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Toward a Permanent Solution: An Investigation of Ways to Protect Family Farms From the Estate Tax

*Joseph G. Kenny**

Introduction

Since its founding, the United States has been a nation of farmers. In colonial days, farm families grew corn, wheat, and tobacco and raised cattle and hogs.¹ These family farmers have developed an admirable lifestyle of hard work, close family ties, and community living. Indeed, people operating family farms have unique moral attributes prized by society and judged by many to be worth subsidizing to preserve.² Labor on family farms has provided a growing nation with sustenance, while adding value to the economy and bringing a pleasant and wholesome aesthetic to America's rural countryside. In fact, a recent Cornell University survey found that "the stated non-economic benefits of agriculture were wide-ranging, including preserving open space (for wildlife and bucolic views), providing a buffer to development, providing a local source of fresh food, and preserving a highly valued heritage and its traditions."³

The diminishing number of family farms in the United States is an issue of major concern for politicians, civilians, environmentalists and farmers alike.⁴ Financial woes are the most likely cause of the decline in the number of family farms in the United States, particularly through

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¹ *Virginia's Natural Resources Education Guide*, VA. DEPT. OF ENVTL. QUALITY, 11.0 (Mar. 3, 2012), <http://www.vanaturally.com/vanaturally/guide/chapter1.pdf>.

² Luther Tweeten, *Overview of U.S. Agricultural Policy* 5, http://aede.ag.ohio-state.edu/programs/anderson/papers_old/Overview%20of%20US%20Agricultural%20Policy.pdf

³ Duncan L. Hilchey, Gilbert W. Gillespie, Jr., David L. Kay, & R. David Smith, *The Impact of Agriculture: It's More Than Economic*, RURAL N.Y. MINUTE. (Cornell Univ., Ithaca, N.Y.), April 2008, available at <http://cals.cornell.edu/cals/devsoc/outreach/cardi/publications/loader.cfm?csModule=security/getfile&PageID=2333> 15.

⁴ See generally STEPHEN CARPENTER, *THE RELEVANCE OF FAMILY FARMS TODAY*, (2006).

price competition with larger and more efficient farms.⁵ Small American family farms face serious competition from larger commercial farms, imported crops, and increased operating costs.⁶ Some believe family farmers can not compete in the current marketplace, and that modern economic efficiency requires farmers to leave—the phrasing often used is ‘to be released from’—agriculture.⁷ In addition to competition from larger farms, others argue that these family farms are adversely impacted by the financial burdens of the federal estate tax, which imposes a tax based on the value of all assets held by a decedent.⁸

There has been a historic protest about the impact of the estate tax on family farms, which suggests that the tax is so burdensome as to require the sale of such farms to satisfy tax obligations.⁹ Tales of farms being subdivided and sold to pay estate taxes are presented in the media.¹⁰ Despite this outcry, the current estate tax laws are likely adequate to protect small family farms.¹¹ Going forward, the best way to aid family farms is to maintain the existing \$5 million individual and \$10 million married couple’s exemption with an annual inflation adjustment, and permit deferral of tax liability for family farms valued at more than the exemption amount.

This Note will focus on how to prevent the continued decline in the number of active family farms in the United States through the minimization of estate tax on such farms. It will consider the impact of the estate tax on family farms and examine past proposals for relief. It will identify two existing legislative solutions for relief, namely H.R. 390 and H.R. 1593, which are

⁵ *Id.* at 8.

⁶ *Id.* at 8.

⁷ *Id.* at 6.

⁸ CONG. BUDGET OFFICE, EFFECTS OF THE FEDERAL ESTATE TAX ON FARMS AND SMALL BUSINESSES (2005) at Preface.

⁹ *Id.*

¹⁰ Paul Wenger, *Farmer stories reveal estate-tax impact*, THE BUSINESS JOURNAL, Aug. 27, 2010.

¹¹ I thank Prof. John Coverdale for this observation; Interview with John Coverdale, Professor of Law, Seton Hall Law School (Oct. 4, 2011).

before the current Congress. In addition, this Note will discuss the current state of the estate tax law on this issue and propose a permanent solution which protects family farms from the estate tax.

Part I of this Note will present the history and background of this dilemma with an emphasis on the significance of family farms. Part II will discuss several historical proposals for relief, and Part III will explain the current state of the law on this matter. Part IV consists of an analysis and recommendation for a permanent solution to this debate, specifically the maintenance of the current \$5 million/\$10 million exemption with an annual inflation adjustment.

Part I – History and Background

America's foundation as an agricultural nation is rooted in the early existence of family farms. During colonization, citizens acquired land and built their lives around establishing small farms. The family farm was the cornerstone of the agricultural landscape in the United States of America and it reflected a lifestyle based on beliefs and traditions about living and working.¹² In addition to serving as a foundation of the earliest American economy, in early American culture the pastoral was a repository of order, beauty, and humane society.¹³ Some suggest that modern family farms make sense in terms of the overall well-being of the family, and thus family farms are directly related to the well-being of society.¹⁴

¹² Mieke Calus and Guido Van Huylenbroeck, *The Persistence of Family Farming: A Review of Explanatory Socio-economic and Historical Factors*, 2010 J. OF COMP. FAM. STUD. 639, 640.

¹³ Carpenter, *supra* note 4, at 18.

¹⁴ JOHN IKERD, SUSTAINING THE FAMILY FARM para. 19, (2006), <http://web.missouri.edu/~ikerdj/papers/Lethbridge-Family%20Farms.htm>.

Defining Family Farm

Individuals, family partnerships, and family corporations own ninety-eight percent of America's two million farms and ranches.¹⁵ While many of these are small, local operations, many of the nation's largest farms are also family owned.¹⁶ It is estimated that large scale family farms account for ten percent of all farms and seventy-five percent of agricultural production in the United States.¹⁷ Other sources suggest that large scale family farms account for twelve percent of United States farms, but eighty-four percent of the value of production.¹⁸

There is some difficulty in defining a family farm.¹⁹ Although the term 'family farm' is broadly defined, for purposes of this Note, the term refers to an active agricultural operation owned primarily by members of a family unit who are involved in the daily work of the farm. This description is made while acknowledging that there is no hard and fast definition of the family farm.²⁰ Further compounding this definitional difficulty is the fact that any definition would have to account for the varying characteristics of family farms.²¹ Such family farming operations are quite common in the United States, although their numbers are in decline.²² It is estimated that small family farms made up eighty-eight percent of United States farms in 2007.²³ This number has remained relatively consistent in recent years, as the 1997 Census of

¹⁵ AMERICAN FARM BUREAU FEDERATION, TAXES - ESTATE TAX REFORM (2012), <http://www.fb.org/issues/docs/estatetax12.pdf>.

