



Analysis of State Estate Taxes in New England:

Identifying policy barriers and
opportunities around land
access and farm transfer



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THIS PAPER IS ONE IN A SERIES PRODUCED THROUGH THE NEW ENGLAND LAND ACCESS POLICY PROJECT

A collaboration between American Farmland Trust (AFT), Conservation Law Foundation (CLF) and Land For Good (LFG), the New England Land Access Policy Project facilitated dialogue in each New England state to identify policy barriers and opportunities around land access and farm transfer.

In several states, state estate taxes were identified as barriers because of their perceived role in encouraging conversion of farmland to development. This paper documents existing policy in each state and considers policy options at both the federal and state level.

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INTRODUCTION

For generations farmers have often been “land-rich” and “cash-poor.” This holds especially true in New England, where farm real estate values are among the highest in the country. And as land, buildings, equipment and other farm assets appreciate over time farmers can find themselves facing significant state and federal estate taxes when a parent or surviving spouse dies. The unfortunate consequence is that farm families may be forced to sell off assets, including land and agricultural infrastructure, to meet estate tax obligations. This complicates intergenerational farm transfers and can lead to conversion of farmland to non-farm uses.

Since 2000, the federal estate tax exemption has increased significantly while the maximum estate tax rate has fallen.¹ As a result, the number of estates required to file a return or pay federal estate tax has decreased. The 2016 federal estate tax exemption is \$5.45 million, up from \$5.43 million in 2015. Under this structure an individual can leave \$5.45 million to heirs and pay no federal estate tax. The top federal estate tax rate remains at 40 percent.² At this level of exemption, relatively few farm families across the U.S. are likely subject to the federal estate tax. Using survey data from the 2013 Agricultural Resource Management Survey, USDA’s Economic Research Service (ERS) estimated that 0.8 percent of farm estates in the United States would have owed federal estate tax in 2014 at the exemption level of \$5.34 million.³ ERS estimated total federal estate tax liabilities on all farm estates in 2014 at more than half a billion dollars. Historically, these figures have been much higher.

Although the federal estate tax applies to fewer farms than in the past, state estate taxes are assessed in all of the New England states except for New Hampshire. As discussed below, several states have lower estate tax thresholds than the federal level, meaning that more farms are likely subject to state-imposed estate taxes. This paper compares these state-level estate tax policies and seeks to estimate the number of New England farms that may be subject to both federal and state estate taxes. It suggests changes in federal and state estate tax policies that could reduce the number of farms affected, helping to reduce loss of farmland as a result of ownership transitions impacted by estate tax laws.

FEDERAL ESTATE TAX

Estate values exceeding \$5.45 million are subject to the 2016 federal estate tax. The tax rate is capped at 40 percent. In valuing a farm estate, the Internal Revenue Code Section 2032A allows a special use valuation assessment for farmland, reducing its taxable value. For qualifying family farms, 2032A allows an inflation-adjusted reduction from fair market value of up to \$1,110,000 for 2016, which is up from \$1,100,000 in 2015 and \$1,090,000 for 2014. To qualify, the farm estate must be made up of real property with a fair market value of 25% of the total value of the adjusted estate; the farm assets, both real and personal, must make up at least 50% of the estate; the property must have been used as a farm for five of the eight years prior to the decedent’s death; the decedent or a family member must have been a participant in the farm business; and the property must be passed to an heir. The use value tax benefit is lost if the property is sold to a

¹ The maximum rate for federal estate tax in 2000 was 55 percent.

² The federal estate tax law is at 26 C.F.R., part 20.

³ U.S. Department of Agriculture Economic Research Service, *Federal Estate Taxes*, May 6, 2015. <http://www.ers.usda.gov/topics/farm-economy/federal-tax-issues/federal-estate-taxes.aspx> (accessed March 10, 2016).

non-family member or if the land is not used for farming for 10 years following the death of the decedent. In private letter rulings, the Internal Revenue Service has notified taxpayers that the sale of a conservation easement on a farm would trigger recapture of the estate tax saved by the lower special use valuation allowed under 2032A. Therefore, under the current tax structure, it is likely that the sale of conservation easements (as opposed to an outright gift) will trigger recapture on land subject to special use valuation.⁴

