax was $15,085. The present value of the combined federal-state income tax liability for 1988 and 1989 using the installment sale was $33,531 ($18,446 + 15,085). The state portion of the total income tax liability for the two tax years, using the installment sale accounted for 20 percent.

A tax savings of $1,240 ($34,771-33,531) results by the hypothetical landowners electing to use the installment sale. The state savings was $227. Had the hypothetical landowners not used the installment sale, the present value of the combined federal-state income tax liability for 1988 and 1989 would have been $34,771 ($24,924 for 1988 + $9,847 for 1989).

High income level

For 1988 the total income tax liability was $37,664 ($30,804 for federal + $6,860 for state), the state portion being 18 percent. The total income tax liability for 1989 was $35,779 ($29,772 for federal + $6,007 for state) with the state portion accounting for 17 percent. The present value of the combined 1989 tax was $33,526. The combined federal-state income tax liability for 1988 and 1989 using the installment sale was $70,190 ($37,664 + 33,526). The state portion of the total income tax liability over the two-year period accounted for 18 percent.

At the high income level, a tax savings of $616 ($70,806-70,190) results for the hypothetical landowners electing to use the installment sale and spreading timber sale revenue over two years. The state savings was $95. Had the hypothetical landowners reported all of their timber sale revenue in 1988, and not elected to use the installment sale, the present value of the combined federal-state income tax liability for 1988 and 1989 would have been $70,806 ($44,439 for 1988 + $26,367 for 1989).

Discussion

Alternative tax planning is used primarily to save taxes and to provide income to offset deductions if the landowners are passive forest managers. Taxpayers may also have other reasons, such as business or personal income reasons, for smoothing cash flows. The alternative tax planning analysis of this chapter has shown the tax savings for several hypothetical cases. Under the model assumptions and for the selected states used in the analysis, significant tax savings ($2,414 to $2,829) resulted at the low income level for the hypothetical landowners (Table 27). Landowners also saved tax by electing the installment sale method at the medium income level ($1,203 to $1,279), but not nearly as much as at the low income level. At the high income level the installment sale did not provide much of a tax savings for the hypothetical cases. Savings of $530 to $616 resulted among the hypothetical cases.

Taxpayers should evaluate their income tax situation on an individual basis and examine the tradeoffs between electing and not electing to use the installment sale. The installment sale election should be used to spread timber sale revenue over a series of years if it reduces the amount of income subject to the higher federal marginal tax rates. Otherwise, all timber sale revenue is reported in the year of sale, possibly increasing substantially the amount of income subject to the 33 percent federal marginal tax rate. It may be smart, however, to report timber sale revenue in the current year if it is known or strongly suspected that state (or federal) tax rates will increase in subsequent tax years (as in the Federal-Vermont case).

Special forestry provisions in North Carolina may provide taxpayers an extra opportunity to reduce their state income tax liability. Only one-third of timber sale revenue may be reported at the state level in the year of the sale. One-third of the revenue is then reported in North Carolina in each of the two succeeding tax years. The current deduction of the entire amount of qualified

Table 27. Tax Savings by Electing to use the Installment Sale Method of Reporting Timber Revenue as Compared to not Electing to use the Installment Sale, for the Hypothetical Model at Three Income Levels.a/

State	Tax savings b/		
	Income level		
	Low	Medium	High
	($)	($)	($)
Georgia	2,578	1,203	585
Minnesota	2,689	1,279	612
Vermont	2,829	1,208	530
Oregon	2,414	1,240	616

a/ The installment sale method spreads timber sale revenue evenly over two years (1988 and 1989) in this study, where when not electing it, all timber sale revenue is reported in the first year (1988).

b/ Net present value using a 10 percent discount rate. These calculations were made with the Income Tax Spreadsheet -- with Fifty State Planner, a computer package designed by the Bureau of National Affairs (1988).

reforestation expenditures for North Carolina income tax purposes further reduces state tax liability. Alternatively, qualified reforestation expenditures can be amortized over a 60 month period.

Two other states, Oregon and Maryland, offer tax incentives for forest management expenditures. Oregon allows a 30 percent tax credit (total) for reforestation expenditures. Half of the credit (15 percent) is allowed in the year of reforestation, and the other half (plus 30 percent of any additional expenses in connection with the reforestation) is allowed after the reforestation is inspected and certified by a state forester. Maryland allows a deduction equal to double the amount of reforestation or timber stand improvement expenses on 10 to 100 acres of commercial forestland for qualified landowners.

Chapter 7

Conclusion

TRA '86 eliminated many favorable federal tax provisions for timberland owners and severely restricted others. This has made the federal income tax a more complex and burdensome levy for those landowners who sell timber. In addition, many of the federal changes flow through to the states adding to the amount and the complexity of income tax impacts on forestry-related income and expenses. The hypothetical case analysis demonstrates the more important federal-state interactions within a nonindustrial private forest (NIPF) landowner scenario.

The impacts of state income taxes on timber income have received little attention in the past because federal income tax impacts have always been considered to be much more significant. However, state income taxes are the main source of revenue in most states with a comprehensive income tax. The variability of state tax systems, their complexity, and the possible non-existence of a state income tax (9 states) may have contributed to the lack of attention. Regardless of the reasons, state income taxes are important and the state marginal tax rate should be included in an economic analysis of forestry investments. The results of this study show that for a hypothetical landowner who invests in forest management, and has timber sale revenue, the state portion of the total income tax liability ranged from 5 to 25 percent. Interestingly enough, several states which are considerably timber-oriented (California, Maine, Minnesota, New York, North Carolina, South Carolina and Wisconsin) imposed relatively high income taxes on the hypothetical cases.

In contrasting this study with the previous study the results show that the same states that imposed relatively low and relatively high tax levies had also done so previously. There are a few exceptions, however. For example, New Mexico ranks relatively high now where it had previously ranked among the lowest in the West. New Jersey and Pennsylvania moved substantially lower in this study at the low income level with timber sale revenue, than previously. Wisconsin also ranked lower at the low and medium income levels with timber sale revenue. In this study North Dakota ranked substantially higher in every case than it had previously. Finally, in the South the state percentages are generally higher now in the cases where there is no timber sale, and generally lower in the cases where there is a timber sale. State percentage ranking in the other three regions have generally remained the same except for the low income level when there is a timber sale, where they have moved lower.

Capital gains exclusions and a deduction for federal income taxes on the state level were important for providing a low state income tax in every region. Tax rates and schedules were important provisions in the Northeast and Midwest. Standard deductions and personal exemption amounts were important in the South where maximum ordinary income tax rates did not substantially vary among states. The West had the highest maximum ordinary income tax rates and maximum effective long-term capital gains tax rates. There are more states in the West, however, that do not impose an income tax. There seems to be no significant regional differences in state tax liabilities, since each region has states which imposed relatively low and relatively high tax levies on the hypothetical cases.

