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How Will the Phaseout of Federal Estate Taxes Affect Farmers?

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Concern among policymakers that the Federal estate tax might force the liquidation of some family farms has resulted in the enactment of a variety of special provisions over the years. Providing relief to farmers and other small business owners was the primary impetus for the 1997 changes to Federal estate and gift tax policies and a major objective of the 2001 law that will phase out and eventually repeal the Federal estate tax. While only about 4 percent of all farm estates owe Federal estate taxes, a much larger percentage of farm estates must file an estate tax return, make use of special farm provisions, alter their business practices, or engage in costly estate planning in order to reduce the impact of the estate tax on their farm business. Thus, the phase-out and repeal of the Federal estate tax will affect a much broader group of farmers than just those who owe tax.

The current Federal estate tax was enacted in 1916. Throughout much of its history, the tax has not raised a significant portion of Federal tax revenue or, with the exception of a short period during the early 1970s, subjected more than 1 or 2 percent of all estates to tax. While only about 2 percent of all estates are currently taxable, the number of estates subject to tax more than doubled from 1987 to 1997, when 42,901 estates owed Federal estate tax. This increase in the number of taxable estates and the increasing budget surplus were the primary factors contributing to a reduction in Federal estate and gift tax burdens in 1997, especially for farmers and other small business owners. While many of the provisions enacted in 1997 are still being phased in, Congress, as part of the Economic Growth and Tax Relief Reconciliation Act of 2001, made additional changes to Federal estate and gift taxes. These changes will be phased in over the next decade.

Farmers and owners of other small businesses hold significant amounts of wealth in the form of business assets and are thus more likely than

other taxpayers to be subject to Federal estate taxes. Providing relief to farmers and other small business owners was the primary impetus for the 1997 changes to Federal estate and gift tax policies and a major objective of the 2001 phaseout and eventual repeal of the Federal estate tax.

Overview of Current Law

The current Federal estate and gift tax system applies a unified tax rate structure and a cumulative lifetime credit to gifts and transfers of money and other property at death. Under the system, individuals can transfer a specified amount (\$1 million in 2002) in cash and other property without Federal estate or gift tax liability as a result of the unified lifetime credit. Although every estate with more than \$1 million in gross assets must file an estate tax return, the taxable amount is reduced by deductions for funeral expenses, administrative expenses, debts, charitable contributions, and transfers to the decedent's spouse. As a result, less than half of all estates required to file a return are actually taxable. Gifts of up to \$11,000 annually to an unlimited number of individuals are

not subject to tax and do not count against the amount exempted from tax by the unified credit. Transfers in excess of the exempt amount are taxed at a graduated rate that begins at an effective rate of 41 percent, rising to a maximum rate of 50 percent on taxable estates above \$2.5 million.

Estate and gift tax receipts have historically accounted for a relatively small share of total Federal revenues, accounting for a little over 1 percent of total revenue in 1998. However, while the aggregate importance of estate and gift taxes is small relative to other Federal Government revenue sources, the potential impact of these taxes on an individual or group of individuals, such as farmers and other small business owners, can be substantial.

Special Farm Provisions

The appreciation in land values, the increase in average farm size, and the rising investment in farm machinery and equipment have increased farm estate values and taxes. Over the years, congressional concern that the farm sector's increasing estate and gift tax liability might

cause the breakup of some family farms and other small businesses led to the enactment of a number of targeted provisions to provide tax relief to farmers and other small business owners. Targeted provisions include the special-use valuation of farmland, the installment payment of estate taxes, and a new deduction for family-owned business interests.

Special-Use Value

In general, the value of property for estate tax purposes is the fair market value at the date of death. However, if certain conditions are satisfied, the estate's real property devoted to farming (or other closely held business) use may be valued at its use value as a farm (or other closely held business) rather than at its fair market value. To qualify for this use value, the property must be transferred to a qualified heir, must have been used as a farm for 5 years during the 8-year period ending with the decedent's death, the decedent or a member of the decedent's family must have participated in the farm business, the value of the qualified real property must equal at least 25 percent of the estate, and the combined value of the real and other business property must be at least 50 percent of the gross estate.