¹⁶ David E. Banker & Robert E. Hoppe, UNITED STATES DEPARTMENT OF AGRICULTURE ECONOMIC RESEARCH SERVICE, STRUCTURE AND FINANCES OF U.S. FARMS: FAMILY FARM REPORT i (2010).

¹⁷ CENTER FOR SUSTAINABLE SYSTEMS AT UNIVERSITY OF MICHIGAN, U.S. FOOD SYSTEM, http://css.snre.umich.edu/css_doc/CSS01-06.pdf.

¹⁸ Banker and Hoppe, *supra* note 16.

¹⁹ *Id.* at 2.

²⁰ *Id.* at 2.

²¹ Alex E. Snyder, Note, *Saving the Family Farm Through Federal Tax Policy: Easier Said than Done*, 62 WASH. & LEE L. REV. 729, 775 (2005).

²² Carpenter, *supra* note 4, at 6.

²³ Banker & Hoppe, *supra* note 16, at iv.

Agriculture suggested ninety percent of American farms were run by families and individuals.²⁴ Such farms account for approximately sixteen percent of agricultural output, but made more significant contributions to the production of specific commodities such as hay, tobacco, cash grains and soybeans, and beef cattle.²⁵

In essence, these small family farms struggle to produce goods, but those goods which are produced are particularly important commodities which would otherwise be under-produced. For example, small farms account for twenty-three percent of the value of production of cash grains and soybeans, and fifty-one percent of hay in the United States.²⁶ They likewise produce thirty-four percent of the nation's tobacco and twenty-two percent of beef.²⁷ Without the production contributions of these small farms, these items would be in short supply.²⁸

The United States Department of Agriculture defines family farms for loan purposes and mandates that such farms must produce agricultural commodities for sale in such quantities so as to be recognized in the community as a farm and not a rural residence.²⁹ Furthermore, that definition requires that the farm produce enough income to pay family and farm operating expenses, pay debts and maintain the property.³⁰ In addition, the farm must be managed by the operator and have a substantial amount of labor provided by the operator and his family, though reasonable use of seasonal and other labor is permitted.³¹ As an alternative definition, the Department of Agriculture's Economic Research Service suggests a "family farm" is any farm

²⁴ United States Environmental Protection Agency, *Ag 101: Demographics*, AGRICULTURE, <http://epa.gov/agriculture/ag101/demographics.html>.

²⁵ Banker & Hoppe, *supra* note 16, at iv.

²⁶ *Id.* at 6.

²⁷ *Id.*

²⁸ See generally Banker & Hoppe, *supra* note 16.

²⁹ 7 U.S.C. § 1941.4 (2006); 7 U.S.C. § 1943.4 (2006).

³⁰ *Id.*

³¹ *Id.*

organized as a sole proprietorship, partnership, or family corporation.³² Family farms are closely held and controlled by their operator and the operator's household.³³

Decline in the Number of American Farms

The past century has seen tremendous decline in the number of farms in the United States.³⁴ After peaking at 6.8 million in 1935, the number of American farms has fallen steadily.³⁵ The past decade reflects this decline; from 2.1 million farms in 2002 to approximately 2.08 million in 2007.³⁶ An alarming statistic suggests that “the country was losing roughly 30,000 farms a year....”³⁷

The reasons for the declining number of American farms vary.³⁸ Growing productivity, farm consolidation, and farm operators leaving the industry are cited as some of many reasons for this decline.³⁹ In addition, there is extensive evidence that small family farms can not compete with larger commercial farms and agribusiness.⁴⁰ In particular, large corporations have gained increasing dominance over agricultural inputs and outputs.⁴¹ In sum, agriculture in the United States has changed from a system of small and independent producers to a technologically advanced, corporation-dominated, and globally-oriented system of food production.⁴²

³² United States Department of Agriculture Economic Research Service, *Farm Structure: Glossary*, THE ECONOMICS OF FOOD, FARMING, NATURAL RESOURCES, AND RURAL AMERICA, <http://www.ers.usda.gov/briefing/farmstructure/glossary.htm#familyfa>.

³³ *Id.*

³⁴ Banker & Hoppe, *supra* note 16, at 4.

³⁵ *Id.*

³⁶ Christopher Doering, *U.S. farms decline in 2007 to 2.08 mln.*, REUTERS (Feb. 1, 2008), <http://www.reuters.com/article/2008/02/01/us-usa-farms-usda-idUSN0123218120080201>.

³⁷ Carpenter, *supra* note 4, at 6.

³⁸ See generally, Banker & Hoppe, *supra* note 16, at 4.

³⁹ See Banker & Hoppe, *supra* note 16, at 4.

⁴⁰ Carpenter, *supra* note 4, at 6.

⁴¹ Snyder, *supra* note 21, at 737.

⁴² *Id.* at 777.

Some critics contend that estate taxation plays a significant role in the decline in the number of family farms in the United States because without prudent estate planning, many farm families will be forced to sell the land in order to pay the estate taxes due.⁴³ American Farm Bureau President Bob Stillman argues, “when Uncle Sam comes to pay his respects, surviving family members without enough cash on hand may be forced to sell land, buildings or equipment that they need to keep their operations going.”⁴⁴ This statement reflects the Economic Research Service’s opinion that much of the net worth of farm households is illiquid and not easily available to spend for consumption because it is largely based on assets necessary to continue farming.⁴⁵

At the death of the farm owner, heirs are required to pay estate tax on the value of this illiquid asset, which can be difficult or impossible without additional liquid assets.⁴⁶ Some argue that the estate tax places such a significant burden on farm heirs that it requires the liquidation of the farm property to pay estate taxes.⁴⁷ While the prevalence of this scenario is disputed, there remains a call for exclusion of farmland from the estate tax valuation.⁴⁸

Controversy over the impact of the estate tax

The estate tax has existed in various forms in American history since 1787.⁴⁹ In its earliest form, the estate tax was a stamp tax on wills admitted for probate in order to pay for

⁴³ Lori Lynch, *Farmland Preservation: An Estate Planning Tool*, UNIVERSITY OF MARYLAND COOPERATIVE EXTENSION, 1, available at <http://extension.umd.edu/publications/pdfs/fs779.pdf>

⁴⁴ Jason Vance, *Press Conference Urges Estate Tax Reform*, OHIO FARMER, (Nov. 30, 2010), <http://ohiofarmer.com/story.aspx/press/conference/urges/estate/tax/reform/44283>.