In Chapter 3, I noted that many of the favorable provisions lost on the federal level (i.e. capital gains differential, income averaging) were not shifted to the state level. The pattern tends to be for states to follow the federal lead concerning these provisions. In fact, 37 states which once had a capital gains exclusion now do not, whereas 8 states still retain this provision. Most states still allow an amortization deduction of qualified reforestation expenditures and have adopted the passive loss rules. Finally, the maximum effective long-term capital gains tax rate has increased on the federal level and in 31 states. The rate decreased in only 3 states.

Shifts in regional forestry activity as a response to TRA '86 are difficult to determine. One may assert that even though state income taxes may be higher now than prior to TRA '86, state tax levies as a percentage of the total income liability have not changed that much. Even a large change in maximum tax rates in one state may not induce a shift in forestry activity to other states. If forestry investments were very mobile, one might argue that a higher tax in one state could result in a shift to states which do not impose an income tax. But timberland assets are somewhat illiquid and a total analysis (including income taxes, sales taxes, property taxes, costs, prices, ect.) should be made before an investment or disinvestment is made. The benefit from public services should also be considered as part of this equation.

Although the loss of the capital gains exclusion and the imposition of the new passive loss rules indicate a reduction in the attractiveness of certain timber investments, other types of forestland investments may have similarly become less attractive. Recreation and wildlife management may not include selling timber, but the annual costs associated with these types of management are affected by the passive loss rules.

There are still ways in which timberland owners can reduce the amount of income tax liability from periodic timber sales. The installment sale method of reporting timber revenue may be utilized to reduce the amount of income subject to higher marginal tax rates by spreading payments over a series of years. Special forestry provisions may also reduce the tax burden on timber management activities in states which allow such provisions. Landowners in low income levels may realize a substantial tax savings by doing so. Landowners should also reevaluate their participation in timber management activities to insure their eligibility for a current deduction of annual management costs, taxes and interest. Good recordkeeping is essential if NIPF landowners are to realize the full benefits of those timber-related federal and state provisions that remain.

General economic trends in the economy due to changes in exchange rates and other macroeconomic variables may have overwhelmed any tax-induced changes at both the federal and state levels. The conclusions of this analysis are partial equilibrium solutions, however, and do not include possible feedback effects of tax-induced changes in other parts of the economy. Other factors may enter into an investment analysis (severance taxes, property taxes), which may have a greater impact on expected returns than state income taxes. A state income tax that is relatively high, then, does not necessarily mean that a particular state is hampering economic development, nor does a relatively low state income tax indicate a particular state is pro-business. States collect tax revenues from many sources with the income tax being the main source in several cases, but not in others.

Future research may involve a greater sensitivity analysis including more personal income and capital gain levels, in order to get a more complete picture of state income tax impacts on timber income in the U.S. Researchers should also integrate state income taxes into investment analyses. Future research could determine whether there are regional variations in state income tax levies, and what tax threshold induces a shift in investment across state lines or to a different region entirely. Researchers may want to quantify the reduction in timber, recreation or wildlife management investment attractiveness with the new laws and compare it to the reduction in investment attractiveness of general business opportunities. The specific impacts of special forestry provisions on the state level is yet another area that may be of interest to both forest economists and legislators interested in the effect of forest taxation on timber supply.

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Appendix A

Federal Income Tax Laws

An abstract of the provisions of the federal income tax, as it applies to individuals, follows. The purpose of this information is only to serve as a basis for which many state tax laws use, build upon or deviate from. The information contained within was derived from *West's Federal Taxation: Individual Income Taxes* (Hoffman et al 1987) and is by no means complete.

Income is essentially gross receipts, and includes both taxable and non-taxable income of the taxpayer.

Exclusions from the tax base:

1. Annuities (to a limited extent).
2. Bequests.
3. Gifts.
4. Inheritances.
5. Compensatory damages.
6. Welfare payments.
7. other.

Gross income includes:

1. Annuities.
2. Business income.
3. Commissions.
4. Compensation for damages.
5. Dividends.
6. Estate and trust income.
7. Farm income.
8. Gains from the sale of property.
9. Interest.
10. Mileage allowance.
11. Partnership income.

12. Professional fees.
13. Salaries.
14. Travel allowance.
15. Wages.
16. other.

Deductions for AGI include:

1. Ordinary and necessary business expenses occurring in trade or business.
2. Alimony paid.
3. Capital loss deduction.
4. other.

Itemized deductions include:

1. Expenses related to the production or collection of income.
2. Expenses related to the measurement of property held for the production of income.
3. Expenses related to the determination, collection, or refund of any tax.
4. Medical expenses in excess of 7.5% of AGI.
5. State and local income taxes.
6. Real estate taxes.
7. Home mortgage interest.
8. Investment interest.
9. Casualty and theft losses.
10. Miscellaneous expenses, to the extent they exceed 2% of AGI.
11. other.

Standard deductions:

1. Single, $3,000.
2. Married filing joint and surviving spouse, $5,000.
3. Head of household, $4,400.
4. Married filing separate, $2,500.

Personal exemptions:

1. 1988: for the taxpayer, spouse and each dependent, $1,950.
2. 1989: for the taxpayer, spouse and each dependent, $2,000.

Tax rates:

Single:

$0	to	$17,849	15%
17,850	to	43,149	28%
43,150	to	89,559	33%
89,560 and over			28%

Married filing joint:

$0	to	$29,749	15%
29,750	to	71,899	28%
71,900	to	149,249	33%
149,250 and over			28%

Married filing separate:

$0	to	14,874	15%
14,875	to	39,949	28%
39,950	to	113,299	33%
113,300 and over			28%

Head of Household:

$0	to	23,899	15%
23,900	to	61,649	28%
61,650	to	123,789	33%
123,790 and over			28%

These rates only include the 5% surtax to eliminate the benefit of having income taxed at the 15% marginal tax rate. Additional calculations are needed to determine the how much larger the 33 % marginal tax bracket will be in order to eliminate the benefit of personal exemptions.

Hoffman et al (1987)

Appendix B

State Income Tax Laws

Abstacts of the 50 states in the U.S., as they apply to individual income taxation, follow. The information contained within was derived from the income tax section of state tax codes (West Publishing Company 1989) and state income tax forms. The abstacts were supplemented by a review of the *State Tax Guide* (CCH 1989f) and by information from the Bureau of National Affairs (1988).

Alabama

Adjusted gross income is income from all sources,

Less:

1. Property acquired by gift, bequest, demise or descent.
2. Interest on federal obligations, securities of the federal Farm Loan Act or bonds issued by the war finance corporation.
3. other.

Deductions:

1. Standard deduction: married filing joint -- 20% of AGI or $4,000, whichever is lesser; single, head of household, married filing separate -- 20% of AGI or $2,000, whichever is lesser.
2. Ordinary and necessary business expenses.
3. Interest accrued on indebtedness.
4. Income taxes, estate taxes, gift taxes, ect.
5. Reasonable expenses for depreciation, obsolescence and depletion.
6. other.