The method used to value farmland for use-value purposes is to divide the 5-year average annual gross cash or share rental for comparable land in the area, minus State and local real estate taxes, by an average of the annual effective interest rate for all new Federal Land Bank (FLB) loans for the year of death. For most farms, the use-valuation law can reduce the value of the real property portion of qualifying estates by 40 to 70 percent, with the largest reductions occurring for farmland which has residential or commercial development potential. The maximum reduction in value for 2001 is \$800,000 (\$820,000 for 2002). All or a portion of the estate tax benefits obtained under the special-use valuation provision are recaptured if the property is sold to a nonfamily member or if the property ceases to be used for farming or other closely held business purpose within 10 years of the decedent's death.

Installment Payment of Estate Tax for Closely Held Businesses

A second special provision for farmers and other small business owners is aimed at the liquidity problem that these businesses can face as a result of having a large portion of the estate in land and other relatively illiquid business assets. Federal estate and gift taxes generally must be paid within 9 months of the date of death. However, when at least 35 percent of an estate's value is a farm or closely held business, estate taxes may be paid over an additional 14-year period with only interest due for the first 5 years. Beginning in 1998, the interest rate on the first \$1 million in taxable value (above amounts exempted by the unified credit) of the farm or other closely held business was reduced to 2 percent, with the interest rate on amounts above \$1 million equal to 45 percent of the normal rate applicable to tax underpayments. The amount of estate tax eligible for the 2-percent interest rate is scheduled to increase from \$153,000 in 1997 to \$435,000 for 2002. This provision, combined with the increase in the amount of property that can be transferred tax free, has greatly reduced the liquidity problem that some farm heirs might otherwise experience as a result of Federal estate taxes.

Deduction for Qualified Family-Owned Businesses

Beginning in 1998, a new deduction for the first \$675,000 of value in qualified family-owned business interests was enacted. The deduction is in addition to any benefits from special-use valuation and the unified credit. The total amount excludable from the combination of this provision and the unified credit is limited to \$1.3 million. Thus, as the amount exempted by the unified credit increases (as scheduled under current law), the additional amount of farm and closely held business property that can be transferred free of tax declines.

A qualified family-owned business interest is any stake in a business with its principal place of business in the United States in which one family owns at least 50 percent of

the business, two families own at least 70 percent, or three families own at least 90 percent, as long as the decedent's family owns at least 30 percent. To be eligible for the exclusion, such interests must comprise more than 50 percent of a decedent's estate and the decedent, the decedent's heirs, or a member of their family must satisfy certain pre- and post-death ownership and participation requirements. The benefits from the exclusion are recaptured if the qualified heir fails to meet the material participation requirements, disposes of the business interest other than to a family member or through a qualified conservation contribution, loses U.S. citizenship, or moves the principal place of business outside the United States.

The deduction for farms and other family-owned businesses, combined with the increased unified credit, is expected to significantly reduce both the number of taxable farm estates and total taxes paid. Nevertheless, the targeting provisions associated with the deduction are extremely complex and contain a number of pitfalls for the uninformed. Qualifying for the deduction requires careful planning, further increasing the administrative burden and expense associated with the Federal estate tax.

Exclusion for Land Subject to Conservation Easement

In addition to the targeted provisions, farmers and other landowners will be the primary beneficiaries of a new exclusion for land subject to a conservation easement. Since 1981, a deduction has been allowed for Federal income and estate and gift tax purposes for a contribution of a qualified real property interest to a charity or other qualifying organization exclusively for conservation purposes. A "qualifying real property interest" means a perpetual restriction or easement on the use of real property. A "conservation purpose" is defined as (1) the preservation of land for the general public's outdoor recreation or education, (2) the preservation of a natural habitat, (3) the preservation of open space for the scenic enjoyment of

the general public or in furtherance of a governmental conservation policy, or (4) the preservation of historically important land or certified historic structures.

Beginning in 1998, in addition to the reduction in value for the conservation easement, up to 40 percent of the value of the land in an estate subject to a qualified conservation easement and located within 25 miles of a metropolitan area, a national park, or wilderness area, or within 10 miles of an Urban National Forest can be excluded for Federal estate tax purposes. The land must have been owned by the decedent or a member of the decedent's family for at least 3 years prior to the date of death, and the donation must have been made by the decedent or his family. The exclusion is based on the value of the property after the conservation easement is placed, but does not include any retained development rights to use the land for any commercial purpose except farming. If the value of the conservation easement is less than 30 percent of the value of the land for purposes of the exclusion then the exclusion percentage is reduced 2 percentage points for each percentage point below 30 percent. The maximum exclusion was \$400,000 in 2001 but increased to \$500,000 in 2002 and thereafter.