⁴⁵ Banker & Hoppe, *supra* note 16, at 32.

⁴⁶ See generally IRC § 2033 (2006); An illiquid asset is one which is not easily converted into cash.

⁴⁷ Wenger, *supra* note 10; CONG. BUDGET OFFICE, *supra* note 8.

⁴⁸ See generally, Family Farm Preservation and Conservation Estate Tax Act, H.R. 390, 112th Cong. (2011); see also, Farmland Preservation and Land Conservation Act of 2011, H.R. 1593, 112th Cong. (2011).

⁴⁹ Stephanie A. Weber, Note, *Rethinking the Estate Tax: Should Farmers Bear the Burden of a Wealth Tax?*, 9 ELDER L.J. 109, 112-113 (2001).

military expenses in defending against the French.⁵⁰ Despite major changes, several constitutional challenges, and periods of elimination, a variation of the estate tax remains in effect and in controversy today.⁵¹ There have been fluctuating rates of taxation which have varied between eighteen percent and seventy-seven percent since the inception of the tax.⁵²

Some critics claim that the tax has a particularly adverse impact on family farms. Political advocacy groups and think tanks suggest that the impact is large.⁵³ The American Farm Bureau fairly asserts that the frequent changes in estate tax policy make it difficult for farmers to plan ahead to minimize the tax's impact.⁵⁴ Furthermore, some suggest that the estate tax actually costs taxpayers more than the stated amount because of the need for complex estate planning used to circumvent the tax.⁵⁵ The Maryland Cooperative Extension makes clear that "without good estate planning, many farm families will be forced to sell the land in order to pay the estate tax."⁵⁶

In response to speculation that the estate tax had a disparate impact on farms, there have been several government studies and publications which examine this issue. In 2005, the Congressional Budget Office issued a paper entitled "Effects of the Federal Estate Tax on Farms and Small Businesses."⁵⁷ Also, the Economic Research Service regularly publishes a report entitled "Structure and Finances of U.S. Farms: Family Farm Report."⁵⁸ Generally, these reports

⁵⁰ Mary R. Wampler, Note, *Repealing the Federal Estate Tax: Death to the Death Tax or Will Reform Save The Day?*, 25 SETON HALL LEGIS J. 525, 529 (2001).

⁵¹ See generally, Weber, *supra* note 49.

⁵² See Weber, *supra* note 49, at 531-532.

⁵³ Lynch, *supra* note 43.

⁵⁴ *Supra* note 15.

⁵⁵ Wampler, *supra* note 50, at 535.

⁵⁶ Lynch, *supra* note 43.

⁵⁷ See CONG. BUDGET OFFICE, *supra* note 8.

⁵⁸ See Banker & Hoppe, *supra* note 16.

suggest a minimal impact on family farms because of the estate tax.⁵⁹ For example, the Congressional Budget Office's paper explains that in recent years, fewer than 2% of all estates nationwide had to pay any estate tax at all.⁶⁰ Of those, farm land has comprised only 2.5% of total gross estate assets.⁶¹ While this report intentionally does not state a conclusion so as to remain unbiased, the statistics therein suggest that small farms are rarely impacted by the estate tax and as such, the allegations are unfounded. This conclusion is representative of the controversy on this issue: some groups assert a large agricultural impact via the estate tax while others suggest that the tax has little, if any effect.

Part II – Past Theories for Relief

Regardless of the veracity of the idea that the estate tax has a significant impact on family farms, there have been several proposals throughout history which attempted to shield family farms from estate tax liability.⁶² Some plans advocate deferral, exemption, or even total repeal of estate tax liability for family farms. The existence of these proposals and their continued significance today suggests that the estate tax's impact on agriculture remains a salient and divisive issue in American tax policy. The discourse on this issue has manifested into a variety of plans and proposals, few of which have been effectively implemented.

⁵⁹ *Id.*

⁶⁰ CONG. BUDGET OFFICE, *supra* note 8, at vii.

⁶¹ *Id.*

⁶² See generally, Family Farm Preservation and Conservation Estate Tax Act, H.R. 390, 112th Cong. (2011); See also, Farmland Preservation and Land Conservation Act of 2011, H.R. 1593, 112th Cong. (2011); See also *infra* "President Ford's Deferral Proposal in the 1970s"; See also *infra* Sen. Birch Bayh's exemption plan; *infra* Article - Saving the Family Farm Through Federal Tax Policy: Easier Said Than Done; See also *infra* Total Repeal of the Federal Estate Tax.

President Ford's Deferral Proposal in the 1970s

In an attempt to secure the “farm vote” in 1976 reelection, President Gerald Ford supported a change in estate tax law which would permit deferral of estate tax liability on family farms or five years after the owner’s death.⁶³ Once payment obligations began, payment could be made over twenty years at four percent interest.⁶⁴ The rationale behind this plan was to give farm heirs the opportunity to stabilize farm finances before being faced with burdensome estate tax payments. This proposal was intended to apply to all estates worth \$300,000 or less with a twenty percent share or greater in a farm or small business.⁶⁵

Sen. Birch Bayh's Exemption Plan

In contrast to President Ford’s proposal, Democratic candidate Senator Birch Bayh developed his own solution to the agricultural estate tax dilemma in 1976.⁶⁶ Bayh proposed exemption of the first \$200,000 of estates for those who “inherit family farms that were controlled by the deceased for the last 10 years.”⁶⁷ Bayh’s plan attempted to excuse family farms from estate tax liability based solely on their value.⁶⁸

This sort of blanket exemption is not dissimilar to the contemporary \$5 million exemption for individuals and the \$10 million exemption for married couples. However, Bayh’s plan was distinct from the current exemption in that it acknowledged the need for special

⁶³ *Taxes: Saving the Family Farm*, TIME, Jan. 19, 1976.