Credits and exemptions:

1. Personal exemptions: single or married person not living together ($1,500); head of family or married filing joint ($3,000); dependents ($300).
2. other.

Tax rates:

First	$1,000	2%
Next	5,000	4%
over	6,000	5%

Code of Alabama, Annotated, Section 40, Chapter 18

Alaska

The net income tax for Alaska individuals and fiduciaries was repealed, effective January 1, 1979.

Code of Alaska, Section 9, Chapter 2

Arizona

Adjusted gross income is federal AGI,

Less:

1. Federal income taxes.
2. Net operating losses.
3. Income tax refunds received from other states, which were included in federal AGI.
4. other.

Plus:

1. The ordinary income portion of a lump sum distribution that was excluded from adjusted gross income.
2. Income from an installment sale required to be recognized as income upon the death of a taxpayer.
3. other.

Deductions:

1. Standard deduction: 21.25% of AGI to a maximum of $2,125 for joint filers, or $1,063 for all other filers.
2. Interest.
3. Income taxes, estate taxes, gift taxes, ect., of other states.

4. Expenses for the production of income or for management of property held for income production.
5. other.

Credits and exemptions:

1. Personal exemptions: individuals ($2,125); husband and wife, or head of household ($4,250); dependents ($1,227); all adjusted annually for inflation.
2. other.

Tax rates:

$0 to $1,183	2%
1,183.01 to 2,366	3% less $12
2,366.01 to 3,549	4% less $35
3,549.01 to 4,732	5% less $71
4,732.01 to 5,915	6% less $118
5,915.01 to 7,098	7% less $177
7,098.01 and over	8% less $248

Code of Arizona, Section 43

Arkansas

Adjusted gross income is income from all sources,

Less:

1. Deductions for alimony and separate maintenance payments.
2. Forefeited bank interest on premature withdrawals.
3. Deductions allowed for cash payments to individual retirement accounts.
4. other.

Deductions:

1. Standard deduction: married filing joint, $1,000 or 10% of AGI, whichever is less.
2. other.

Credits and exemptions:

1. Personal exemptions: single individuals ($20 tax credit); married filing joint ($40 tax credit); dependents earning less than $3,000 ($20 tax credit).
2. "Original purchaser" common stock credit.
3. other.

Tax rates:

First	$2,999	1%
Next	3,000	2.5%
Next	3,000	3.5%
Next	6,000	4.5%
Next	10,000	6%
Over	25,000	7%

Code of Arkansas, Section 26, Chapter 51

California

Adjusted gross income is federal AGI,

with the following exclusions from gross income:

1. Interest on bonds issued by California or its local governments.
2. The provisions of Secs. 103 and 141 to 150 of the IRC, relating to interest on government obligations, are not applicable.
3. other.

Deductions:

1. Alternative energy equipment amortization deduction.
2. Standard deduction: head of household, married filing joint and surviving spouse ($3,932); all others ($1,966).
3. Depletion and depreciation of improvements deduction for mines, oil and gas wells, other natural deposits, and timber.
4. other.

Credits and exemptions:

1. Personal exemption tax credits: single or married filing separate ($52); head of household, surviving spouse, or married filing joint ($104); each dependent ($52); estate ($10); trust ($1).
2. Low income tax credit.
3. Credit for net tax on net capital gains of qualified residential rental property and farm property.
4. Solar energy system credit.
5. other.

Tax rates:

$0 to $7,300	1%
7,300 to 17,300	$73 plus 2% of excess over $7,300
17,300 to 27,300	$273 plus 4% of excess over $17,300
27,300 to 37,900	$673 plus 6% of excess over $27,300
37,900 to 47,900	$1,309 plus 8% of excess over $37,900
47,900 and over	$2,109 plus 9.3% of excess over $47,900

Revenue and Taxation Code of California

Colorado

Taxable income is federal taxable income,

Less:

1. Interest income included in federal taxable income.
2. other.

Plus:

1. Any federal net operating loss deduction carried over from year prior to 1987.
2. other.

Deductions:

1. Net operating loss, as in the federal return.
2. other.

Credits and exemptions:

1. School bond interest exemption.
2. other state taxes.
3. other.

Tax rate:

5% of federal taxable income with modifications.

Code of Colorado, Section 39, Article 22

Connecticut

Connecticut does not levy a tax on personal income. A tax, however, is imposed on capital gains and dividend income.

Capital gains income is "gains from the sale or exchange of capital assets," Less:

1. An allowance for losses and holding periods.
2. A deduction of 60 percent of net long-term capital gains.

Dividends are taxable if federal AGI equals or exceeds $54,000.

Credits and exemptions:

1. Personal exemption: $100 per exemption for capital assets.
2. other.

Tax rates:

1. Capital gains: 7%
2. Dividend income:

Adjusted gross income	Rate
$54,000 to $57,999	1%
58,000 to 61,999	2%

62,000 to 65,999	3%
66,000 to 69,999	4%
70,000 to 73,999	5%
74,000 to 77,999	6%
78,000 to 81,999	7%
82,000 to 85,999	8%
86,000 to 89,999	9%
90,000 to 99,999	11%
100,000 and over	12%

General Statutes of Connecticut, Annotated, Section 12

Delaware

Adjusted gross income is federal AGI,

Less:

1. Interest or dividends exempt from state taxes, but not exempt from federal tax.
2. Pensions from employers, not to exceed $2,000.
3. State lottery prizes.
4. other.

Plus:

1. Interest or dividends on obligations or securities of any political subdivision other than Delaware.
2. Deduction for oil and gas well depletion.
3. other.

Deductions:

1. Standard Deduction: resident individual ($1,300); resident husband and wife ($1,600).
2. Deduction for federal income taxes, not to exceed $300 ($600 for a joint return).
3. other.

Credits and Exemptions:

1. Personal exemption: $1,250 per exemption
2. Child and dependent care credit.
3. Credit for income taxes paid to another state.

Tax rates:

Over	not over	
$0	$2,000	0.0%
$2,000	$5,000	3.2%
5,000	10,000	5%
10,000	20,000	6%
20,000	25,000	6.6%
25,000	30,000	7%
30,000	40,000	7.6%
40,000 and over		7.7%

Delaware Code, Title 30, Chapter 11

Florida

Florida does not impose a personal income tax.

Georgia

Taxable income is federal AGI,

Less:

1. Standard deduction: single ($2,300); married filing joint ($3,000); head of household ($1,500).
2. Income from public pension or retirement funds, if included in federal AGI.
3. other.

Plus:

1. Dividend or interest income excluded from federal AGI and from obligations of states other than Georgia.
2. Interest on federal obligations exempt from federal taxation, but not state taxation.
3. Income taxes imposed by other taxing jurisdictions, other than Georgia, to the extent deductible on the federal return.
4. other.