The exclusion provides an additional incentive to donate a conservation easement within the designated areas. The new exclusion is especially attractive for farmers who own land near urban areas where the difference between the value of land for farm purposes and for development purposes can be significant. However, given the increased unified credit, the availability of special-use valuation, and the new deduction for family-owned business interests, the number of landowners subject to the Federal estate tax who would benefit from the additional exclusion is relatively small. Geographic targeting of conservation easements has also limited the pool of potential donors.

Impact of Federal Estate Taxes on Farmers

The changes enacted in 1997 reduced the number of farm estates

subject to tax primarily by increasing the favored treatment of farm and other business assets over other types of assets for estate tax purposes. Despite this favorable treatment, farm estates are twice as likely as nonfarm estates to be subject to the estate tax. Based on simulations using 1998 farm-level survey data, an estimated 4 percent of all farm estates owed Federal estate and gift taxes, versus just about 2 percent of all estates. Of the 31,161 estimated farm estates for 1998, 5,394 (17 percent) had assets in excess of \$625,000 and would be required to file an estate tax return (fig. 1). After deductions, special-use value, and the family business deduction, only 1,219 of these estates would be taxable. The total amount of Federal estate taxes owed by farmers was estimated at \$735 million. The average tax due was about \$602,000 on an average net worth of \$2,832,000 for an average tax rate of 21 percent.

The Federal estate tax burden for farmers can be further analyzed by the size and type of farm (table 1). Using Agricultural Resource Management Survey (ARMS) data and the new ERS farm typology (see *America's Diverse Family Farms*, AIB-769, May 2001, <http://www.ers.usda.gov/publications/aib769>), the Federal estate tax appears to be of little concern to most small farms (farms with sales under \$250,000). Only about 3.5 percent of all small farms owed any Federal estate taxes in 1998 (fig. 2). Within the small-farm category, no limited-resource

farmers owed any estate tax because of the low level of assets associated with this group. Of the remaining farm types within the small-farm typology, the only farm type with more than 4 percent of farm estates owing taxes were primary occupation farms with sales less than \$100,000. An estimated 5 percent of these farms owed taxes. Compared with small farms, the share of large and very large farms that owe taxes is significantly greater—10 percent and 17 percent, respectively. In most instances, the tax owed is also greater, with the very large farms on average owing over \$1 million in Federal estate taxes.

Without the special provisions, the Federal estate tax would impose a much greater burden on farmers (see example below). The potential for savings from these provisions is highlighted by the fact that the special-use valuation and the family business deduction reduced both the number of taxable estates and total Federal estate taxes for all farm estates by about half (fig. 3). The largest percentage reductions occurred for primary occupation farms with sales between \$100,000 and \$250,000. Federal estate taxes for this category of farms were cut by nearly 75 percent. Reductions for retirement farms were substantially less, with such farms experiencing only about a one-third reduction in taxes. This reflects the inability of many retirement farms to qualify for the family business deduction due to the relative value of nonfarm

Example of farm and nonfarm-nonbusiness estate tax liability, 1998

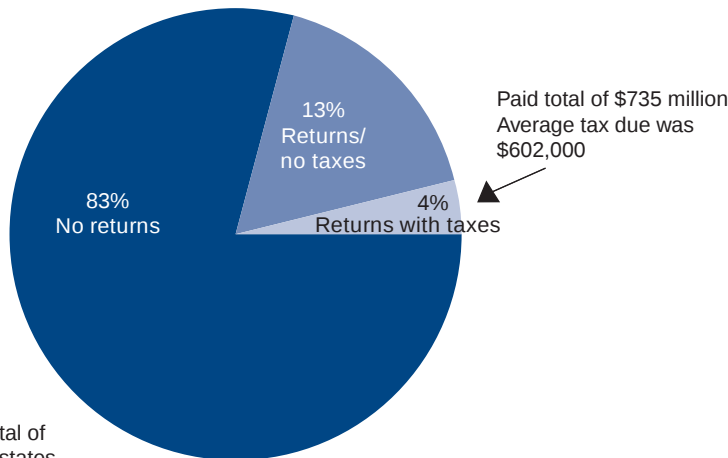
	Farm estate ¹	Other estate
Gross estate	\$2,000,000	\$2,000,000
Reduced by—special-use value ²	-\$750,000	NA
Family business deduction	-\$675,000	NA
Taxable estate	\$575,000	\$2,000,000
Tentative tax	\$183,550	\$780,800
Reduced by—unified credit	-\$202,050	-\$202,050
Estate tax owed	0	\$578,750

NA= not applicable.