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *See Taxes: Saving the Family Farm*, TIME, Jan. 19, 1976.

protection of inherited family farms.⁶⁹ The current exemption makes no special provision for family farms over other estate assets.⁷⁰

H.R. 390 - Family Farm Preservation and Conservation Estate Tax Act

The debate over the estate tax as it affects agriculture lingers today, as demonstrated by 2011 legislation drafted by Congressman Mike Thompson (D-CA). The Family Farm Preservation and Conservation Estate Tax Act, known as H.R. 390, proposes a total exemption of all family farmland from the estate tax valuation and thus a total exclusion of family farms from estate tax liability.⁷¹ The stated purpose of the bill is to amend the Internal Revenue Code of 1986 to provide an exclusion from the gross estate for certain farmlands and lands subject to qualified conservation easements, and for other purposes.⁷² In addition, the bill imposes a recapture tax, such that any tax benefits are negated if the family farm were to fall out of family control or to cease being used as a farm.⁷³

Congressman Thompson advocates for this bill by saying

The estate tax as it is currently written unfairly burdens our family farmers. When farms pass from generation to generation, too often families have to sell the farm to developers in order to pay the estate taxes. We need to preserve our agricultural land and open space, which is why I introduced this legislation to fix the tax code.⁷⁴

⁶⁹ *Id.*

⁷⁰ *See* IRC § 2033.

⁷¹ Family Farm Preservation and Conservation Estate Tax Act, H.R. 390, 112th Cong. (2011).

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Thompson Introduces Estate Tax Relief Bill*, U.S. CONGRESSMAN MIKE THOMPSON, <http://mikethompson.house.gov/News/DocumentSingle.aspx?DocumentID=204118>.

It should be noted that Congressman Thompson proposed a similar bill in the 2010 Congress, which was then known as H.R. 5475, which was referred to the House Subcommittee on Health but never reached the floor of Congress for a vote.⁷⁵

Thompson's plan for exemption itself combines elements of the Ford and Bayh plans to offer family farms a blanket exemption from federal estate taxation. Like these proposals, it is directly focused on farmland. However, the Thompson plan gives no consideration to value and instead exempts all family farmland regardless of the value.⁷⁶ This exemption applies to estates wherein the decedent was a citizen of the United States, and during the eight years prior to the decedent's death there were periods aggregating five years or more in which the qualified farmland was owned by the decedent or a member of the decedent's family and there was material participation by the decedent or a member of the decedent's family in the operation of such farmland.⁷⁷ While such an exemption sounds particularly useful to family farms, this Note will address the notion that a similar benefit is provided by the current estate tax exemption.⁷⁸

The bill's exemption for conservation land is also quite beneficial. Small farms account for eighty-two percent of the land controlled by the Conservation Reserve Program and Wetlands Reserve Program, so the impact of this provision for family farms is substantial.⁷⁹ This portion of the bill modifies the definition of a qualified conservation easement to permit "de minimis use for a commercial activity."⁸⁰ Such terminology is meant to permit small fishing or hunting enterprises to exist on conservation land and family farms while still preserving the estate tax

⁷⁵ Gillian Brunet & Chye-Ching Huang, *Unlimited Estate Tax Exemption for Farm Estates is Unnecessary and Likely Harmful*, CENTER ON BUDGET AND POLICY PRIORITIES, <http://www.cbpp.org/cms/index.cfm?fa=view&id=3223>.

⁷⁶ See Family Farm Preservation and Conservation Estate Tax Act, H.R. 390, 112th Cong. (2011).

⁷⁷ *Id.*

⁷⁸ *Infra*, part IV.

⁷⁹ Banker & Hoppe, *supra* note 16, at 7.

⁸⁰ Family Farm Preservation and Conservation Estate Tax Act, H.R. 390, 112th Cong. (2011).

benefits for this land. Fishing, hunting, and other recreational enterprises on family farms have come to be called ‘agritourism’ and often provide a valuable source of revenue for farm families.⁸¹ Over the last several decades, families have begun to invite tourists onto their farms for profit.⁸²

The final portion of H.R. 390 imposes a recapture tax should the land cease to be used as a family farm.⁸³ While this provision appears as a penalty, it also works to prevent fraud and abuse of this proposed provision. The language of the bill imposes this tax “if the qualified heir disposes of any interest in qualified farmland (other than by disposition to a member of his family) or the qualified heir ceases to use the real property which was acquired (or passed) from the decedent as a farm for farming purposes...”⁸⁴ This recapture tax is in the amount of the larger of the tax which would have been due if the qualified farmland was not so used, or the tax imposed by Section 2001 reduced by any credits.⁸⁵ It should be noted that Section 2001 enumerates and imposes the progressive estate tax rates based on the value of the gross estate.⁸⁶

There could be some danger in the bill’s total exclusion of “family” farmland from the estate valuation, however. For example, such legislation could encourage fraudulent tax shelters for the wealthy, who would be wise to purchase qualifying farm land as a means of protecting assets from estate tax. An article published by the Center on Budget and Policy Priorities suggests that “wealthy individuals whose primary occupation is *not* farming [would have a] strong incentive to sell financial assets and buy up large tracts of farmland in order to avoid

⁸¹ See generally, Anne Chesky, *Can Agritourism Save the Family Farm in Appalachia? A Study of Two Historic Family Farms in Valle Crucis, North Carolina*, 15 J. OF APPALACHIAN STUD. 87 (2009), available at http://www.appalachianstudies.org/jas/pdf/ASA_TOC_JAS15-1and2.pdf.

⁸² *Id.* at 87.

⁸³ Family Farm Preservation and Conservation Estate Tax Act, H.R. 390, 112th Cong. (2011).

