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Do Family Farms Need More Estate Tax Breaks?

Pre-Bush Tax Rules Are Well Designed to Protect Farms

The failure of a procedural vote this week in the U.S. Senate means that Republican efforts to make permanent the Bush administration's 2001 estate tax cuts have failed—for the moment. If nothing else is done, in 2011 the federal estate tax cuts pushed through by Bush will expire. Will the resulting "pre-Bush" estate tax be sufficiently generous to American family farms? This CTJ issue brief evaluates the special estate tax breaks for farmers that existed before the 2001 Bush tax cuts were enacted—and will exist again in 2011 if the Bush tax cuts are allowed to expire as currently scheduled.

Estate Tax Breaks Available to Family Farms

Opponents of the estate tax frequently assert that avoiding the destruction of family farms is one of their primary goals in repealing the tax. As Senator Jon Kyl (R-AZ) said yesterday, "the special interests we're trying to protect here are the family-owned businesses, the family farms." But Congress has enacted a variety of generous targeted tax breaks for family farms over the past thirty years.

- For most decedents, the taxable value of an estate is based on its market value; a home that is worth $1 million is valued, for estate tax purposes, at $1 million. But for farm estates, a much more generous measure of value is used. Farm properties can be valued according to their "**current use" as farmland**, which is typically much lower than its value for sale or development purposes. The reduction in taxable value due to the current use break is capped at $900,000 in 2006. This amount is adjusted upwards annually for inflation, so by 2011 this provision will likely shelter more than $1 million of farm value from tax.
- Farm estates are allowed the same **basic exemption** that is available to non-farm estates. In 2006, the first $2 million of an estate's value ($4 million for married couples) is exempt. In 2011, the exemption will fall back to $1 million ($2 million for couples). The basic exemption is not indexed for inflation, so the $1 million exemption will be worth less in 2011 than it would be today.
- Farms can also receive an **extra exemption** on top of this basic exemption. If a working family farm comprises at least half the value of an estate, an extra $300,000 exemption is available in 2011. This amount is also not indexed for inflation.
- For farms that incur some estate tax liability despite these special tax breaks, heirs are given an **extended grace period** to pay the tax. For most estates, taxes are due nine months after a death; for qualifying farm estates, decedents are given a four-year grace period (although interest is charged for the first four years, with a 2 percent interest rate applying to the first $1 million of taxable value), and then can pay the remaining tax bill over a period of ten years—giving heirs of taxable farm estates 14 years to pay the tax.

Reform Options

The tax breaks described above are narrowly targeted to ensure that family farms will receive tax breaks unavailable to the very wealthiest estates. The estate tax cuts signed into law by President Clinton as part of the Taxpayer Relief Act of 1997 made these tax breaks more generous—but some of these breaks are becoming less valuable each year due to the impact of growing real estate prices and inflation.

- When the Bush tax cuts expire in 2011, the $1 million basic exemption will be worth less than $875,000 in today's dollars.
- The extra exemption for family farms will be worth only $260,000 in today's dollars by 2011.

Increasing the basic exemption to roughly $1,150,000 starting in 2011, and indexing the exemption for inflation in future years, would ensure that the basic exemption remains as valuable as Congress intended when it increased the exemption in 1997. (The 1997 law gradually increased the exemption to $1,000,000 starting in 2006.) The extra exemption for family farms could also be increased and indexed; setting the 2011 additional family farm exemption at $430,000 would restore the original value of this important tax break. These changes would leave the combined exemption for a farm in 2011 at almost $1.6 million.

Estate Tax Exemptions Under Pre-Bush Law

	2006	2011	2011 if Indexed
Basic	$1 million	$1 million	$1,150,000
Extra Farm Exemption	$300,000	$300,000	$430,000
Total	$1.3 million	$1.3 million	$1,580,000

The federal estate tax was designed to restrain the rampant growth of wealth inequality in this country—and the array of special tax breaks for family farms that existed before President Bush took office are well designed to ensure that the estate tax applies primarily to a small number of the very wealthiest estates rather than family farms. Modest modifications of these tax breaks (rather than wholesale repeal of the estate tax) before 2011 would help ensure that family farms would remain largely sheltered from the estate tax—while keeping the cost of estate tax reform at a manageable level.

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