¹Assumes that 80 percent of estate is composed of farm assets (75 percent farmland) and that all other ownership and participation requirements are satisfied for special-use valuation and the family business deduction.

²In this example, special-use valuation results in a reduction in the farmland portion of the estate by 50 percent of fair market value.

Figure 1
Share of farm estates with returns and taxes, 1998



Based on a total of
31,161 farm estates

Source: USDA-ERS, estimates based on ARMS data.

assets in the estate. For retirement farms, average nonfarm net worth exceeds the average value of farm assets other than land and buildings. This may reflect the disposition of farm assets in anticipation of or during retirement. Reductions as a percentage of tax were also smaller for very large farms. This can be attributed to the \$750,000 cap (in 1998) on the reduction in value under the

special-use value provision and the maximum \$675,000 exemption from the new deduction for family-owned business interests.

The installment payment provision further reduced the estate tax burden by providing for below-market interest rates on installment payments over an extended repayment period. Nearly 60 percent of all taxable farm

estates were eligible for installment payment. These estates owed much higher taxes on average and accounted for over 87 percent of total Federal estate taxes paid by farmers. The present value of Federal estate tax payments for these farm estates was reduced by about a third.

New Law

The Economic Growth and Tax Relief Reconciliation Act of 2001 provides for the phaseout and eventual repeal of the Federal estate tax. Beginning in 2002, the unified credit is increased to \$1 million and the top tax rate is reduced from 55 percent to 50 percent. Additional increases in the unified credit and reductions in tax rates will be phased in through 2009 before the estate tax is completely repealed in 2010 (table 2). The gift tax will remain in effect but with a \$1 million exemption amount and a tax rate equal to the top individual income tax rate (35 percent) under the new law.

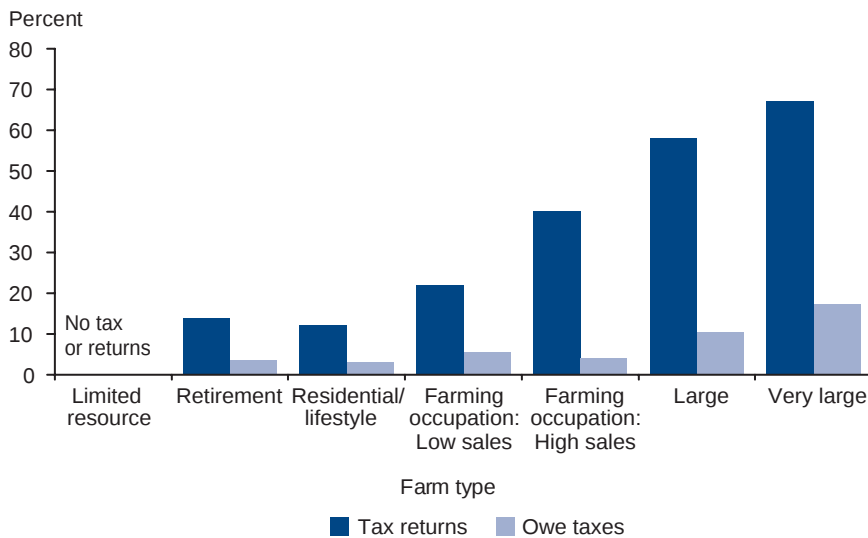
In 2004, the deduction for qualified family-owned business interests will be repealed once the exemption from the unified credit reaches \$1.5 million, exceeding the \$1.3 million