⁸⁴ *Id.*

⁸⁵ *Id.*

⁸⁶ IRC § 2001.

paying the tax.”⁸⁷ Furthermore, it is alleged that the total lost federal revenue from this proposal, if enacted, would be approximately \$4.2 billion.⁸⁸ The Joint Committee on Taxation estimated a similar bill from the previous Congress as costing \$4.2 billion over ten years.⁸⁹

Critics of H.R. 390 also point out that the bill’s unlimited exemption for farm land could also harm ordinary farmers by increasing the cost of purchasing farm land.⁹⁰ If the wealthiest Americans began buying up farm land to take advantage of the tax exemption, the increased demand would lead to higher prices, making it more difficult for aspiring farmers to acquire land to begin farming and putting pressure on cash-strapped small farmers to sell.⁹¹

H.R. 1593 - Family Farm Preservation and Conservation Estate Tax Act

The importance of the estate tax as it affects agriculture is further demonstrated by the existence of a second contemporary proposal for relief. The Farmland Preservation and Land Conservation Act of 2011, known as H.R. 1593, is a bipartisan proposal by Representative Tim Bishop (D-NY) and Representative Richard Hanna (R-NY).⁹² The stated purpose of this bill is to amend the Internal Revenue Code of 1986 to allow an unlimited exclusion from transfer taxes for certain farmland and land of conservation value, and for other purposes.⁹³

Like H.R. 390, this bill proposes a deduction from the gross estate for the value of qualified farmland and/or land subject to a conservation easement.⁹⁴ Also, as seen in H.R. 390, H.R. 1593 proposes a recapture tax with interest on the value of this land upon cessation of use

⁸⁷ Brunet and Huang, *supra* note 75, (emphasis in original).

⁸⁸ Estate Tax Reform and Land Conservation, LAND TRUST ALLIANCE, <http://www.landtrustalliance.org/policy/tax-matters/campaigns/estate-tax-reform-and-land-conservation>.

⁸⁹ Estate Tax Reform and Land Conservation Fact Sheet, LAND TRUST ALLIANCE, (Land Trust Alliance), *available at* <http://www.landtrustalliance.org/policy/tax-matters/campaigns/estate-tax-reform-and-land-conservation>.

⁹⁰ Brunet and Huang, *supra* note 75.

⁹¹ *Id.*

⁹² Farmland Preservation and Land Conservation Act of 2011, H.R. 1593, 112th Cong. (2011).

⁹³ *Id.*

⁹⁴ *Id.*

as a farm.⁹⁵ In addition to these provisions, H.R. 1593 also exempts from gift tax liability any pre-death transfer of qualified farm land or conservation land.⁹⁶ Although this bill is largely similar to H.R. 390, its proposal is further evidence of the lingering concern about the effect of the estate tax on family farms. The existence of so many legislative attempts to resolve this problem is a testament to significant burden which the estate tax places on family farms.

Article - Saving the Family Farm Through Federal Tax Policy: Easier Said Than Done

Another theory for relief appears in an article in the 2005 Washington and Lee Law Review.⁹⁷ After examining the current tax policy, and considering the state of family farms, this article proposes a solution to the estate tax dilemma using a farmland exception as seen in H.R. 390 and H.R. 1593.⁹⁸

The article advocates for an increased exemption amount which would shield family farms from liability without the need for a provision specifically excluding farmland.⁹⁹ The author expresses concern about a complete exemption of farm land, as it could lead to incentives and bias toward larger farms, with such farms taking advantage of benefits intended for small family farms.¹⁰⁰ The article makes clear “Congress should settle on an exemption level that eliminates estate tax liability for small farm estates but continues to subject wealthier estates to the tax.”¹⁰¹

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ Snyder, *supra* note 21.

⁹⁸ *Id.* at 780.

⁹⁹ *Id.* at 775-776.

¹⁰⁰ *Id.* at 775.

¹⁰¹ *Id.* at 776.

Total Repeal of the Federal Estate Tax

Some advocate for a total repeal of the federal estate tax.¹⁰² It has been suggested that a repeal of the death tax would lead to a 2.26 percent increase in gross domestic product (\$538 billion) by 2021 as a result of spurred economic growth.¹⁰³ Of course, such repeal would also negate any issues as to the estate tax's impact on agriculture. However, scholars and economists alike acknowledge that this policy would cause an untenable decrease in American tax revenue and also have negative ramifications on charitable organizations.¹⁰⁴ A repeal of the estate tax could reduce the number of people who donate their estate assets to charity in order to receive the charitable deduction from the gross estate.¹⁰⁵ Indeed, some believe that legislation allowing the permanent repeal of the federal estate tax would cost almost \$1.3 trillion over the first ten years of enactment.¹⁰⁶

Part III – Current state of the law and provisions which benefit family farms

The provisions of the federal estate tax are codified at IRC § 2033. As this section explains, “The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.”¹⁰⁷ For purposes of estate tax calculations, assets are valued based on current market value and their highest and best use at the

¹⁰² Wampler, *supra* note 50.

¹⁰³ Stephen J. Entin & Dick Patten, *To Reduce the Deficit, Kill the Estate Tax*, FORBES (Oct. 25, 2011 5:16 PM), <http://www.forbes.com/sites/realspin/2011/10/25/to-reduce-the-deficit-kill-the-estate-tax/>.

¹⁰⁴ Wampler, *supra* note 50.

¹⁰⁵ Wampler, *supra* note 50, at 541.

¹⁰⁶ The Estate Tax: Myths and Realities, (Center on Budget and Policy Priorities), Feb. 23, 2009, *available at* <http://www.cbpp.org/files/estatetaxmyths.pdf>.

¹⁰⁷ IRC § 2033.

time of the decedent's death.¹⁰⁸ Estates are then progressively taxed on the sum of the value of all included assets at rates ranging from eighteen percent to fifty-five percent in 2011.¹⁰⁹ The mechanics of this provision are typically effectuated by an executor who, with professional assistance from attorneys and accountants, evaluates all assets and liabilities to determine the value of the gross estate.¹¹⁰ Tax payments are typically made from estate assets, rather than through income tax payments by the heirs.¹¹¹

Special Valuation under IRC §2032A

Despite the valuation terms of IRC § 2033, IRC § 2032A includes special valuation provisions.¹¹² This section alters the valuation method for active farmland and other businesses by calculating from the "current use" value which is typically much lower than the market value which would be used otherwise.¹¹³ The market value method creates some problems for farm estates, because farmland typically comprises the bulk of the value of a family farm estate, and the highest and best use valuation may make such estates very large in nominal terms.¹¹⁴ In areas facing increased development, the highest and best use value might be for real estate development, which would be significantly higher than the use value as a farm.¹¹⁵ Instead, qualified farmland is valued under the "current use value" method of this section, and taxed on

¹⁰⁸ See generally, Leah LaPorte, Note, *Keeping the Farm: Estate Tax Deferral and Closely Held Business Owners*, 41 COLUM. J.L. & SOC. PROBS. 177, 180-181 (2007).