Credits and exemptions:

1. Personal exemptions: married filing joint ($3,000); any other taxpayer, and each dependent ($1,500).
2. other.

Tax rates:

First	$1,000	1%
Next	2,000	2%
Next	2,000	3%
Next	2,000	4%
Next	3,000	5%
Over	10,000	6%

Code of Georgia, Annotated, Section 48, Chapter 7

Hawaii

Hawaii imposes a tax on the entire taxable income of resident individuals, estates or trusts.

Deductions:

1. Standard deductions: married filing joint ($1,700); head of household ($1,500); single individual ($1,000); married filing separate ($850).
2. "First principle residence" housing account deduction.

Credits and exemptions:

1. Personal exemption deduction: $1,040 per exemption.
2. Credit for taxes paid to another state, attributable to sources outside Hawaii.
3. A tax credit ($1) for each resident individual who is not claimed or is not eligible to be claimed by another taxpayer, and for each dependent.
4. Food tax credit.
5. other.

Tax rates:

Over	but not over	
$0	$2,400	2.25%
2,400	4,400	4.25% plus $54.00
4,400	6,400	6.25% plus $139.00
6,400	10,400	7.25% plus $264.00
10,400	20,400	8.25% plus $554.00
20,400	28,400	9.25% plus $1,379.00
28,400	40,400	9.75% plus $2,119.00
40,400 and over		10.00% plus $3,289.00

Hawaii Statutes, Annotated, Section 235

Idaho

Taxable income is federal taxable income,

Less:

The proportion that the adjusted gross income of the taxpayer from Idaho sources bears to total adjusted gross income from all sources.

Deductions:

1. 60 percent of net capital gains not already deducted.
2. other.

Credits and exemptions:

1. Grocery credit: $15 per exemption.
2. Solar, wind, or geothermal energy system credits.
3. Charitable contributions, with limitations.
4. Credit for taxes paid to another state.
5. other.

Tax rates:

Over	not over	
$0	$2,000	2%
2,000	4,000	$40 plus 4% of excess over $2,000
4,000	6,000	$120 plus 4.5% of excess over $4,000
6,000	8,000	$210 plus 5.5% of excess over $6,000
8,000	10,000	$320 plus 6.5% of excess over $8,000
10,000	15,000	$450 plus 7.5% of excess over $10,000
15,000	40,000	$825 plus 7.8% of excess over $15,000
40,000 and over		$2,775 plus 8.2% of excess over $40,000

Idaho Code, Section 63

Illinois

Base income is federal AGI,

Less:

1. Armed forces compensation.
2. All payments under the Soil and Water Conservation Districts Act for soil and water conservation, flood prevention, and erosion prevention or control.
3. Property taxes paid on taxpayer's principle residence.
4. Illinois income tax refunds.
5. other.

Plus:

1. Interest or dividends included in federal AGI.
2. Any Illinois income that was deducted in computing federal AGI.
3. other.

Deductions:

1. dividends paid by a corporation conducting business operations in an enterprise zone created under the Illinois Enterprise Zone Act.
2. There is no standard deduction.

Credits and exemptions:

1. Personal exemption: $1,000 per exemption.
2. Exemption for income derived from college savings bonds.
3. Income tax paid to another state.
4. other.

Tax rate:

2.5% on net income of individuals, estates and trusts.

Illinois Statutes, Annotated, Chapter 120

Indiana

Base income is federal AGI,

Less:

1. Income exempt from federal tax.
2. State and local property taxes.
3. Any amounts included in federal AGI as recovery items previously deducted as itemized deductions.
4. other.

Deductions:

1. Trade or business expenses.
2. First $2,000 of armed services income.
3. other.

Credits and exemptions:

1. Personal exemptions: individuals ($1,000); dependents ($1,000).
2. College contribution credit.
3. Motor fuel tax credit.

4. Research expense credit.
5. other.

Tax rate:

A 3.4% tax is imposed on income of resident individuals, estates and trusts.

Indiana Statutes, Annotated, Section 6

Iowa

Net income is federal AGI,

Less:

1. Interest and dividends from federal securities.
2. Business asset and capital loss deductions for married taxpayers filing a joint federal return, but separate state returns.
3. other.

Plus:

1. Interest and dividends from foreign securities and from securities of states and other political subdivisions exempt from federal taxation.
2. Combined net losses from passive farming activities in excess of $25,000 that offset income from other sources.
3. Oil, gas or geothermal well depletion in excess of cost depletion amount.
4. other.

Deductions:

1. Standard deductions: married filing joint ($3,030); single or married filing separate ($1,230).
2. 60 percent of net capital gains, up to $17,500.
3. other.

Credits and exemptions:

1. Personal exemption tax credits: estate, trust, single or married filing separate ($20); head of household or married filing joint ($40); dependents ($15).
2. Child care credit.
3. other.

Tax rates:

Over	but not over	
$0	$1,000	0.4%
1,000	2,000	0.8%
2,000	4,000	2.7%
4,000	9,000	5.0%
9,000	15,000	6.8%
15,000	20,000	7.2%
20,000	30,000	7.55%
30,000	45,000	8.8%
45,000 and over		9.98%

Code of Iowa, Annotated, Section 422

Kansas

Adjusted gross income is federal AGI,

Less:

1. Interest or dividends on U.S. obligations, to the extent included in federal AGI.
2. Amounts included in federal AGI specifically exempt from Kansas income tax.
3. other.

Plus:

1. Interest income on obligations of state or political subdivisions to the extent not included in federal AGI.
2. Federal net operating loss deduction.
3. Federal income tax refunds if the refunded taxes resulted in a tax benefit for Kansas income tax purposes.
4. other.

Deductions:

1. Standard deduction: federal standard deduction amounts.
2. other.

Credits and exemptions:

1. Personal exemption: $1,000 per exemption.
2. Solar energy tax credit.
3. other.

Tax rates:

Not over $2,000	2%
$2,001 to 3,000	3.5% plus $40
3,001 to 5,000	4% plus $75
5,001 to 7,000	5% plus $155
7,001 to 10,000	6.5% plus $255
10,001 to 20,000	7.5% plus $450
20,001 to 25,000	8.5% plus $1,200
25,001 and over	9% plus $1,625

The rates above are for single residents, estates and trusts. The tax for married filing joint is determined by doubling the income thresholds and using the same rates.

Kansas Statutes, Annotated, Section 79

Kentucky

Adjusted gross income is federal AGI determined by the provisions of the Internal Revenue Code of 1954.

Deductions:

1. Standard deduction: married filing joint ($650).
2. 60 percent of net long-term capital gains.
3. other.

Credits and exemptions:

1. Personal exemption tax credits: single individual ($20); married filing separate ($20); married filing joint ($40); dependents ($20).
2. Credit for taxes paid to another state.
3. Solar power tax credit.
4. other.