Table 1—Average net assets and estate taxes by type of farm, 1998

	Small family farms			Farming occupation		Large family farms Farm sales (\$1000)	Very large farms Farm sales (\$1000)
	Limited resource	Retirement	Residential/ lifestyle	<\$100	\$100-250		
				Farm sales (\$1000)			
				<\$100	\$100-250	\$250-500	>\$500
All farmers	150,268	290,938	834,321	422,205	171,469	91,939	61,273
				Number			
Share across farm types	7	14	41	21	8	5	3
				Percent			
Taxable estates	0	365	178	448	68	78	82
				Number			
Share across farm types	0	30	15	37	5	6	7
				Percent			
Average net assets for taxable estates				Thousand dollars			
Total	0	2,534	1,657	3,335	2,303	2,921	4,330
Farm	0	2,027	921	2,895	1,916	2,602	4,037
Nonfarm	0	507	736	440	387	319	293
				Thousand dollars			
Federal estate tax paid				Thousand dollars			
Total	0	208,470	44,645	333,599	17,850	35,735	94,584
				Percent			
Share across farm types	0	28	6	45	3	5	13
				Thousand dollars			
Average	0	571	250	745	262	458	1,156

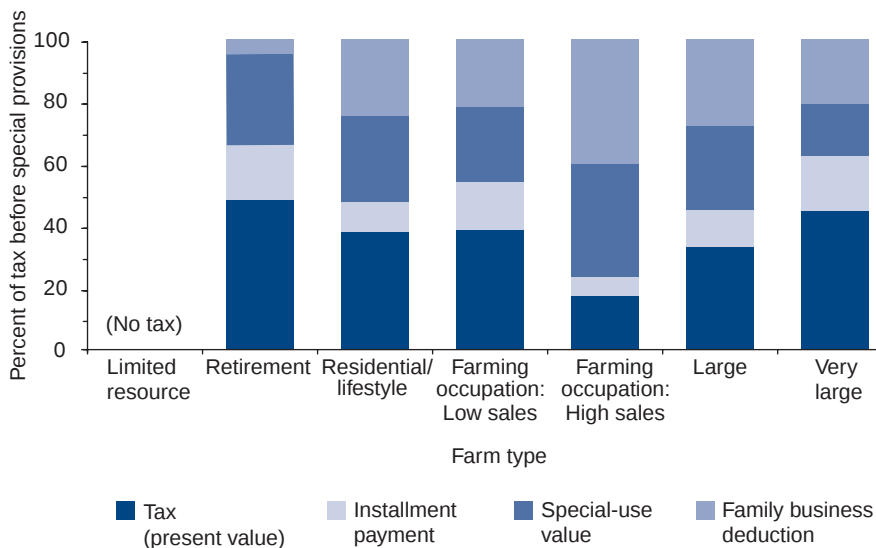
Source: Estimated by USDA-ERS from ARMS data.

Figure 2
Farm estate returns and taxes by farm type, 1998



Source: USDA-ERS, based on 1998 ARMS data.

Figure 3
Tax and tax reductions from special farm provisions, 1998



Source: USDA-ERS, based on 1998 ARMS data.

currently allowed under the family business deduction and unified credit. The act also expands the availability of qualified conservation easements by eliminating the requirement that the land be located within a certain distance of a metropolitan area, national park, wilderness area, or Urban National Forest. Thus, a qualified conservation easement can now be claimed on all land located in the United States.

The entire 2001 Act is scheduled to terminate on December 31, 2010. Unless the sunset provision is repealed, the Federal estate and gift tax will revert to the law in effect prior to the 2001 Act. Under this law, the applicable exclusion amount from the unified credit for both the Federal estate and gift tax would be \$1 million with a maximum tax rate of 55 percent.

Who Would Benefit from Phaseout and Repeal?

While only about 4 percent of all farm estates owe Federal estate tax, a much larger number are required to file, utilize special farm provisions, alter business practices, or engage in estate planning to reduce the impact of the tax on their business. Thus, the phaseout and repeal of the Federal estate tax will affect a much broader group of farmers than just those who owe tax.

Prior to the 2001 Act, about 1 out of every 6 farm estates were required to file an estate tax return. As a result of the phaseout and repeal of the tax, this group of farm heirs will be relieved of the administrative burden of filing. Also, those required to file but who owe no tax due to special provisions, including special-use valuation and the deduction for family-held business interests, currently may be subject to the recapture of estate tax benefits and may face increased income tax liability.¹ The number of farm estates that must file but owe no tax due to these special provisions is estimated at nearly double the number of estates that actually owe Federal estate taxes. Under repeal, these individuals would realize income tax savings and could avoid potential estate tax recapture liability. Finally, farmers with assets near the filing threshold would no longer need to alter their business plans or engage in other estate planning techniques to avoid the estate tax.

