



A FairTaxSM White Paper

The impact of the FairTax on timber-related industries

The industry

Timber and timber-related industries comprise an integral part of the U.S. economy. Logging and sawmills alone, which employ more than one-quarter million Americans, ship about \$45 billion in product each year.¹ On an annual basis, each American consumes about 235 board feet of lumber for a total U.S. consumption of 63 million board feet.² Moreover, the U.S. exports approximately 2.9 million board feet of lumber, 2.4 million board feet of logs, 10 million tons of paper and board, 6.4 million tons of wood pulp, and 1.8 million square feet of plywood annually.³

The timber industry, like farming, ranching, fishing, mining, and other extractive industries supports numerous related industries downstream. These include millworking, packaging, building supplies, paperboard containers, paper, and pulp mills.

The disadvantages of the current income tax landscape

On its face, the industry appears to enjoy significant preferential tax treatment. U.S. timber growers are currently eligible for a small ten percent “reforestation credit,”⁴ and limited amortization of reforestation expenditures.⁵ Non-corporate growers may treat sales of timber as qualifying either for capital gains treatment (a maximum tax rate of 28 percent) or for ordinary loss (allowing for an unlimited offset against ordinary or capital income), depending upon whether the sale generated a gain or loss.⁶

These small benefits, however, are outweighed to a large degree by the frequent application of the alternative minimum tax (AMT), which treats much of this income as “ordinary.” A large proportion of expenses must be capitalized. Finally, as many of these companies are small and family owned, the burden of income taxes is multiplied by the estate and gift tax that can amount to a confiscation of 50 percent of the timber enterprise.⁷

¹ U.S. Bureau of the Census, Census of Manufactures, 1992 Final Industry Series, and Annual Survey of Manufactures. Reported in Statistical Abstract of the United States, 1999, Table 1151, p. 699. Figures are for 1996.

² Statistical Abstract of the United States, 1999, Table 1154, p. 700.

³ Statistical Abstract of the United States, 1999, Table 1153, p. 700.

⁴ IRC §46, §48 and §194. This credit applies to the direct costs incurred through planting or seeding, preparing the site for planting or seeding, and for labor and tools.

⁵ IRC §194. This is allowed only up to \$10,000 per year.

⁶ IRC §631(a) and §1231(b).

⁷ Foreign investors in timber, if they are not operating a trade or business effectively connected to the timber sales, are subject to a tax of 30 percent on the gross receipts received for the timber from U.S. sources. IRC §873.



To exacerbate these tax problems, the industry is highly susceptible to increases in the cost of production since these costs cannot be readily passed along in the global timber market. Already, U.S. timber imports exceed exports by a ratio of five-to-one as American timber companies and workers face considerable competition from Canada. Of course, the success of American lumber and wood product producers directly affects the success of the many value-adding, dependent industries.

Under the FairTax timber owners enjoy a zero rate of taxation.

Like farming, ranching, fishing, mining, and other extractive industries, the timber industry benefits greatly from the repeal of the income tax and its replacement with the FairTax. Unless timber is sold at the retail level for final consumption (to a consumer as firewood, for example), it is not taxed upon its sale to the processing industry. This means that all sales of timber to sawmills or planing mills, pulp mills, paper or paperboard mills for use in furniture, homes, packaging or paper are free of taxation. The timber industry also benefits from the elimination of the payroll tax in its entirety.

Equally important, the timber industry benefits from complete repeal of the estate and gift taxes. Of course, since many timber companies operate as family-owned businesses, relief from the estate and gift taxes eliminates the need for timber growers to plan around heavy estate taxes (usually involving major legal expense and expensive life insurance products) and eliminates the punitive effects on transfers of family-owned enterprises.

Favorable interest rates and more viable export prices

The industry is advantaged by more favorable interest rates. Interest rates are expected to be reduced by 25 to 30 percent under the FairTax.⁸ In addition, interest earnings are not taxed.⁹ The industry benefits from a substantial reduction in costs stemming from complexity related to current tax law. For example, companies that engage in international commerce no longer need to be concerned with foreign sourcing rules, with whether a foreign charge is an income tax or with the calculation of foreign tax credits. But perhaps most importantly, under the FairTax, timber companies, like all companies, are no longer subjected to the burdens associated with unnecessary record keeping and the preparation of income tax returns, employee benefits taxation, withholding taxes from employees or with employer payroll taxes, almost all of which involve substantial complexity and fixed costs. These costs disproportionately affect the smaller timber companies.

The current tax system unnecessarily burdens American exports. U.S. exports contain embedded income and payroll taxes, as well as compliance costs that must be included in the price of goods sold, reducing their competitiveness in the world marketplace. On the other hand, under current tax law, imported goods usually bear no income or payroll tax on the value added abroad.

⁸ For a more detailed discussion of the impact of a national sales tax on interest rates, see Golob, John E., "How Would Tax Reform Affect Financial Markets?" *Economic Review*, Federal Reserve Bank of Kansas City, Fourth Quarter, 1995. He estimates a 25 to 35 percent drop (p. 27).

⁹ Interest is neither taxable nor deductible under the FairTax.



Under the FairTax, U.S. timber producers, like all other domestic producers, are significantly more competitive in the world marketplace. American producers are able to export products whose price structures are no longer inflated by the costs of the income and payroll taxes or compliance cost burdens. The timber industry, for example, competes more effectively with Canadian timber producers with the alleviation of approximately \$700 million in corporate taxes.

The advantages of the FairTax extend to purchasers of timber products.

The benefits of the FairTax system extend to the purchasers of wood and wood products. All known economic studies predict growth from replacing the income tax with a consumption tax. Economists typically estimate economic growth to be 10 to 12 percent greater within a decade under the FairTax, compared to growth under current tax law.¹⁰ Because the economy grows, industrial production and homebuilding grow and demand for wood products increases considerably.

What is the FairTax Plan?

The FairTax Plan is a comprehensive proposal that replaces all federal income and payroll based taxes with an integrated approach including a progressive national retail sales tax, a prebate to ensure no American pays federal taxes on spending up to the poverty level, dollar-for-dollar federal revenue replacement, and, through companion legislation, the repeal of the 16th Amendment. This nonpartisan legislation (HR 25/S 1025) abolishes all federal personal and corporate income taxes, gift, estate, capital gains, alternative minimum, Social Security, Medicare, and self-employment taxes and replaces them with one simple, visible, federal retail sales tax – administered primarily by existing state sales tax authorities. The IRS is disbanded and defunded. The FairTax taxes us only on what we choose to spend on new goods or services, not on what we earn. The FairTax is a fair, efficient, transparent, and intelligent solution to the frustration and inequity of our current tax system.

What is Americans For Fair Taxation (FairTax.org)?

FairTax.org is a nonprofit, nonpartisan, grassroots organization solely dedicated to replacing the current tax system. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the Web page: www.FairTax.org or call 1-800-FAIRTAX.

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¹⁰ Jorgenson, Dale W., "The Economic Impact of the National Retail Sales Tax," Final Report to Americans for Fair Taxation, May 18, 1997; Kotlikoff, Laurence J., "Replacing the U.S. Federal Tax System with a Retail Sales Tax: Macroeconomic and Distributional Impacts," December, 1996; Kotlikoff, Laurence J., "The Economic Impact of Replacing Federal Income Taxes with a Sales Tax," Cato Institute Policy Analysis No 193, April, 15, 1993.