¹⁰⁹ IRC § 2001(c)(1) (2000).

¹¹⁰ See generally, LaPorte, *supra* note 108, at 180-181.

¹¹¹ See The Executor's Role, FINDLAW, available at http://estate.findlaw.com/probate/probate-help/le28_8_1.html.

¹¹² IRC § 2032A.

¹¹³ Martha Eller Gangi & Brian G. Raub, *Utilization of Special Estate Tax Provisions for Family-Owned Farms and Closely Held Businesses*, INTERNAL REVENUE SERVICE 128, available at <http://www.irs.gov/pub/irs-soi/spestate.pdf>.

¹¹⁴ Snyder, *supra* note 21, at 751.

¹¹⁵ *Id.*

that value, which results in a substantially less estate tax liability.¹¹⁶ This method began because of the Tax Reform Act of 1976, which permitted the “current use” provision.¹¹⁷

The benefits of § 2032A are somewhat restricted, however. There is a limitation in that the aggregate decrease in value from the current market value shall not exceed \$750,000.¹¹⁸ This \$750,000 limitation is, though, indexed for inflation for estates filing after 1998 using a cost of living adjustment.¹¹⁹ For example, a farm with a market value of \$2 million but a current use value of \$1 million would not be able to take full advantage of this section because the difference between the two values exceeds \$750,000. Instead, this farm would be valued at \$1,250,000 in order to take advantage of the provisions of § 2032A while remaining in compliance with that section.¹²⁰

Section 2032A is widely used by farm estates and other businesses. Congress set strict qualifications for special-use valuation, effectively targeting the Section so that it benefits small family farmers.¹²¹ Indeed, of the 839 returns in 2001 which utilized this provision, 47.6 percent used it for farm property elections.¹²² Such prevalence seems to suggest that this provision is of particular importance to farm estates. Further evidence of this provision’s attempt to aid farms is shown by the Economic Recovery Act of 1981 which decreased the time period to ten years for which heirs had to continue farming in order to use the “current use” provision.¹²³

Deferral under IRC § 6166

¹¹⁶ Gangi and Raub, *supra* note 113.

¹¹⁷ CONG. BUDGET OFFICE, *supra* note 8, at 2.

¹¹⁸ IRC § 2032A(a)(2).

¹¹⁹ IRC § 2032A(a)(3).

¹²⁰ See IRC § 2032A.

¹²¹ Snyder, *supra* note 21, at 752.

¹²² Martha Britton Eller, *Which Estates Are Affected by the Federal Estate Tax?: An Examination of the Filing Population for Year-of-Death 2001*, INTERNAL REVENUE SERVICE 13, available at <http://www.irs.gov/pub/irs-soi/01esiod.pdf>.

¹²³ CONG. BUDGET OFFICE, *supra* note 8, at 3.

There is an additional portion of the estate tax code which aims to help family farms. Section 6166 permits deferral of estate tax liability for five years for estates which include interest in a closely held business such as a family farm.¹²⁴ As Internal Revenue Service guidelines make clear, “under the law, an estate’s executor can elect to pay estate tax attributable to the business interest in two or more, but not exceeding ten, equal payments and defer tax payments for five years, paying only interest on the tax liability during the deferral period.”¹²⁵ This provision only permits deferral of the portion of the estate tax which is attributable to the decedent’s closely held business and requires installment payments of the remainder.¹²⁶ The rationale behind this provision was clearly articulated in H.R. Rep. No. 85-2198 which explained “by spreading out the period over which the estate tax may be paid, it will be possible for the estate tax in most cases to be paid for out of earnings of the business, or at least that it will provide the heirs with the time to obtain funds...without upsetting the operation of the business.”¹²⁷

Despite the clear benefits of this provision, it seems that this provision is not widely used. In 2001, an estimated 382 estates, or 0.4 percent of all estates and 2.4 percent of estates that reported closely held and agribusiness assets elected to use this deferral provision.¹²⁸ In that year, of 108,330 filings, only 15,612 claimed assets in a closely held or agri-business.¹²⁹

Exemptions under the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010

¹²⁴ IRC § 6166.

¹²⁵ See Martha Eller Gangi, Kimberly Henry, and Brian G. Raub, *Factors in Estates’ Utilization of Special Tax Provisions For Family-Owned Farms and Closely Held Businesses*, INTERNAL REVENUE SERVICE, available at <http://www.irs.gov/pub/irs-soi/06rpppgangi.pdf>.

¹²⁶ Gangi & Raub, *supra* note 113, at 128.

¹²⁷ LaPorte, *supra* note 108, citing H.R. Rep. No. 85-2198 at 713, (1958).

¹²⁸ Gangi, Henry, & Raub, *supra* note 125, at 97.

¹²⁹ LaPorte, *supra* note 108, at 186.

There have long been exemptions to the federal estate tax which attempt to lessen the impact of the federal estate tax.¹³⁰ Former President George W. Bush's 2001 revisions to the tax code resulted in significant changes to the estate tax.¹³¹ President Bush advocated for the Economic Growth and Tax Relief Reconciliation Act (EGTRRA).¹³² This legislation gradually increased the exemption amount which excludes estates from tax liability.¹³³ The 2002 exemption rose to \$1 million from \$675,000.¹³⁴ In 2004, the exemption level rose to \$1.5 million, in 2006 to \$2 million, and in 2009 to \$3.5 million.¹³⁵ This legislation created an unlimited exclusion amount for 2010, such that decedents who died in 2010 were not subject to estate tax liability regardless of the value of their assets.¹³⁶ This provision essentially eliminated the federal estate tax for one year.¹³⁷

The current estate tax exemptions were promulgated as a result of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.¹³⁸ This Act established a \$5 million per person exemption from the estate tax for 2011 and 2012.¹³⁹ This \$5 million exemption is "portable" and thus amounts to \$10 million for couples, who can aggregate their joint assets on the death of the second spouse.¹⁴⁰ As a result, the first \$5 million for individuals

¹³⁰ See generally, Wampler, *supra* note 50, at 531-534.