The significant increase in the unified credit will greatly reduce the number of estates that are required to file but owe no tax. In fact, while the number of estates that owe tax is projected to be cut in half by 2006, the number required to file will decline from 17 to 10 percent of all farm estates in 2002 and to only 4 percent by 2006 (fig. 4).

¹The election of special-use value reduces the value of qualified farm property for estate tax purpose. This special-use value rather than fair market value then also becomes the value used to determine gain for income tax purposes. Thus, electing special-use value can increase future gain and income tax liability upon sale of the special-use value property.

Table 2—Estate tax exemption amount and tax rates, 1998-2010

Calendar year	Estate tax exemption amount	Highest estate and gift tax rates
1998	\$625,000	55%
1999	\$650,000	55%
2000	\$675,000	55%
2001	\$675,000	55%
2002	\$1,000,000	50%
2003	\$1,000,000	49%
2004	\$1,500,000	48%
2005	\$1,500,000	47%
2006	\$2,000,000	46%
2007	\$2,000,000	45%
2008	\$2,000,000	45%
2009	\$3,500,000	45%
2010	Estate tax repealed	35% gift tax rate
2011*	\$1,000,000	55%

*Under current law, the 2001 Act sunsets on December 31, 2010, resulting in a reversion to the law applicable prior to the 2001 Act.

While phaseout and repeal of the estate tax may benefit as many as a third of all farm estates, the bulk of the benefits will accrue to the 4 percent of farm estates that owe taxes. Under the new law, taxes are gradually cut in half before final repeal in 2010. On average, taxable farm estates will save over \$600,000 as a result of the repeal of the estate tax, but the benefits would vary significantly with farm size. Taxable estates with net worth under \$1 million would save about \$68,000 on average beginning in 2002. The primary beneficiaries of repeal would be farm estates with net assets in excess of \$5 million; such farm estates currently account for an estimated two-thirds of all Federal estate taxes paid by farmers.

Impact of Repeal

Repeal of the Federal estate tax could influence farm efficiency and various structural aspects of farming, including farm size and the ownership and control of farmland. However, given the relatively small number of farms affected each year, the impact may be less important than the effects of other government policies or other factors on the agricultural sector.

For 2001, the gap between the amount of farmland and other business assets versus other property that can be transferred tax free was at least \$1,425,000 but could be much higher if both the husband

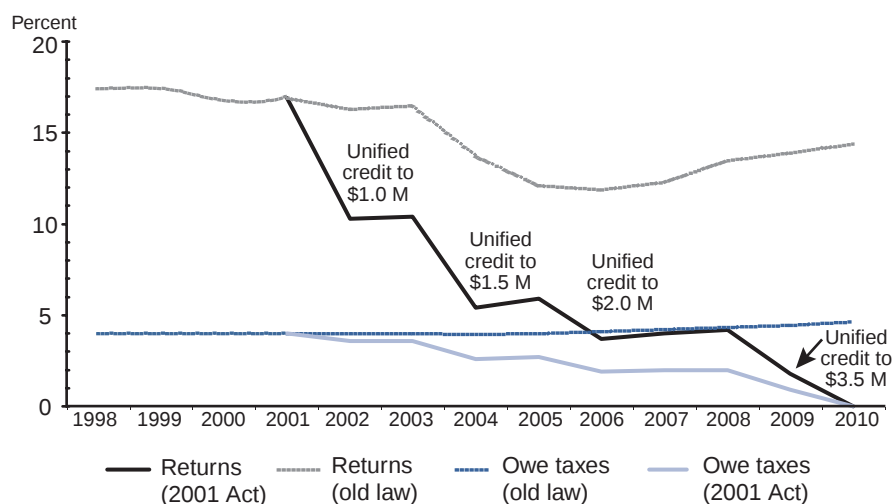
and wife took advantage of the special provisions. The combination of the high marginal estate tax rates and the preferential treatment accorded farm business assets, especially farmland, encourages older farmers to retain ownership of these assets while providing a substantial incentive for nonfarmers to invest in farmland to shelter assets from the Federal estate tax. At the same time, the ownership and participation requirements associated with the preferred treatment tend to reduce the supply of farmland, especially since heirs must hold property for several years to avoid the recapture of tax benefits.