Tax rates:

Up to $3,000	2%
$3,000 to 4,000	3%
4,000 to 5,000	4%
5,000 to 8,000	5%
8,000 and over	6%

Code of Kentucky, Annotated, Section 141

Louisiana

Adjusted gross income is federal AGI,

Less:

1. Excess federal itemized deductions.
2. Federal income tax liability.
3. Income exempt from tax under Louisiana Law.
4. Interest on the obligations of the state of Louisiana or its political subdivisions, to the extent exempt by Law.
5. other.

Credits and exemptions:

1. Combined personal exemption and standard deduction: single ($4,500); married filing joint ($9,000); married filing separate ($4,500); head of household ($9,000).
2. Personal exemption: $1,000 per exemption.
3. Jobs credit.
4. Residential energy credit.
5. other.

Tax rates:

Determined from tax tables, but never to exceed:

up to $10,000	2%
Next 40,000	4%
Over 50,000	6%

Louisiana Revised Statutes, Section 47

Maine

Taxable income is federal AGI,

Less:

1. Interest or dividends included in federal gross income but exempt from state tax under federal law.
2. An amount equal to federal new jobs credit.
3. other.

Plus:

1. Interest or dividends on obligations of any state or political subdivision other than Maine.
2. Interest and dividends exempt from federal tax but not exempt from state tax.
3. The amount of any net operating loss claimed for the tax year.
4. other.

Deductions:

1. Standard deduction: married filing joint -- $100 tax credit.

Credits and exemptions:

1. Personal exemption: $40 tax credit per exemption.
2. Child care credit.
3. Solar energy credit.
4. other.

Tax rates:

Over	not over	
$0	$4,500	1%
4,500	8,700	$45 plus 2% of excess over $4,500
8,700	13,100	$129 plus 3% of excess over $8,700
13,100	17,500	$261 plus 6% of excess over $13,100
17,500	21,800	$525 plus 7% of excess over $17,500
21,800	32,800	$826 plus 8% of excess over $21,800
32,800	50,000	$1,706 plus 9.2% of excess over $32,800
50,000 and over		$3,288 plus 10% of excess over $50,000

Maine Revised Statutes, Chapter 36

Maryland

Taxable income is federal AGI,

Less:

1. Interest or dividends on U.S. obligations to the extent included in federal gross income but excluded from state income taxes.
2. The amount by which employer business deductions for employee wages and salaries are disallowed on the federal return.
3. Expenses incurred in purchasing and installing conservation tillage equipment.
4. 40 percent of a net capital gains.
5. Double the amount incurred in reforestation or timber stand improvement activity on 10 to 100 acres of commercial forestland, except for federal funds, if the taxpayer owns or leases from 10 to 500 acres of commercial forestland or owns or leases 10 to 500 acres of land being restored that is capable of supporting a commercial forest.
6. other.

Plus:

1. Interest or dividends on obligations of state or local governments other than Maryland.
2. 50 percent of the sum of items of tax preference.
3. Federal oil depletion allowance.
4. other.

Deductions:

1. Standard deductions: single -- $1,000 or 15% of Maryland AGI, not to exceed $2,000; married filing joint, head of household, surviving spouse -- $2,000 or 15% of Maryland AGI, not to exceed $4,000.

Credits and exemptions:

1. Personal exemptions: taxpayer ($1,000); dependents ($800).
2. Credit for taxes paid to other states.
3. other.

Tax rates:

First $1,000	2%
Next 1,000	3%
Next 1,000	4%
Over 3,000	5%

Plus a county surtax imposed in all but four Maryland counties, equal up to 50 percent of the Maryland tax liability.

Code of Maryland, Annotated, Article 81

Massachusetts

Gross income is federal gross income,

Less:

1. Interest on federal obligations exempt from state income tax, but included in federal gross income.
2. Social security benefits included in gross income.
3. Dividends received from a taxable corporate trust, to the extent exempt from tax.
4. other.

Plus:

1. Interest on government obligations other than Massachusetts state or political subdivisions.
2. Federal dividend exclusion.
3. other.

Gross income is divided into two classes:

1. Interest, dividend and capital gain net income (Part A).
2. Remainder of Massachusetts gross income (Part B).

Part A deductions:

1. Net short-term capital losses, up to $1,000.
2. 50% deduction of net capital gains.
3. other.

Part B deductions not allowed:

1. Long-term capital gains deduction allowed by the Sec. 1202 of the Code.
2. Moving expenses.
3. Any net operating loss deduction allowed by Sec. 172 of the Code.
4. Two-earner married couple deduction.
5. other.

Part B deductions:

1. Interest and dividends: single ($100); married filing joint ($200); all from savings accounts.
2. Rent: up to 50% of principle residence in Massachusetts, not to exceed $2,500.
3. other.

Credits and exemptions:

1. Personal exemptions: single, married filing separate ($2,200); married filing joint ($4,400); dependents ($1,000).

2. Medical, dental and other expenses allowed under Sec. 213 of the Code.
3. Credit for other state income taxes.
4. Solar energy credit.

Tax rates:

Part A 10%

Part B 5%

Massachusetts General Laws, Chapter 62

Michigan

Taxable income is federal AGI,

Less:

1. Income from the sale or exchange of federal obligations to the extent included in federal AGI.
2. Unemployment compensation.
3. Net operating loss deduction under Sec. 172 of the federal Code, subject to modifications.
4. other.

Plus:

1. Interest and dividends from state obligations other than those of Michigan.
2. Income taxes.
3. Losses from the sale or exchange of federal obligations.
4. Net operating loss deduction under Sec. 172 of the Code.

Deductions:

1. Aside from the above modifications, there are no other deductions.

Credits and exemptions:

1. Personal exemption: $1,800 per exemption.
2. Other state taxes.
3. Solar energy credit.
4. Homestead property tax credit.
5. State lottery and Bingo proceeds.

Tax rate:

4.6% on all taxable income of individuals, estates, and trusts.

Michigan Compiled Laws, Section 206

Minnesota

Net income is federal taxable income,

Less:

1. Interest income on U.S. obligations to the extent taxable on the federal level, but not on the state level.
2. The amount of overpayment of Minnesota or other state tax from the previous year.
3. other.

Plus:

1. Interest on political subdivisions other than Minnesota exempt from federal taxation, but not from state taxation.
2. State taxes paid within the year to any other state, province or territory of Canada, to the extent allowed as a deduction on the federal return.
3. other.

Deductions:

1. Net operating losses carried back or forward, allowed on the federal return.
2. other.

Credits and exemptions:

1. Other state income taxes.
2. Dependent care credit.
3. Property tax credit.
4. other.

Tax rates:

Not over $19,000	6%	
over 19,000		$1,140 plus 8% excess over $19,000

Plus 105 of any tax paid on the federal level under Sec. 1(g) of the federal Code (phase-out of the 15% rate and personal exemptions).

