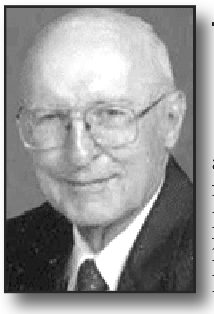
Death Taxes Will Not Die



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Federal estate taxes, labeled death taxes by the American Farm Bureau and others are scheduled for repeal in 2010. But with present demands for federal funds, farmers and farm leaders should not expect that Congress will let estate taxes expire.

A recent report from USDA's Economic Research Service has analyzed the changes in Federal estate provisions for farm households. Increases in value of property that can be transferred to the next generation free of the estate tax have greatly reduced the number of all farm estates subject to the tax and the amount owed. However, an estimated 10 percent of all commercial farm estates will still owe an estate tax in 2009.

Though special provisions have been enacted to limit the impact of the tax on farmers and small business owners, these groups are still more likely than the general public to owe federal estate taxes. Much of the concern for farmers focuses on the ability of the next generation to continue operating and investing in these family owned businesses.

For many farms, business assets account for a large share of the owner's estate so that estate tax liabilities not only drain the business of funds that might otherwise be reinvested, but could also force the liquidation of business assets.

The Economic Growth and Taxpayer Relief Reconciliation Act of 2001 provided tax relief to farmers and other small business owners by reducing federal estate and gift tax rates and substantially increased the amount of property that can be transferred to the next generation free of the Federal estate tax. The 2001 Act also completely repealed the tax in 2010 but restored the estate tax in 2011 at the rates in effect before 2001.

The ERS reports that about 2.9 percent of the 38,234 farm estates projected for 2009 are estimated to have assets of more than $3.5 million and would be required to file an estate tax return. After deductions about half of these farm estate would be taxable. These taxable farm estates have an average net worth of $7million with about 85 percent of the value attributable to farm business assets, primarily farm real estate. The total amount of federal estate taxes due from farm estates in 2009 is estimated at $683 million with the average taxable estate owing about $1.1 million.

The impact of the Federal estate tax varies by farm type. Despite estate tax relief targeted to farmland, an estimated 10 percent of the estates of commercial farmers, those with annual farm sales of $250,000 or more are likely to owe Federal estate taxes in 2009. Commercial farms are 10 times more likely to owe federal estate taxes than other farms.

While representing only 6 percent of all farm estates, commercial farms account for about 40 percent of all Federal estate taxes paid by farm estates. In contrast, rural residence farms, those with sales below $250,000 annually and whose operator has a primary occupation other than farming, account for nearly three-fourths of all farm estates but only pay about a third of the estate taxes.

The estate tax repeal now scheduled for 2010 is only temporary. The resurrected tax in 2011 reverts to the law that was in place prior to the 2001 changes. As a result, the exempt amount would return to $1 million and the tax rate would revert to 55 percent, as established in the 1997 Act. This situation not only creates uncertainty but it also raises concerns regarding the disparate treatment of similar estates depending upon the date of death. The family of a person who dies on January 1, 2011 could owe considerable more than the heirs of a person dying a few days earlier.

The reversion to pre-2001 law will increase the share of estates that owe Federal estate tax and will result in increased government revenue from Federal estate taxes. The share of estates that would owe tax under a reversion to pre-2001 law has been estimated to increase to about 2.5 percent of all estates with total tax liability nearly doubling to over $50 billion. The impact on farm estates is expected to be even larger.

Since 2000 farm equity has more than doubled, primarily due to the increasing value of farm real estate. As a result, it is estimated that as many as one out of very ten farm estates would own estate taxes in 2011. Total payments could increase nearly 300 percent more than farm estates are expected to owe in 2009.

The stepped up basis rule values assets at their value at the date of death. This rule essentially eliminates the recognition of capital gains due to appreciation in the value of property occurring prior to the property owner's death. This rule is especially beneficial for assets such as farmland that are typically held for long periods and have appreciated considerably. Under the 2001 Act the step up in basis ruled is scheduled to change in 2010 limiting the amount of appreciation that would be exempt from income tax when the assets are sold. This change will add to compliance burdens since it will be necessary to determine the original cost or other basis of inherited assets.

With repeal and resurrection of the estate tax approaching, there is increasing interest in a substantial permanent increase in the exemption amount combined with the retention of the stepped up basis at death treatment for inherited assets. The President's 2010 budget would make the current $3.5 million exemption amount and maximum 45 percent tax rate permanent and retain the stepped up basis treatment for inherited assets.

Farm leaders and their organizations should work with their members in Congress to relieve the uncertainty created by the temporary estate tax repeal. Increasing the amount of exemption for farm and small business estates could be a major help for estate planning and relieving future estate tax burdens. Δ

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