The value of this preferential treatment for farm business assets will decline as the unified credit is increased, marginal tax rates are reduced, and the family-owned business deduction is repealed. Thus, the phaseout and repeal of the estate tax will reduce and eventually eliminate the effects of this preferential treatment on farmland markets by reducing the incentive to purchase and hold such assets and by removing the obstacles associated with the heirs' post-death holding requirements. With heirs free to dispose of property without concern for income taxes or recapture of estate taxes, the supply of farmland offered for sale by heirs should increase. However, to the extent that heirs have been forced to sell farmland and other farm assets to pay estate taxes, a partially offsetting effect would occur, since repeal would also eliminate the need to sell such assets, especially for the largest estates.

Limiting Step-up of Basis at Death

Due to concerns regarding the cost of eliminating the estate tax, repeal is phased in over several years and also involves some limitations on the step-up in basis rules that currently apply to inherited property. Under current rules, the basis (value) of property received from a decedent's estate is generally adjusted to the

Figure 4
Share of farm estates with returns and taxes, 1998-2010



Source: USDA-ERS, based on 1998 ARMS data.

property's fair market value on the date of the decedent's death, rather than its original cost. This step-up in basis eliminates any Federal income taxes on the appreciated value of property that occurred prior to the death of the individual from whom the property was inherited.

A complete elimination of the current step-up in basis rules could result in heirs' becoming liable for an estimated \$1.3 billion in unrealized capital gains taxes each year. Almost every estate would have some unrealized capital gains tax liability that would be owed upon the sale of the property. To reduce the impact of a carryover basis for inherited property, the new law provides an exemption amount of \$1.3 million with an additional \$3 million for transfers to a surviving spouse. This amount is added to the existing basis of the assets transferred. Determining this existing basis imposes a significant record-keeping burden on property owners, especially those who have held their property for long periods of time and those whose property value exceeds the exemption amount.

Allowing the basis of estate assets to be stepped up to fair market value by the \$1.3 million exemption amount (\$4.3 million with a surviving spouse) will reduce the number of estates with potential capital gains taxes to just over 1 percent of all estates and will reduce the tax liability to an estimated \$88 million, or about 12 percent of current Federal estate tax liability. Few estates with assets under \$2.5 million would be liable for any tax on unrealized gains (fig. 5). In addition, while estate tax liability is currently triggered by death, the capital gains tax on inherited property is due only if the property is sold. Thus, the carryover basis provisions would not impose a current income tax obligation on farm heirs who continue to use the inherited assets in the farm business.

Estates that currently owe Federal estate taxes are not necessarily identical to those that will have unrealized capital gains taxes under the new-basis-at-death rules. For estate tax purposes, net worth is the

primary determining factor. Thus, debt reduces the potential for owing estate taxes. However, for capital gains tax purposes the amount of gain is not reduced by debt. Also, farms that currently benefit from special-use valuation and the new family business deduction will not receive similar benefits under the new basis rules. Thus, while the repeal of the estate tax, combined with a step-up in basis of \$1.3 million (with an additional \$3 million for transfers to a surviving spouse), will reduce the number of farm estates that owe tax and the amount of tax owed, a small number of farm estates may actually experience a tax increase or owe capital gains taxes even though they would not have been subject to Federal estate or capital gains taxes under prior law.

Summary and Conclusions

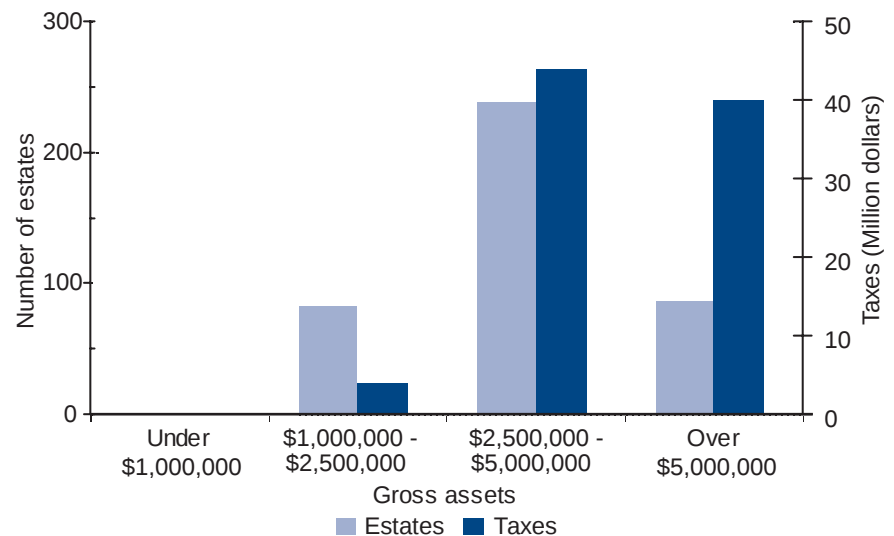
The impact of Federal estate and gift taxes on the ability to transfer the farm business to the next generation has been a major issue for farmers. Concern among policymakers that the Federal estate tax might force the liquidation of some family farms has resulted in the enactment of a variety of special provisions over the years. These provisions include the special-use valuation of farmland, the family-business deduction, and the installment payment of estate taxes. These provisions, combined