Minnesota Statutes, Chapter 268

Mississippi

AGI is income from all sources less certain modifications

Deductions:

1. Amount of federal individual non-business deductions.
2. Standard deduction: married filing joint and head of household ($3,400); married filing separate ($1,700); single individuals ($2,300).
3. Periodic alimony payments included in gross income.
4. Casualty loss exceeding $100 and not compensated by insurance, in federal disaster areas.
5. other.

Credits and exemptions:

1. Personal exemptions: single ($6,000); husband and wife ($9,500); head of household ($9,500); dependents ($1,500); estates ($600); trusts required to distribute all their income currently ($300); other trusts ($100).
2. taxes paid to other states.
3. other.

Tax rates:

First	$5,000	3%
Next	5,000	4%
Over	10,000	5%

Code of Mississippi, Section 27, Chapter 7

Missouri

Adjusted gross income is federal AGI,

Less:

1. Deduction for federal income taxes.
2. Interest or dividends on federal obligations to the extent deducted determining federal AGI or included in Missouri itemized deductions, but only if expenses are at least $500.
3. Any state tax refund that was included in federal AGI.
4. other.

Plus:

1. Any federal tax refund received for a prior year, resulting in a Missouri tax benefit.
2. Interest on government obligation excluded from federal AGI, less interest that would have been deductible, if at least $500.

Deductions:

1. Standard deduction: equal to federal amounts.
2. other.

Credits and exemptions:

1. Personal exemption: residents ($1,200); spouse ($1,200); dependents ($400); head of household ($800).
2. Homestead property tax credit, up to $500.
3. other.

Tax rates:

Over	not over	
$0	$1,000	1.5%
1,000	2,000	$15 plus 2% of excess over $1,000
2,000	3,000	$35 plus 2.5% of excess over $2,000
3,000	4,000	$60 plus 3% of excess over $3,000
4,000	5,000	$90 plus 3.5% of excess over $4,000
5,000	6,000	$125 plus 4% of excess over $5,000
6,000	7,000	$165 plus 4.5% of excess over $6,000
7,000	8,000	$210 plus 5% of excess over $7,000
8,000	9,000	$260 plus 5.5% of excess over $8,000
9,000 and over		$315 plus 6% of excess over $9,000

Missouri Revised Statutes, Section 143

Montana

Adjusted gross income is federal AGI,

Less:

1. Unemployment compensation.
2. Interest on U.S. obligations or other political subdivisions in Montana.
3. Annuity, pension, or endowment benefits in excess of $3,600.
4. 40% of capital gains on the sale or exchange of capital assets before December 31, 1986.

Plus:

1. Interest on obligations of another state, territory, county, or other political subdivision not in Montana.
2. other.

Deductions:

1. Federal itemized deductions, less state income taxes.
2. Federal income taxes.
3. Standard deduction: 20% of Montana AGI, not to exceed $4,280 for married filing joint and heads of households; or $2,190 for individuals.
4. other.

Credits and exemptions:

1. Personal exemption: $1,140 per exemption.
2. other.

Tax rates:

Over	but not over	
$0	$1,400	2%
1,400	2,700	3% less $14
2,700	5,500	4% less $41
5,500	8,200	5% less $96
8,200	11,000	6% less $178
11,000	13,700	7% less $288
13,700	19,200	8% less $425
19,200	27,500	9% less $617
27,500	48,100	10% less $892
48,100 and over		11% less $1,373

Plus a surtax equal to 10% of the state tax liability, through 1989.

Montana Revised Code, Section 15

Nebraska

Adjusted gross income is federal AGI,

Less:

1. Interest or dividends on any U.S. obligation included in federal AGI, but exempt from state taxes.
2. Net operating losses derived from Nebraska sources.
3. State tax refund, if included in federal AGI.
4. other.

Plus:

1. Interest or dividends on obligations of other states or their political subdivisions, to the extent excluded from federal AGI.
2. other.

Deductions:

1. Standard deduction: married filing joint ($5,000).
2. other.

Credits and exemptions:

1. Personal exemption: $1,130 per exemption.
2. Fuel tax credit for agricultural, quarrying or nonhighway purposes.
3. Tax credit for other state income taxes.
4. Renewable energy source system tax credit.

Tax rates:

Over	but not over	
$0	3,000	2%
3,000	28,000	3.2%
28,000	45,000	5%
45,000 and over		5.9%

Revised Statutes of Nebraska, Section 77

Nevada

Nevada does not impose a personal income tax.

New Hampshire

A tax is imposed in interest and dividends only.

New Hampshire Revised Statutes Annotated, Chapter 7

New Jersey

Gross income is:

1. Salaries, wages, tips, ect.
2. Net business profits.
3. Net gain from disposal of property.
4. Net gain from rents, royalties, patents and copyrights.
5. Interest, except on obligations of New Jersey or its political subdivisions.
6. Net income from estates and trusts.
7. Gambling winnings; prizes and awards.
8. other.

Deductions:

1. Medical expenses, to the extent they exceed 2% of gross income.
2. Homestead property tax deduction.
3. other.

Credits and exemptions:

1. Personal exemption: $1,000 per exemption.
2. Exemption for college student, when taxpayer pays for one-half or more of tuition or maintenance costs, $1,000.
3. Tax credit for other state income taxes.
4. other.

Tax rates:

$0	to	$20,000	2%
20,000	to	50,000	2.5%
50,000 and over			3.5%

New Jersey Revised Statutes, Section 54A

New Mexico

Base income is federal AGI,

Less:

1. Payments made for hospital dental, medical or drug expenses.
2. other.

Deductions:

1. Standard deduction: single ($3,000); married filing joint ($4,000); head of household ($3,500); married filing separate ($2,000).
2. other.

Credits and exemptions:

1. Personal exemption: $2,000 per exemption.
2. Tax credit for other state income taxes, with limitations.
3. Solar energy credit.
4. Cultural property credit.
5. Geothermal energy credit.

Tax rates:

Over	not over	
$0	$8,000	2.4%
8,000	16,000	$192 plus 3.8% of excess over $8,000
16,000	24,000	$496 plus 4.8% of excess over $16,000
24,000	36,000	$880 plus 5.9% of excess over $24,000
36,000	48,000	$1,588 plus 6.9% of excess over $36,000
48,000	64,000	$2,416 plus 7.7% of excess over $48,000
64,000 and over		$3,648 plus 8.5% of excess over $64,000

New Mexico Statutes, Section 7, Article 2

New York

Adjusted gross income is federal AGI,

Less:

1. Interest on U.S. obligations, to the extent includable in federal AGI.
2. Interest or dividends on obligations exempt from state income tax, but included in federal AGI.
3. Dependent's college tuition, to the lesser of 1/2 of tuition, or $1,000.
4. other.

Plus:

1. Interest or dividends on obligations exempt from federal income tax, but not from state income tax.
2. Income taxes deducted in determining federal AGI.
3. Mine, oil, or gas depletion allowance.
4. other.