¹³¹ Eller, *supra* note 122, at 1.

¹³² *Id.*

¹³³ LaPorte, *supra* note 108, at 182.

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ Deborah L. Jacobs, *Estate Tax: What You Need To Know for 2010*, CBS MoneyWatch, (Jan. 5, 2010, 3:00 AM) <http://moneywatch.bnet.com/retirement-planning/article/estate-tax-what-you-need-to-know-for-2010/378294/>.

¹³⁸ Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, H.R. 4853, 111th Cong. (2010).

¹³⁹ *Id.*

¹⁴⁰ Deborah L. Jacobs, *Married Couple's Guide to the New Estate Tax Law*, FORBES, available at <http://www.forbes.com/2010/12/23/married-couples-guide-new-estate-tax-personal-finance-deborah-jacobs.html>.

or \$10 million for couples is not taxed.¹⁴¹ In sum, taxpayers can add the unused estate tax exemption of the spouse who died most recently to their own.¹⁴² This dramatic exemption increase enables spouses together to transfer up to \$10 million in assets without any tax liability.”¹⁴³

Without legislative action, this \$5 million per person exemption will diminish to a mere \$1 million per person exemption in 2013.¹⁴⁴ A \$1 million exemption would subject a much greater number of family farms to estate tax liability, based on the value estimates and net worth estimates mentioned below.¹⁴⁵

The American Farm Bureau referred to this year’s increased exemption as “only a temporary fix, but it avoids the cataclysmic rise in farmers’ and ranchers’ taxes this year.”¹⁴⁶ That organization had promulgated a “Put Death Taxes to Rest” campaign prior to this passage of this bill.¹⁴⁷ Members spent months lobbying lawmakers using individual producers’ own stories about how the estate tax affects their operations and their families.¹⁴⁸ Their success is embodied in the terms of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010.

Part IV – Analysis and Recommendations

¹⁴¹ See Carla Fried, *Estate and Gift Rules: Some Clarity, for Now*, N.Y. TIMES, February 12, 2011, available at <http://www.nytimes.com/2011/02/13/business/yourtaxes/13estate.html>.

¹⁴² *Id.*

¹⁴³ Jacobs, *supra* note 140.

¹⁴⁴ AMERICAN FARM BUREAU FEDERATION, *supra* note 15.

¹⁴⁵ See *infra* “Understanding the value of the Average American Farm”.

¹⁴⁶ *Farmers, ranchers cheer passage of estate tax reform, lower cap gains rates*, FB NEWS, (American Farm Bureau) Jan. 11, 2010, at 1, available at http://www.fb.org/newsroom/fbn/2011/FBN_01-10-11.pdf.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

Understanding the value of the average American farm

American farms must be considered in terms of the value of their land and the improvements thereon. It seems that typical family farms are worth less than the current \$5 million individual and \$10 million couples estate tax exemption.¹⁴⁹ Indeed, “the vast majority of small-farm estates already are exempt”¹⁵⁰ As such, these farms are, by default, shielded from the estate tax and will not be detrimentally affected by any estate tax due.

Using a collection of data from different sources, it is possible to estimate the average value of all American farms. In a recent study, the average American farm was valued at \$2,140 per acre.¹⁵¹ A 2002 study revealed that the average American farm was comprised of 441 acres.¹⁵² As such, \$943,740 is thus a very rough approximation of the land value of an American farm. This calculation is clearly well below the \$5 million exemption amount for individuals and also well below the \$10 million exemption amount for couples, though it is precariously close to 2013’s looming \$1 million exemption.

This calculation notably excludes any buildings, improvements, crops, equipment, or other appurtenances which would add significant value to the farm operation. It is likely that, after adding such appurtenances, the value of the average American farm operation exceeds \$1 million.¹⁵³ Indeed, average net worth in 2007 ranged from \$1.3 million for medium-sales farms to \$2.5 million for very large farms.¹⁵⁴ Such an average reflects the value of land in addition to the equipment and property thereon. It is significant that much of the net worth of farm

¹⁴⁹ Coverdale, *supra* note 11.

¹⁵⁰ Brunet & Huang, *supra* note 75.

¹⁵¹ Land Use, Value, and Management, U.S. DEP’T OF AGRIC. ECON. RES. SERV. (Aug. 24, 2011), <http://www.ers.usda.gov/Briefing/landuse/aglandvaluechapter.htm>

¹⁵² Banker & Hoppe, *supra* note 16.

¹⁵³ *Id.* at 30.

¹⁵⁴ *Id.* at 30.

households is illiquid and not easily available to spend for consumption because it is largely based on assets necessary to continue farming.¹⁵⁵

The solution

The current and past proposals enumerated above were created with the noble intention of helping preserve America's agricultural heritage.¹⁵⁶ Each is a valuable and worthwhile plan in its own right. While parts of the older proposals have been adopted, particularly the deferral provisions, the current bills before Congress remain in committee and it is possible that they will never be put up for vote on the floor of Congress.¹⁵⁷ A combination of these proposals is perhaps the best permanent solution.

Given the difficulty in passing these pieces of legislation, it is significant to note that a less controversial solution exists. The simplest solution is to pass legislation which simply continues the current \$5 million individual and \$10 million couples exemption permanently. The current high threshold of this exemption serves as a de facto tax shield for family farms, whose values are typically much lower than the exemption amount and thus not taxable.¹⁵⁸ Without action, this \$5 million/\$10 million exemption will diminish to a mere \$1 million exemption in 2013.¹⁵⁹ A \$1 million threshold would likely subject many more family farms to estate tax liability, given the approximate average value of American farms.

¹⁵⁵ *Id.* at 32.

¹⁵⁶ See generally, *Taxes: Saving the Family Farm*, TIME, Jan. 19, 1976.

