House Bill 123 Creates an Income Tax Disguised as a Property Tax

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Executive Summary

New Hampshire legislators have devised various schemes over the years to protect the logging industry from market forces. The latest scheme comes in House Bill 123, as amended. Promoted as "closing a loophole" in the state's Timber Tax, HB 123 in fact creates a new tax on revenues generated from sales of carbon credits. The new tax blends features of property taxation and income taxation. Though it gives the appearance of using assessed value as its base, it is a tax on net revenue earned in the prior year, which makes it an income tax. And because it has no offsets, it would be an unconstitutional double tax.

Background

The privately owned Connecticut Lakes Headwaters Forest in Coos County has produced varying amounts of lumber for more than 150 years. The logging business supported by harvests on that land has always ebbed and flowed along with changing demand for the region's wood. The last three decades, however, have seen declining production. Industry data show that the forest's timber harvest peaked in 1994 at about 150,000 cords. The next year's harvest fell to 80,000 cords, and annual production has been below 60,000 (frequently below 40,000) ever since.

In 2003, the property owner agreed to put the 145,872 acres under a conservation easement that encourages continued forest management, including logging. The property has been managed for carbon sequestration since 2013. Carbon sequestration involves maximizing tree growth and selling credits based on the amount of carbon trees absorb annually. Trees are still harvested to maintain forest health and maximize returns on healthy trees.

Though logging continues in the forest, recent yields have been lower on average in the last decade than in the decade prior. The number of cords harvested in 2022 fell below 20,000 for the first time since the early 1970s. Though the yield in 2023 rebounded to 28,000 cords, loggers fear that the land's use as a carbon sink threatens the long-term survival of their industry.

Annual harvests of fewer than 40,000 cords are not new for this property and have occurred for long intervals in the past, specifically from 1930 through the end of World War II, from the late 1950s to the early 1970s, and regularly since the mid-1990s. The harvest was below 40,000 cords for 14 of the 21 years from 2003-2023, or 2/3 of the time. Fearing a reduction in logging industry jobs and local tax revenues that come from the state's Timber Tax, legislators amended HB 123 to encourage more logging and discourage the use of forestland for carbon sequestration programs.

The loophole myth

HB 123 uses a stick (taxation) in the hope of increasing timber harvests in the North Country. The bill's committee report says it applies the existing Timber Tax (yield tax) to a new forestry practice. It asserts that "landowners are not paying the timber yield tax on the sale of standing wood and timber associated with carbon offset credits due to a loophole in the law."

But there is no loophole. The Timber Tax is a 10% ad valorem tax on the assessed value of timber at the time of harvest. Trees enrolled in a carbon sequestration program do not escape this tax. They will be cut eventually, at which point their owner must pay the Timber Tax. Trees in carbon sequestration programs are cut, as they have been every year since the Connecticut Headwaters Forest was put into a carbon sequestration program in 2013.

Though the committee report represents the bill as "providing for the assessment of the 10% yield tax on the metric tonnage of carbon sequestered from the timber enrolled in forest carbon programs," that is not what the bill does.

It creates a new tax not on carbon tonnage, but on net revenues from carbon credit sales.

Reversing, not extending, the Timber Tax

Before New Hampshire's Timber Tax was created, trees were assessed and taxed annually along with the land on which they grew. This created an incentive for landowners to cut trees to avoid taxation. Concerned about deforestation, lawmakers created the Timber Tax to reverse this incentive.

"By taxing timber when cut—and only when cut—lawmakers sought to disincentivize the cutting of trees and clearing of land simply to avoid higher property taxes," the Department of Revenue Administration explains in its Timber Tax Guide.

HB 123 by design would reverse the Timber Tax incentive for trees enrolled in a carbon sequestration program. By creating a new tax on the value of carbon credits sold, it replaces the incentive not to cut trees with an incentive to cut them.

Were the tax in HB 123 an extension of the Timber Tax, it could run into conflict with Part II, Article 5 of the state constitution, which allows special timber taxes for one purpose:

“For the purpose of encouraging conservation of the forest resources of the state, the general court may provide for special assessments, rates and taxes on growing wood and timber.”