Federal estate tax must be paid within nine months of the property owner's death. However, for qualifying estates with farm or closely-held business assets, federal estate tax can be paid on an installment basis. This installment payment provision can be helpful to heirs of agricultural landowners that might otherwise struggle to pay taxes on land and other illiquid assets. To qualify for installment payments, the value of the interest in the farm included in the estate must be more than 35 percent of the estate's adjusted gross value. Under the installment method estate tax payment, but not interest, may be deferred for up to five years from the original payment due date. After the first installment of tax is paid, the rest must be paid annually. Payments may extend for a total of 14 years.⁵

Relatively few New England farms are likely to be subject to the federal estate tax, though a precise figure is difficult to calculate. Nationwide, the USDA Economic Research Service estimates that for the 2015 tax year only 3 percent of farm estates would be required to file an estate tax return.⁶ State level data about farm household wealth is not available.

Farm household estates include all assets owned by the farm including land and buildings, equipment, farm financial assets, livestock etc., plus all non-farm assets. A potential proxy for the value of farm household estates by state is the value of land and buildings reported in the Census of Agriculture. Across the region, 2,640 farms in 2012 had farm real estate values between \$1 million and \$1.9 million; another 1,294 farms had farm real estate values between \$2 million and \$4.9 million. Only one percent of farms (335 farms) had farm real estate values higher than \$5 million.⁷

USDA's Economic Research Service estimates that 56 percent of small farm estates (farms with less than \$350,000 gross cash farm income) are made up of farm assets, while farm assets comprise 78 percent or more of the estates of mid-sized and larger farms. Given the region's high percentage of small farms, this suggests that more than 335 farms may be subject to federal estate taxes.

On the other hand, farm real estate values do not reflect liabilities that a farm might have that could reduce the value of the farm household estate and therefore the number of farms subject to the federal estate tax. According to the *2014 Northeast Dairy Farm Summary*,⁸ the average net worth of dairy farms in the New England-New York region is 75 percent of the total asset value

⁴ Private letter rulings from the Internal Revenue Service are issued to specific taxpayers and cannot be used or cited as precedent. However, they are useful indicators of how the IRS approaches an issue. A broader revenue ruling may eventually be published on this issue, or the law amended by Congress. But for now, it appears that only outright gifts of qualified conservation easements on land subject to current use valuation election will not trigger the recapture. See PLR-112932-07.

<http://www.timbertax.org/research/letter rulings/exchanges/ltr0840018.pdf> (accessed May 5, 2016).

⁵ The law authorizing installment payments of federal estate tax is 26 U.S.C. § 6166.

⁶ U.S. Department of Agriculture Economic Research Service, *Federal Estate Taxes*, May 6, 2015.

<http://www.ers.usda.gov/topics/farm-economy/federal-tax-issues/federal-estate-taxes.aspx> (accessed March 10, 2016).

⁷ *2012 Census of Agriculture*, USDA (2012).

⁸ *2014 Northeast Dairy Farm Summary*, Farm Credit East, Enfield, CT, May 2015.

of the farm. And the ERS indicates that, while three percent of farm estates filed an estate tax return in 2014, only 0.8 percent of these estates owed taxes.⁹ So these figures could also over-represent the number of farms potentially impacted.

STATE ESTATE TAXES

Connecticut

In 2016, the Connecticut state estate tax applies to estates with gross values exceeding \$2 million per individual.¹⁰ This is a reduction from the \$3.5 million exemption that was in place prior to 2011. Connecticut's estate tax rate is progressive. Under the lowest bracket estates larger than \$3.5 million pay a rate of 7.2 percent of the excess over \$3,500,000. The highest bracket, for estates valued at more than \$10.1 million, pays \$640,200 plus 12 percent of the excess over \$10.1 million.¹¹ Connecticut has relatively high farmland values for the region and accordingly the lower exemption level adversely affects more farms. Without accounting for other non-real estate assets or other liabilities, 446 farms or 7 percent of farms within the state could be affected by the \$2 million exemption level.¹²

During Connecticut's 2016 legislative session, several bills were introduced to eliminate the state estate tax either immediately or starting in 2017.¹³ Other bills proposed increasing the exemption or phasing out the estate tax over time.¹⁴ H.B. 5195 would have provided an exemption up to the federal exemption level for land classified as agricultural land under the state's agricultural use assessment program.¹⁵ Two other bills would have completely exempted land in agricultural use assessment provided the heirs agree to keep the land in agriculture for eight or more years.¹⁶ None of these bills were acted on.

