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Congress About to Give Away the Farm

Even Worries About the Deficit Don't Stop Lawmakers from Helping the Uber-Rich

Word on the street is that the Senate is considering including an unlimited farm exclusion from estate tax when it addresses the expiring Bush tax cuts during this work period.

California lawmakers, with co-sponsors from other western states, have introduced bills to provide an unlimited estate tax exclusion for farms. The Family Farm Estate Tax Relief Act of 2010 (H.R. 5475) was introduced May 28, 2010 by Rep. Thompson (D-CA).[1] Sen. Dianne Feinstein (D-CA) introduced similar legislation called the Family Farm Estate Tax Deferral Act of 2010 (S. 3664) on July 28, 2010.[2]

The Sky's the Limit on the Exclusion

The most obvious problem with the proposed bills is that there is **no limit** to the amount of exclusion that can be claimed. Even members of the Gallo family, whose net worth was estimated at $1.3 billion in the Forbes 2006 400 Richest Americans list,[3] could exclude the entire value of the vineyards from their estates (the vineyards, incidentally, are located in Rep. Thompson's congressional district). And imagine Ted Turner's estate being able to exclude the 2 million acres of land (about 1-1/2 times the size of Delaware) that he owns in 15 different ranches.[4]

There are no limits at all in the House bill. The Senate bill has some qualification requirements that are designed to keep the benefits limited to farmers making less than $750,000 per year, but if those qualifications are met, there's no dollar limit on the farm value that can be excluded. Also, we're sure there are tax advisors out there already figuring out ways to get around the qualification rules (more on that later).

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[1] Text at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h5475ih.txt.pdf
[2] Text at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s3664is.txt.pdf
[3] Forbes, "The 400 Richest Americans," September 21, 2006, http://www.forbes.com/lists/2006/54/biz_06rich400_The-400-Richest-Americans_land.html
[4] Ted Turner: Ranches, http://www.tedturner.com/enterprises/ranches_Template.asp?page=ranches_faq.html

The Qualification Requirements are Inadequate

You Don't Really Have to Farm to Qualify

The qualification requirements include a provision that the decedent or a member of the decedent's family must have "materially participated" in the farming activity in 5 out of the last 8 years. The statute refers to the material participation rules that apply for self-employment tax—which define "material participation" rather loosely.[5] Merely participating in decisions about crops or livestock to be produced and periodic inspections of production activities is enough. "Let's see, shall we plant soybeans or more grapes?"

The Income Limitations are Too High and Easily Manipulated

The Senate bill allows estates to claim the unlimited farm exclusion if the decedent did not earn more than $750,000 in the three years preceding the death[6] (someone with that much income is the *top 1 percent* of taxpayers). Even more troubling is that those income numbers can be easily manipulated. The farm operations could be put in a pass-through entity like a partnership or trust and the income allocations to the oldest family members could be constrained to make sure they don't run afoul of the $750,000 limit. So with sufficient planning, even the richest of the rich could manage to exclude the "farm" from the estate.

The Estate has to be at Least 50 Percent Farm or Ranch Property

This requirement ought to scare the real family farmers out there. The qualification requirements provide that at least 50 percent of the estate value must be the value of the farm or ranch (including real property and personal property) and at least 25 percent of the estate value must be the farm real property (the farmland and buildings).[7] Wealthy people could convert financial and other assets to land and other property that will qualify for the exclusion—driving up the cost of agricultural land and pricing small farmers out of the market.

This provision is easily subject to manipulation by savvy estate planners. In fact, wealthy Americans would not even have to convert their assets into farmland if they wanted to keep their stocks or baseball team or whatever they own. Wealthy families could borrow against those assets (decreasing their net value for estate tax purposes) and use the proceeds to buy qualifying property.

The Recapture Tax is Easily Avoided

No Requirement to Keep the "Family" in the "Family Farm"

If the decedent's heir later disposes of an interest in the farmland, a recapture tax is imposed. But there is no requirement in the bill that a member of the family continue to participate in the farming operation after the decedent's death. (Remember in order to qualify for the exclusion, the decedent, or a member of the decedent's family, must

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[5] The S. 3664 version of proposed new Code Sec. 2033A requires material participation within the meaning of Sec. 2032A(e)(6) which references the self-employment tax rules in Sec. 1402(a)(1) and regulations thereunder.
[6] Proposed Code Sec. 2033A(b)(3).
[7] Proposed Code Sec. 2033A(b)(4) and (5).

"materially participate" in the operations of the farm before the decedent's death). The bill merely requires that the real property continue to be used in the business of farming.[8] This requirement could be met by the heir leasing the land to someone else to farm. Also, a "sale" of the property could be structured so that the heir retains an interest sufficient to avoid the recapture tax.[9]

The Low Cost of the Provision is Misleading

Although the official cost of the provision is low in the 10-year budget window, the ultimate cost of the farm exclusion is likely to be much higher in subsequent years, as the wealthy and their highly-compensated tax advisors devise schemes to use this provision, converting assets to "farmland" and using the unlimited exemption to completely avoid the estate tax. An analysis by the Tax Policy Center concluded that an unlimited farm exemption is such a strong incentive for aggressive estate-tax planning that it "would make the estate tax essentially voluntary for the very wealthy."[10] So even if offsets are found for the relatively modest costs of the bill, we expect the long-term revenue loss to the treasury to be substantial.

Current Estate Tax Rules Already Safeguard Most Family Farms

The provisions of the estate tax rules scheduled to come back into effect on January 1, 2011 already have substantial breaks targeted to family farms and closely-held businesses including special valuation rules and a 14-year period over which to pay related estate taxes.[11] These rules, along with a $3.5 million per person exemption (the 2009 level which is expected to be enacted for 2011 and subsequent years), would completely shelter a family farm valued at up to $9 million from estate tax. Considering more generous estate tax rules for farms should not even be on the agenda when the country has so many other pressing needs.

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[8] Proposed Code Sec. 2033A(d)(1)(B).

[9] An example of this sort of maneuver is Sam Zell structuring a "sale that's not a sale" of the Chicago Cubs in order to avoid capital gains taxes. See CTJ Tax Justice Digest, "No Tax on the $845 Million Sale of the Cubs?" September 25, 2009, http://www.ctj.org/taxjusticedigest/archive/2009/09/no_tax_on_the_845_million_sale.php.

[10] Leonard E. Burman, Katherine Lim, and Jeff Rohaly, "Back from the Grave: Revenue and Distributional Effects of Reforming the Federal Estate Tax", Urban-Brookings Tax Policy Center, October 20, 2008, pg. 32, http://www.taxpolicycenter.org/UploadedPDF/411777_back_grave.pdf.

[11] Citizens for Tax Justice, "Do Family Farms Need More Estate Tax Breaks?" June 9, 2006, http://www.ctj.org/pdf/farm0606.pdf. See also Center on Budget and Policy Priorities, "Unlimited Estate Tax Exemption for Farm Estates is Unnecessary and Likely Harmful," June 29, 2010, http://www.cbpp.org/files/6-29-10tax.pdf.