¹⁵⁷ *Enactment of a Law*, U.S. SENATE, http://www.senate.gov/legislative/common/briefing/Enactment_law.htm#16.

¹⁵⁸ Coverdale, *supra* note 11.

¹⁵⁹ *Supra* note 15.

Such a policy for estate tax reform must account for inflation. Failure to index a tax provision for inflation will result in that provision's anachronism in a few short years.¹⁶⁰ As such, any legislation to extend the current exemptions must provide for indexing for inflation. The amount of the exemption must rise annually to correspond with inflation. Without such a provision, an increase in land values would minimize the positive impact of such a provision on family farms.

The few farm estates which exceed the exemption amount should continue to be able to take advantage of the deferral provisions of Section 6166, which would allow farm heirs the opportunity to raise funds to pay the estate tax from business income.¹⁶¹ Given a few years of operation, it is hoped that these farms could set aside enough revenue to satisfy estate tax obligations.¹⁶² Such deferral also minimizes the likelihood that farm heirs would have to immediately liquidate farm assets to pay estate tax. The current deferral provisions, if maintained, would likely be satisfactory.¹⁶³

Preserving family farms through federal estate tax policy is difficult but not impossible. Congress can do so using many of the current Code provisions that benefit farmers.¹⁶⁴ Manipulation of the existing provisions is likely sufficient to develop a permanent solution to these problems. It is clear that legislation which incorporates the current exemption threshold, inflation adjusting, and deferral provisions would be a successful and permanent solution for the estate tax dilemma as it affects family farms. Such legislation would finally put to rest the decades-old disputes over the impact of estate taxation on family farms.

¹⁶⁰ See generally Joshua Greene & Hyman Sanders, *Indexing the Income Tax for Inflation*, CONG. BUDGET OFFICE, (1980), available at <http://www.cbo.gov/ftpdocs/112xx/doc11205/80doc26.pdf> ;

¹⁶¹ H.R. Rep. No. 85-2198 at 713, (1958).

¹⁶² *Id.*

¹⁶³ *Do Family Farms Need More Estate Tax Breaks?* (Citizens for Tax Justice), Jun. 9, 2006.

¹⁶⁴ Snyder, *supra* note 21, at 780.

Public Policy

Given the divergent opinions on this subject, it is apparent that the impact of the estate tax on family farms is controversial. Debate exists over whether the impact is overstated, understated, or nonexistent.¹⁶⁵ The above solution works toward minimizing turnover of family farms through sale, abandonment, or subdivision. Consequently, the above solution also works toward slowing the decline in the number of family farms in the United States.

The exemption, when indexed for inflation, will serve as a de facto tax shield for most farms. Indeed, “higher exemption amounts would have an even greater impact on farmers.”¹⁶⁶ For those few farms which exceed the exemption amount, the deferral provision, even as it currently exists, is intended to give farm heirs a fair opportunity to raise revenue to pay the tax without necessitating liquidation.¹⁶⁷ However, if this exemption were lowered to previous levels, or not indexed for inflation, small family farms would be placed in jeopardy. A return to the \$1 million exemption in 2013 would subject many small farms, whose average land value alone is almost \$1 million, to the estate tax.¹⁶⁸

The importance of preserving family farms warrants discussion from an ideological public policy perspective. In addition to serving as a foundation of the earliest American economy, in early American culture the pastoral was a repository of order, beauty, and humane society.¹⁶⁹ More simply,

some people just like to see cows grazing in the pasture, and, based on nostalgia or aesthetics, embrace the idea that our agriculture should be based on family farms. It is

¹⁶⁵ See Weber, *supra* note 49, at 130.

¹⁶⁶ *Supra* note 8, at 13.

¹⁶⁷ H.R. Rep. No. 85-2198 at 713, (1958).

¹⁶⁸ *Supra* note 15.

¹⁶⁹ Carpenter, *supra* note 4, at 18.

sometimes argued that these amorphous reasons to support family farming are behind the public's support.¹⁷⁰

This aesthetic and cultural value of family farms undoubtedly impacts the opinions of those considering how to best protect such farms, though such thoughts are hardly injurious and instead serve to protect an important part of American culture.

An Alternative Solution?

The proposal above would likely serve as a permanent legislative solution to this problem. However, if such a solution were not adopted, farmers have alternative options to minimize the impact of the estate tax.

A very simple solution would be for farmers to obtain life insurance in the amount of any anticipated tax due. The proceeds of a life insurance policy could be used to satisfy any estate tax obligations and allow the farm to remain active. The use of an irrevocable life insurance trust would exclude the insurance proceeds from taxation in the decedent's estate. Though this strategy would undoubtedly be costly and even untenable for many farmers, it would serve to hedge against the burdens faced by their heirs and work toward preserving America's family farms.

Conclusion

America's agricultural system faces a unique crisis through the decline in the number of active family farms, both large and small. This agrarian nation is changing and a foundational part of the nation's economy is deteriorating.¹⁷¹ However, there are ways to aid those farmers

¹⁷⁰ *Id.*

¹⁷¹ See generally, Banker & Hoppe, *supra* note 16, at 4-6.

enduring this challenge through proper legislation which protects such farms from the burdens of the estate tax.

The best way to aid family farms is to pass legislation which maintains the existing 2011 threshold exemptions from estate tax liability. These exemptions, if properly indexed for inflation, would serve as a de facto tax shield which would protect all but the largest and most valuable family farms from estate tax liability. Those large family farms could likewise benefit, however, if a deferral provision as currently exists were maintained. Such a provision would allow farm heirs to run the business for several years without facing the burden of estate tax liability.¹⁷²

This legislation, together with a societal respect for the importance of family farms, will preserve family farms and ensure that this part of America's heritage will remain strong throughout the 21st century. Indeed, as Thomas Jefferson remarked in his *Notes on Virginia*, "Those who labor in the Earth are the chosen people of God, if He ever had a chosen people..."¹⁷³ It is the responsibility of contemporary Americans to respect and treasure the nation's agrarian heritage through sound tax policy.

¹⁷² See H.R. Rep. No. 85-2198 at 713, (1958).

¹⁷³ THOMAS JEFFERSON, NOTES ON VIRGINIA, (1787), available at <http://xroads.virginia.edu/~hyper/jefferson/ch19.html>.