Maine

On June 30, 2015 Maine's Legislature voted to override Governor LePage's veto of the state budget. The override led to significant changes to Maine's state estate tax structure. Prior to 2016, Maine imposed tax on estates with a value exceeding \$2 million. In 2016, the new state estate tax exemption for individuals dying in or after 2016 matches the federal estate tax exemption of \$5.45 million. The estate tax rate begins at 8 percent of the excess over \$5.45 million and increases. The highest bracket is for estates worth more than \$11.45 million; the tax is equal to \$540,000 plus 12 percent of the excess over \$11,450,000. Prior to 2016, the lowest bracket began at 8 percent of the excess over \$2,000,000 and the highest bracket tax was \$540,000 plus 12 percent of the excess over \$8,000,000.¹⁷ Based only on Maine farm real estate values, at least 31 farms may be affected by the current state-level estate tax.¹⁸

A bill that would have eliminated Maine's estate tax died between houses in March 2016.¹⁹

⁹ USDA-ERS, *supra*, note 6.

¹⁰ The Connecticut estate tax law is at Conn. Gen. Stat. 12-391.

¹¹ These rates were last adjusted for decedents dying after January 1, 2010.

¹² 2012 Census of Agriculture, Volume 1, Chapter 1, State Level Data Table 46 (Connecticut).

¹³ H.B. 5024, Gen. Assem., Feb. Sess. (Conn. 2016); H.B. 5027, Gen. Assem., Feb. Sess. (Conn. 2016); S.B. 51, Gen. Assem., Feb. Sess. (Conn. 2016); S.B. 446, Gen. Assem., Feb. Sess. (Conn. 2016).

¹⁴ H.B. 5112, Gen. Assem., Feb. Sess. (Conn. 2016); S.B. 61, Gen. Assem., Feb. Sess. (Conn. 2016).

¹⁵ H.B. 5195, Gen. Assem., Feb. Sess. (Conn. 2016).

¹⁶ H.B. 5093, Gen. Assem., Feb. Sess. (Conn. 2016); H.B. 5221, Gen. Assem., Feb. Sess. (Conn. 2016).

¹⁷ The Maine estate tax law is at 36 M.R.S., part 6.

¹⁸ 2012 Census of Agriculture, Volume 1, Chapter 1, State Level Data Table 46 (Maine).

¹⁹ L.D. 1622, 127th Legislature, 2nd Sess. (Me. 2016).

Massachusetts

The Massachusetts estate tax applies to the gross value of estates higher than \$1 million per individual. The Massachusetts estate tax is a graduated tax with rates ranging from 0.8 percent to a maximum 16 percent. This structure has been in place since 2006.²⁰ Approximately 16% or 1,263 farms in the Commonwealth had a real estate value that exceed \$1 million in 2012, and therefore could potentially be subject to the estate tax.²¹

On January 25, 2016 the Massachusetts House of Representative's Committee on Revenue recommended passage of H. 3963 to amend estate tax valuation for farms. Under current law, Massachusetts estates may elect to use 2032A valuation for state estate tax purposes, subject to the substantive and procedural provisions of the federal code (including recapture). The legislation would allow farm estates to elect valuation either pursuant to 2032A or according to the values established by the state's farmland valuation advisory commission for the purposes of Chapter 61A, the Commonwealth's current use assessment program. This option would only be available for farm real estate meeting the eligibility definitions of 61A, and it need not actually be enrolled in the property tax program. When such land no longer meets the definition for current use assessment, the land would be subject to current use roll back taxes in the year it is disqualified as well as the preceding nine years.²² The Joint Committee on Environment, Natural Resources and Agriculture reported out similar language as part of its omnibus agricultural bill (S. 2171) on March 10th, 2016. Although this language was not included in the bill as passed by the Senate, House action is still pending.

H. 2489 would adjust the graduated brackets. Estates valued between \$0 and \$5 million would be subject to a ten percent estate tax. The highest bracket, for estates in excess of \$20 million would include a tax of \$2,250,000 plus 13 percent of the excess over \$20 million.²³

H. 2612 and S. 1478, introduced in 2015, would abolish the estate tax.²⁴

New Hampshire

There is no state estate or inheritance tax in New Hampshire and no bills or measures to enact such a tax are currently under consideration by the legislature.