The point of HB 123 is to discourage conservation of forest resources through taxation. Because the bill does not tax timber, it likely avoids conflict with this constitutional provision. If it were, as its supporters claim, an extension of the Timber Tax, however, a constitutional challenge could arise.

HB 123 taxes net revenues (income), not property

Instead of extending the Timber Tax, HB 123 creates an entirely new tax. The bill’s language explains it this way:

“The owner of a property that has been enrolled or registered for the purpose of sequestering carbon dioxide and/or generating carbon offset credits shall annually pay a yield tax of 10 percent of the estimated net value of the carbon offset credits issued and sold in the previous calendar year.”

The bill draws from property taxation a requirement that the value of carbon credits be assessed by local tax officials. It then draws from income taxation the requirement that taxes are paid on the net value of credits “sold in the previous calendar year.”

So is it a property tax or an income tax?

The Timber Tax is triggered when timber is cut, regardless of whether it is sold. It is an ad valorem property tax on assessed value. The tax created by HB 123 is not like this. It is triggered by sales and applied to the net value of property sold.

The committee report states that “the timber yield tax shall be assessed on the sale of standing wood and timber enrolled in a forest carbon program for the purpose of providing carbon offset credits to a buyer.”

That is confusing because the timber itself isn’t sold, only the carbon credits are sold. But it states clearly that the “tax shall be assessed on the sale….”

The next sentence provides additional clarity.

“Importantly, this bill as amended provides for the assessment of the timber yield tax related to this new type of timber sale,” it states.

The committee report emphasizes that the sale of carbon credits is a taxable event that triggers a 10% tax on the net value of credits sold in the prior year. This is clearly a new tax. Its purpose, substance and form are not at all like the Timber Tax.

The game is given up by checking the Official New Hampshire Assessing Reference Manual published by the Department of Revenue Administration. The manual’s definitions of ad valorem tax and income are as follows:

- **Ad Valorem Tax:** A tax levied in proportion to the value of the thing(s) being taxed. Exclusive of exemptions, use-value assessment provisions, and the like, the property tax is an ad valorem tax.

- **Income:** The payments to its owner that a property is able to produce in a given time span, usually a year, and usually net of certain expenses of the property.

Despite the fig leaf of an assessment, HB 123 taxes payments that a property produces annually. Requiring a local assessment doesn't transform the tax into a property tax. It is a tax on income.

The bill requires the carbon credits "issued and sold" in the previous year to be assessed, and a 10% tax to be levied on their net value. This assessment creates the appearance of a property tax. Section IV of the bill attempts to explain the valuation process. It's confusing, but it does state that the value is determined by the "average price-per-metric ton paid" minus the developer's and land owner's costs. How else would assessors determine the value of property sold *in the prior year* if not by using actual prices paid? Any valuation that differs from actual revenues would be easily challenged in court.

If you're taxing net revenue generated from the prior year's sales, what else are you taxing besides income?

Additional problems

Because the bill does not create an offset against the Business Profits Tax (BPT) or Business Enterprise Tax (BET), it creates a double tax on business income if the carbon credits are sold by a business. That violates the state constitution's provision that taxes be proportional.

HB 123 also does not allow a credit against the Timber Tax, which eventually will be paid on trees taxed through this new levy. Instead of paying one tax when a tree is cut, owners of trees that generate carbon credits will pay annually on income from the tree, then again on the tree's assessed value when cut.

If the tax were just the timber tax applied to trees not yet cut, then the same trees shouldn't be hit with the Timber Tax again when cut. The bill has no provision to avoid piling a cumulative property tax on top of annual property taxes because it isn't an extension of the Timber Tax, but a new tax on revenues generated from carbon credit sales.

Conclusion

Many advocates of HB 123 as amended seem to genuinely believe that it is a simple extension of the Timber Tax. In their defense, the bill's language is confusing and initially creates the appearance of conforming with the statutory process of determining a yield tax. That's likely why it received an endorsement from the New Hampshire Union Leader, which has an editorial policy of opposing income taxes. Be that as it may, the bill as written creates a new tax on income generated by carbon credit sales. Elected officials who have pledged to oppose new taxes, especially an income tax, would violate those pledges by voting for this bill.