Deductions:

1. Standard deduction: resident individual ($5,000); married filing joint or surviving spouse ($8,500); head of household ($6,000); married filing separate ($4,250).
2. Joint filing deduction.
3. other.

Credits and exemptions:

1. Personal exemption: $900 per exemption.
2. Household and dependent care exemption.
3. Credit for other state, local or Canadian province income taxes.
4. other.

Tax rates:

Over	not over	
$0	$6,000	3%
6,000	10,200	$180 plus 4% of excess over $6,000
10,200	14,600	$348 plus 5% of excess over $10,200
14,600	18,800	$568 plus 6% of excess over $14,600
18,800	24,800	$820 plus 7% of excess over $18,800
24,800	34,000	$1,240 plus 8% of excess over $24,800
34,000 and over		$1,976 plus 8.375% of excess over $34,000

New York Consolidated Laws, Chapter 60, Article 22

North Carolina

Gross income is income from all sources,

Less:

1. Armed forces active duty pay in a combat zone (with limitations).
2. Death payments to estates or heirs, up to $5,000.
3. Federal employee retirement pay, up to $3,000.
4. Value of property acquired by gift, bequest, devise, or descent, except certain income in respect of decedents.
5. Interest on obligations of U.S. and North Carolina or its political subdivisions.
6. other.

Deductions:

1. Ordinary and necessary business expenses, with limitations.
2. Uninsured medical expenses incurred in producing income or managing property held for the production of income.
3. 10% of AGI, but not over $550.
4. Expenses paid by farmers for clearing land and soil and water conservation, with limitations.
5. Interest paid on indebtedness.
6. Certain taxes.
7. Certain casualty losses.

8. Bad debts.
9. Depreciation and obsolescence of property.
10. Reasonable reforestation expenditures for taxpayers engaging in commercial tree growing. These expenses may be alternatively amortized over 60 months.
11. other.

Credits and exemptions:

1. Personal exemptions: single ($1,100); married filing joint ($3,300); head of household ($2,200); dependents ($800); additional $660 for dependent attending college or university.
2. Credit for other state tax.
3. Alternative energy credits.

Tax rates:

up to $2,000	3%
$2,000 to 4,000	4%
4,000 to 6,000	5%
6,000 to 10,000	6%
10,000 and over	7%

North Carolina General Statutes, Section 105

North Dakota

Taxable income is federal taxable income,

Less:

1. Interest received from federal obligations.
2. Income exempt from state taxation.
3. Federal income taxes.
4. Standard deduction: joint returns ($300); head of household ($300).
5. Medical expenses disallowed on federal return due to limitations.
6. other.

Plus:

1. Income taxes deducted on the federal return, with limitations.
2. Income from foreign, state and local obligations except North Dakota and its political subdivisions.

Credits and exemptions:

1. Geothermal or solar wind energy device credit.
2. Venture capital corporation investment tax credit.

Tax rates:

Over	not over	
$0	$3,000	2.67%
3,000	5,000	4%
5,000	8,000	5.33%
8,000	15,000	6.67%
15,000	25,000	8%
25,000	35,000	9.33%
35,000	50,000	10.67%
50,000 and over		12%

North Dakota Century Code, Section 57, Chapter 38

Ohio

Adjusted gross income is federal AGI,

Less:

1. Income from federal obligations to the extent includable in federal AGI, but exempt from state taxation.
2. Disability and survivor benefits.
3. other.

Plus:

1. Income from obligations of states, or political subdivisions thereof, other than Ohio.
2. Income from federal obligations which is exempt from federal taxation, but not exempt from state taxation.
3. other.

Credits and exemptions:

1. Personal exemption: $650 per exemption.
2. Joint filing credit.
3. Additional exemption: $350 per exemption, or $20 tax credit per exemption.
4. Solar energy system tax credit.

Tax rates:

Over	not over	
$0	$5,000	.743%
5,000	10,000	$37.15 plus 1.486% over $5,000
10,000	15,000	$111.45 plus 2.972% over $8,000
15,000	20,000	$260.05 plus 3.715% over $15,000
20,000	40,000	$445.80 plus 4.457% over $20,000
40,000	80,000	$1,337.20 plus 5.201% over $40,000
80,000	100,000	$3,417.60 plus 5.943% over $80,000
100,000 and over		$4,606.20 plus 6.9% over $100,000

Ohio Revised Code, Section 5747

Oklahoma

Taxable income is federal AGI,

Less:

1. Any income that is prohibited from being taxed in Oklahoma.
2. Dividend exclusion.
3. other.

Plus:

1. Interest on obligations of any state or political subdivision not otherwise exempt.
2. other.

Deductions:

1. Standard deduction: the larger of 15% of Oklahoma AGI or $1,000, not to exceed $2,000 for all except married filing separate, which is the larger of 15% of Oklahoma AGI or $500, not to exceed $1,000.
2. Federal income taxes, but only to the extent they relate to Oklahoma income.
3. Armed services pay, up to $1,500.
4. Political contributions, up to $100.
5. other.

Credits and exemptions:

1. Personal exemptions: single ($1,000); married filing joint ($1,000) if AGI does not exceed $25,000; married filing separate ($1,000) if AGI does not exceed $12,500; head of household ($1,000) if AGI does not exceed $19,000.
2. Solar energy system credit.
3. Severance tax credit.

Tax rates:

Over	not over	
$0	$2,000	.5%
2,000	5,000	1%
5,000	7,500	2%
7,500	10,000	3%
10,000	12,500	4%
12,500	15,000	5%
15,000 and over		6%

Oklahoma Statutes, Title 68

Oregon

Taxable income is all income,

Less:

1. Interest and dividends on federal obligations to the extent included in federal gross income, but exempt from state taxes.
2. Inheritance tax administrative expenses and fees.
3. Job-related travel expenses of a logger.
4. other.

Plus:

1. Interest or dividends exempt from federal tax on obligations or securities of any foreign state or political subdivision, or on U.S. obligations, exempt from federal, but not state taxation.
2. Depletion allowance allowed on federal return in excess of taxpayer's adjusted basis in the depleted property.
3. other.

Deductions:

1. Standard deduction: married filing joint or surviving spouse ($3,000); unmarried ($1,800); married filing separate ($1,500); head of household ($2,640); dependents (the larger of earned income or $500).

2. Federal income taxes, up to $3,000.
3. other.

Credits and exemptions:

1. Personal exemption tax credits: $89 per exemption.
2. Indian tribe income credit for residents of Oregon reservations.
3. Reforestation credit for under-productive forest lands.
4. Fish habitat improvement project credit.
5. other.

Tax rates:

Over	not over	
$0	$4,000	5%
4,000	10,000	$200 plus 7% of excess over $4,000
10,000 and over		$620 plus 9% of excess over $10,000

Oregon Revised Statutes, Section 316

Pennsylvania

Taxable income includes the following:

1. Compensation (e.g. salaries, wages, ect.).
2. Net profits from businesses, professions, ect.
3. Net gains from the disposition of property.
4. Net gains from royalties, rents, patents, copyrights.
5. Dividends.
6. Interest on obligations not exempt from state or local tax under Pennsylvania or federal Law.
7. Gambling or lottery winnings, other than Pennsylvania state lottery winnings.
8. Net income from estates and trusts.
9. other.