Rhode Island

Rhode Island's farm real estate values are the highest in the nation.²⁵ Rhode Island also has a relatively low exemption level, meaning that Rhode Island residents are more likely to owe state estate tax than federal estate tax. Estates with values exceeding \$1.5 million are subject to Rhode Island's estate tax. Rhode Island has a progressive tax rate that applies to gross estates of \$1.5 million or more. Estates above the exemption are taxed at rates ranging from 0.8 to 16 percent. Rates increase by 0.8 percent in regular increments. The top rate of 16 percent applies to estates with a value in excess of \$10,040,000. This structure went into effect in 2015.²⁶ Prior to 2015

²⁰ The Massachusetts estate tax law is at M.G.L. c. 65c. See *A Guide to Estate Taxes*, Mass.gov, <http://www.mass.gov/dor/individuals/taxpayer-help-and-resources/tax-guides/estate-tax-information/estate-tax-guide.html> (last visited January 28, 2016).

²¹ 2012 Census of Agriculture, Volume 1, Chapter 1, State Level Data Table 46 (Massachusetts).

²² H. 3963, 189th Gen. Court (Mass. 2016). See H. 3507, 189th Gen. Court (Mass. 2016). Similar language was included in an initial version of the Senate omnibus agriculture bill (S. 2171), but was dropped from the Senate Ways and Means substitute bill (S. 2258). The Senate was in session at the time of publication.

²³ H. 2489, 189th Gen. Court (Mass. 2016).

²⁴ H. 2612, 189th Gen. Court (Mass. 2016); S. 1478, 189th Gen. Court (Mass. 2016).

²⁵ *Land Values 2015 Summary*, USDA (Aug. 2015).

²⁶ The Rhode Island estate tax law is at R.I.G.L. §§ 44-22-1 to -2.

the exemption was set at \$921,655. Like the federal government, the Rhode Island law allows the exemption to be adjusted annually for inflation.

More than 18 percent of the farms in Rhode Island – 232 farms—had farm real estate values in excess of \$1 million in 2012.²⁷ However, in 2013, Rhode Island enacted legislation that allows farmland to be assessed at current use value for estate tax purposes.²⁸ In doing, it likely reduced the number of farms subject to the state estate tax.

Rhode Island’s General Assembly is considering several measures relating to estate and transfer taxation in 2016. H.B. 7270 provides that estates must be taxed at a rate equal to the maximum federal exemption rate.²⁹ Another bill would raise the estate tax exemption to \$2,500,000.³⁰ H.B. 7463 establishes the portability of the estate tax credit and allows a deceased spousal unused credit against the state estate tax of a surviving spouse for the unused estate tax credit of the first spouse to die.³¹

Vermont

Vermont’s exemption level increased from \$2 million in 2011 to \$2.75 million per individual in 2016. The tax rate is calculated using marginal tax brackets that begin at 45% for estates in excess of \$2.75 million. The rate decreases to 9.6 percent for estates in excess of \$3.4 million. The rate then rises to 16 percent for estates valued in excess of \$10 million.³² Approximately 263 farms in Vermont had farm real estate values that exceeded \$2 million in 2012.³³

However, Vermont’s estate tax structure allows for a reduction for estates of farmers. Tax on Vermont estates that qualify for installment payments under 26 U.S.C. § 6166 as a farm business are eligible for a reduction equal to the portion of the estate comprised of farm assets.³⁴ For example, if the farm business makes up 50 percent of the federal adjusted gross estate, Vermont’s state estate tax will be reduced by 50 percent. To date, there is no data available indicating the frequency or rate this reduction has been used.

S. 55, passed by both houses on May 6, 2016, creates a flat rate of 16 percent on all taxable estates and requires a study of the impacts of bringing Vermont’s estate exclusion amount in line with the federal exclusion. (Prior versions of the bill would have increased the exclusion to match the federal exclusion as well as capped the rate at 16%.) The estate tax reduction for farmers is unaffected. The Governor had not taken action on the bill at the time of publication.³⁶

POLICY OPTIONS

Federal Options:

- Family Farm Estate Tax Relief Act of 2010 (H.R.5475): Although the federal estate tax special use valuation assessment allows agricultural land to be valued

²⁷ 2012 Census of Agriculture, Volume 1, Chapter 1, State Level Data Table 46 (Rhode Island).

²⁸ The Rhode Island law allowing farmland to be appraised at use value when calculating state estate tax is at R.I.G.L. § 44-23-5.