Estimating Procedures

Estimates in the report are based on simulations using data from the 1998 USDA Agricultural Resource Management Survey (ARMS). The age of the operator was used to estimate the probability that the operator would die. Estate values for future years were estimated based on the USDA baseline.

The ARMS survey is a stratified sample of farms with detailed financial information, including nonfarm assets. Since the ARMS does not include questions about previous or planned future operation of the farm, the analysis is based on the relative amounts of farm real estate, other farm property, and the gross estate to determine eligibility for special-use valuation and the family business deduction. Since some farmers may not meet the participation requirements or elect special-use valuation or the family business deduction, the benefits shown here represent the maximum benefits available for the special provisions. However, the analysis also does not attempt to account for estate planning strategies such as annual gifts, etc.

Figure 5
Number of farm estates with unrealized capital gains taxes exceeding step-up allowance, by size of estate, 2001



with the increase in the unified credit, have greatly reduced both the number of taxable estates and the total Federal estate and gift tax burden. Based on an analysis of 1998 data, less than 4 percent of all small farm estates owe any Federal estate taxes. In comparison, 12 percent of large and very large farm estates owe Federal estate taxes.

While only about 4 percent of all farm estates have owed Federal estate tax, a much larger percentage of farm estates have been required to file an estate tax return, utilize special farm provisions, alter their business practices, or engage in estate planning to reduce the impact of the estate tax on their farm business. Thus, the phaseout and repeal of the Federal estate tax will affect a much broader group of farmers than those who owe tax. In fact, during the phaseout period, the significant increase in the unified credit will substantially reduce the share of estates that are required to file but that owe no tax. However, the primary beneficiaries of complete repeal are farm estates with assets in excess of \$5 million; such estates currently account for an estimated two-thirds of all Federal estate taxes paid by farm estates.

Placing limits on the amount of property eligible for step-up in basis to fair market value at death with an exemption amount of at least \$1.3 million and an additional \$3 million for a surviving spouse will affect a relatively small number of farmers. Furthermore, since capital gains tax rates are lower than estate tax rates

and the taxes are due only when the property is sold or otherwise triggered, such a change should not impose a significant burden on estates with property above the exempt amount, especially those who want to continue farming. However, the change, combined with the uncertainty caused by the extended phase-in and sunset provision, will impose a record-keeping and planning burden, especially for the largest farm estates.

Identifying the effects of repeal on farm structure and opportunities to enter farming is more difficult than identifying who benefits from the reduction in taxes and the reduced administrative burden associated with the Federal estate tax. The current preferred status of farmland and other business assets for Federal estate tax purposes clearly increases the demand for such assets. At the same time, the ownership and participation requirements associated with the preferred treatment tend to reduce the supply of farmland, especially since heirs are required to hold property for several years to avoid the recapture of tax benefits. The elimination of the deduction for family-held business interests and the eventual repeal of Federal estate taxes will eliminate these effects on farmland markets. However, repeal will also eliminate the need to sell farmland to pay Federal estate taxes, especially for the largest estates. Thus, the net effect on farm structure and on opportunities for beginning farmers who do not inherit farmland or other farm property is not clear but may be relatively small.

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 3. Tax remission--United States.
 4. Family farms--Taxation-United States.
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Further Reading

Durst, R., and J. Monke. *Effects of Federal Tax Policy on Agriculture*, AER-800. U.S. Department of Agriculture, Economic Research Service. April 2001.

Also see the discussions on the ERS website <http://www.ers.usda.gov/briefing/Federaltaxes/>

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