Credits and exemptions:

1. Amounts withheld from compensation.
2. State and local income taxes, from Pennsylvania or its political subdivisions.
3. other.

Tax rate:

2.1% on all taxable income.

Purdon's Statutes, Title 72

Rhode Island

Tax base is federal tax liability with the following

modifications to gross income:

Less:

1. Interst or dividends on federal obligations to the extent includable in federal gross income, but exempt from state taxation.

Plus:

1. Interest on obligations of any state or political subdivision other than Rhode Island.
2. Interst or dividends on federal obligations exempt from federal taxation, but not state taxation.

Credits and exemptions:

1. Renewable energy resource system credit.
2. Political contribution credit: $4 for married filing joint, $2 otherwise.
3. other.

Tax rate:

22.96% of federal income tax liability.

General Laws of Rhode Island, Section 44

South Carolina

Taxable income is federal taxable income,

Less:

1. Federal civil service annuity for retired persons or surviving spouse, up to $3,000.
2. Retirement benefits.
3. other.

Credits and exemptions:

1. Credit for married filing joint: 0.7% of the lesser of $30,000 or qualified earned income of the spouse with the lower qualified earned income for the taxable year.
2. Credit for taxes paid to another state on income from personal services.
3. other.

Tax rates:

Over	not over	
$0	$4,000	3%
4,000	6,000	$120 plus 4% of excess over $4,000
6,000	8,000	$200 plus 5% of excess over $6,000

8,000	10,000	$300 plus 6% of excess over $8,000
10,000 and over		$420 plus 7% of excess over $10,000

South Carolina Code, Section 12

South Dakota

South Dakota does not impose a personal income tax.

Tennessee

Tennessee imposes a tax on interest and dividend income only.

Tennessee Code, Section 67-2

Texas

Texas does not impose a personal income tax.

Utah

Taxable income is federal AGI,

Less:

1. Interest or dividends on U.S. obligations to the extent includable in federal gross income, but exempt from state taxation.
2. Federal standard deduction amounts.
3. Adoption expenses, up to $1,000.
4. other.

Plus:

1. Any income tax imposed by Utah, or any other state to the extent deducted from federal AGI.
2. Any lump-sum distribution allowable as a deduction under Sec. 402(C)(3) of the IRC.
3. other.

Credits and exemptions:

1. Personal exemption: $1,463 per exemption.
2. Residential energy system credit.
3. Credit for contribution to research and development partnerships.
4. other.

Tax rates:

Over	not over	
$0	$1,500	2.75%
1,500	3,000	$41 plus 3.75% of the excess over $1,500
3,000	4,500	$98 plus 4.75% of the excess over $3,000
4,500	6,000	$169 plus 5.75% of the excess over $4,500
6,000	7,500	$255 plus 6.75% of the excess over $6,000
7,500 and over		$356 plus 7.75% of the excess over $7,500

Utah Code, Annotated, Section 59, Chapter 10

Vermont

Tax base is federal income tax liability with the following modifications to federal AGI:

Less:

1. Income exempt from state taxation under federal law.
2. Military pay.
3. For individuals over 65 years of age, the first $1,000 of net long-term capital gains.
4. other.

Plus:

1. Interest income from state and local obligations other than obligations of Vermont and its political subdivisions.
2. other.

Credits and exemptions:

1. Low income personal exemption tax credit.
2. Credit for taxes paid to another state.
3. Renewable energy system credit.

4. Full-time student credit for resident individuals.

5. other.

Tax rate:

23% of the federal income tax liability (25% in 1989).

Vermont Statutes, Annotated, Title 32.

Virginia

Adjusted gross income is federal AGI,

Less:

1. Interest or dividends on federal obligations to the extent exempt from state taxation.
2. Interest on obligations of Virginia or its political subdivisions.
3. Any amount included in federal AGI representing less than $600 in prize money from the Virginia state lottery.
4. other.

Plus:

1. Interest on obligations of other states or their political subdivisions.
2. Interest or dividends on U.S. obligations exempt from federal tax.
3. other.

Deductions:

1. Mileage associated with charitable contributions, equal to $.18 per mile.
2. Standard deduction: married filing joint ($2,700).
3. other.

Credits and exemptions:

1. Personal exemption deduction: $800 per exemption.
2. Credit for income taxes paid to another state.
3. Renewable energy source credit.
4. other.

Tax rates:

Over	not over	
$0	$3,000	2%
3,000	5,000	3%
5,000	15,000	5%
15,000 and over		5.75%

Virginia Code, Section 58.1

Washington

Washington does not impose a personal income tax.

West Virginia

Adjusted gross income is federal AGI,

Less:

1. Interest on U.S. obligations to the extent includable in federal gross income.
2. Any lottery prize included in federal AGI awarded by the West Virginia lottery.
3. Any other income exempt from state taxation.
4. other.

Plus:

1. Interest income from any state or political subdivision other than West Virginia.
2. Interest or dividend income on U.S. obligations exempt from federal taxation, but not state taxation.
3. other.

Credits and exemptions:

1. Personal exemption: $2,000 per exemption.
2. Credit for income taxes paid to another state.
3. Gross bingo proceeds are exempt.
4. Severance tax credit.
5. other.

Tax rates:

Over	not over	
$0	$10,000	3%
10,000	25,000	$300 plus 4% of excess over $10,000
25,000	40,000	$900 plus 4.5% of excess over $25,000
40,000	60,000	$1,575 plus 6% of excess over $40,000
60,000 and over		$2,775 plus 6.5% of excess over $60,000

West Virginia Code, Section 11, Chapter 21

Wisconsin

Adjusted gross income is federal AGI,

Less:

1. Interest or dividend income exempted by federal law from taxation on the state level.
2. 60% of capital gains on assets held longer than one year.
3. other.

Plus:

1. Interest not included in federal AGI.
2. The amount of lump-sum distribution taxable under Sec. 402(e)(1) of the IRC.
3. Any amount excluded from AGI under Sec. 641(c)(1) of the IRC.
4. other.

Deductions:

1. Standard deduction: rules for standard deductions vary depending on status and income level. For married filing a joint return, the standard deduction is 19.778 percent of (Wisconsin AGI-10,000).
2. Net capital losses, up to $500.
3. other.

Credits and exemptions:

1. Personal exemption: $50 tax credit per exemption.
2. Property tax credit.
3. Joint filing credit.

Tax rates:

$0 to $10,000	4.9%
10,001 to 20,000	6.55%
20,000 and over	6.93%

Wisconsin Code, Section 71

Wyoming

Wyoming does not impose a personal income tax.

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