²⁹ H.B. 7270, 2016 Leg. Sess. (R.I. 2016).

³⁰ H.B. 2066, 2016 Leg. Sess. (R.I. 2016).

³¹ H.B. 7463, 2016 Leg. Sess. (R.I. 2016).

³² The Vermont estate tax law is at 32 V.S.A. §§ 7401-97.

³³ 2012 Census of Agriculture, Volume 1, Chapter 1, State Level Data Table 46 (Vermont).

³⁴ The statute authorizing the reduction is 32 V.S.A. § 7443.

³⁶ S. 55, Gen. Assem., 2015-16 Sess. (Vt. 2015). See

<http://legislature.vermont.gov/assets/Documents/2016/Docs/JOURNAL/sj160506.pdf>, pp. 2222-2227 and 2243 (accessed May 20, 2016).

at its agricultural use value, it limits the exemption to \$1.11 million. The Family Farm Estate Tax Relief Act of 2010 proposed eliminating the cap for use value assessment, retaining the recapture provision if the property or a portion is sold or ceases to be used for agriculture, and adding an adjustment of the recapture tax to reflect increases in the value of the farmland.

- American Farmland Trust (AFT) proposal: Expanding on H.R.5475, AFT has proposed additional changes beyond those in H.R.5475 that eliminate many of the eligibility restrictions for special use valuation assessment under Section 2032A. AFT is working to identify a bill sponsor. These include:
 - Remove the requirement that the property must pass from the decedent to a family member;
 - Remove language requiring that the decedent or a family member to have “materially participated” in the operation prior to the decedent’s death. Also eliminate language requiring surviving family members to continue to participate in the operation following the death of the decedent;
 - Eliminate the requirements to qualify for special use valuation. Under the current standard at least 50 percent of the value of the decedent’s estate must be dedicated to a qualified use;
 - Enlarge the recapture period from 10 years to 30 years. Amend the Internal Revenue Code to eliminate recapture on conservation easement sales. Permit property that has been subject to special use valuation under 2032A to be freely transferable without triggering recapture if the land continues to remain in the qualified use.

The policy changes outlined above are likely to reduce the number of New England farms subject to the federal estate tax, though the degree of impact is unclear. An analysis of how these changes might affect New England farms would be beneficial.

State Options:

Farmland protection advocates may want to consider advocating for these state policy “best practices” around estate taxes:

- In those states with no provision for current use assessment valuation of farmland-- Connecticut, Massachusetts and Maine—consider amending state law to allow. This would be a higher priority in Connecticut and Massachusetts because of their relatively low estate tax exemption levels as well as their high farm real estate values. Legislation to do so has been introduced in both Massachusetts and Connecticut.
- In states that allow current use valuation for farmland, and where state law currently adopts the limitations contained in IRC Section 2032A, consider the changes to Section 2032A that American Farmland Trust has proposed:
 - Eliminate any recapture on conservation easement sales;
 - Remove the requirement that the property must pass from the decedent to a family member;
 - Permit property that has been subject to special use valuation to be freely transferable without triggering recapture if the land continues to remain in agriculture. This may require an extension of the look-back provision;
 - Remove language requiring that the decedent or a family member have “materially participated” in the operation prior to the decedent’s death. Also

- eliminate language requiring surviving family members to continue to participate in the operation following the death of the decedent;
 - Reduce or eliminate the estate value threshold to qualify for special use valuation. Under the current standard at least 50 percent of the value of the decedent's estate must be dedicated to a qualified use.
- For estates that are subject to state estate taxes, consider allowing installment payments as is allowed under federal law.
- Consider variations on Pennsylvania's estate tax approach. Pennsylvania exempts land used for farming purposes from estate tax entirely as well as other agricultural real estate, including buildings, if certain criteria are met. Criteria include requirements that the property must transfer within the family, the agricultural operation must continue for at least seven years following the death of the decedent, and the farm business must gross at least \$2,000 in annual income during that seven-year period. While Pennsylvania's framework might be improved for New England states by including recapture based on the exempted value of farmland that is subsequently taken out of agriculture, as well as provision for transfer out of the family to unrelated farmers, the expansion of the exemptions to include all farmland as well as buildings and other farm assets under a second tier of criteria could offer a valuable approach for additional estate tax relief.

Given the potential impact on New England farms and farmland, policy alternatives such as these may help ensure that farm transitions keep land in agriculture and farm businesses thriving.

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