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## Lowering Values: The Federal Estate Tax and the American Farmer

Alicia Leanne Taylor

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# LOWERING VALUES: THE FEDERAL ESTATE TAX AND THE AMERICAN FARMER

*Alicia Leanne Taylor\**

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The first-federal estate tax with any staying power<sup>1</sup> was enacted in 1916 to fund wartime government shortfalls,<sup>2</sup> just three years after the implementation of the federal income tax.<sup>3</sup> Back then, the federal estate tax received little attention<sup>4</sup> but it has become much more controversial in modern times. With the expiration of the old tax scheme and the recent passage of new tax provisions in December 2010, the federal estate tax remains at the forefront of the nation's political commentary.<sup>5</sup>

In 2001, then President George W. Bush achieved the passage of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA).<sup>6</sup> This massive tax cutting bill began a decade-long phase-out of the federal estate tax, culminating in a complete repeal in 2010.<sup>7</sup> The EGTRRA scheduled a gradual increase in the federal estate tax exemption value while lowering the tax rate.<sup>8</sup> Under the EGTRRA, the value of an estate exempted from estate taxes steadily increased from \$675,000 in 2001 to \$3.5 million in 2009.<sup>9</sup> But the EGTRRA was never meant to be a permanent tax solution; unless Congress took action, the EGTRRA would "sunset" at the end of 2010 and the federal estate tax would revert to its pre-2001 conditions.<sup>10</sup> This meant that, starting on January 1, 2011, the exemption value would fall to \$1 million, and any excess estate value over this amount would be taxed at 55%.<sup>11</sup> For American farmers, the EGTRRA was a ticking time bomb.

Congress and the White House waited until the "eleventh hour" to

1. A federal estate tax was enacted (in varying forms) in 1787 (when an altercation with the French seemed imminent), during the Civil War and again in 1898 during the Spanish-American war. Stephanie A. Weber, *Re-thinking the Estate Tax: Should Farmers Bear the Burden of a Wealth Tax*, 9 ELDER. L.J. 109, 112 (2001).

2. MICHAEL J. GRAETZ & IAN SHAPIRO, *DEATH BY A THOUSAND CUTS: THE FIGHT OVER TAXING INHERITED WEALTH* 6 (2005).

3. JOEL SLEMROD & JON M. BAKIJA, *TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES*, 288 (MIT Press 2004) (2008).

4. *Id.*

5. See Richard A. Thaler, *Estate Tax Issue Offers Quick Test for Congress*, N.Y. TIMES, (Nov. 6, 2010), <http://www.nytimes.com/2010/11/07/business/economy/07view.html> (calling the federal estate tax a "pressing issue" for the "lame-duck" Congress); see also Andrew Taylor, *GOP, Obama Embrace Bush Tax Cuts Compromise*, WASH. POST (Nov. 5, 2010), [http://www.washingtonpost.com/wpdyn/content/article/2010/11/05/AR20101105\\_00802.html](http://www.washingtonpost.com/wpdyn/content/article/2010/11/05/AR20101105_00802.html).

6. *Id.* at 26.

7. GRAETZ & SHAPIRO, *supra* note 2, at 5.

8. SLEMROD & BAKIJA, *supra* note 3, at 288.

9. Ron Durst, *Farm Household Economics and Well-Being Briefing Room: Federal Taxes and Households*, Economic Research Service, Briefing Room (2009), <http://www.ers.usda.gov/Briefing/WellBeing/federaltaxes.htm>.

10. *Id.*

11. Ron Durst, *Federal Estate Taxes Affecting Fewer Farmers but the Future is Uncertain* 12, 7 AMBER WAVES (Sept. 2, 2009), <http://www.ers.usda.gov/AmberWaves/June09/PDF/FederalEstateTax.pdf>.

end the uncertainty surrounding the expiration of the EGTRRA.<sup>12</sup> On December 17, 2010 President Barack Obama signed H.R. 4853: Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (2010 Tax Relief Act).<sup>13</sup> Upon President Obama's signature, the Act became Public Law No: 111-312.<sup>14</sup> Sponsored by Rep. James Oberstar, a Democrat from Minnesota, the bill's introduction came on March 16, 2010 and passed the House the next day.<sup>15</sup> It would take more than six months before the Senate would successfully pass the bill<sup>16</sup> and another three months before Congress and the Obama administration could agree on acceptable compromises and a final draft.<sup>17</sup> Among other modifications, discussed later in this Note, the 2010 Tax Relief Act reinstates the federal estate tax as of January 1, 2011, increasing the exclusion amount to \$5 million while lowering the maximum taxable rate to 35%.<sup>18</sup> On its face, the 2010 Tax Relief Act sounds like a win-win for taxpayers—but, like the EGTRRA, these provisions are only temporary.<sup>19</sup> The federal estate tax scheme contained in the 2010 Tax Relief Act expires on December 31, 2012.<sup>20</sup> Once again, if Congress fails to act before the expiration of this Act, the pre-EGTRRA levels will “be resurrected.”<sup>21</sup>

This unusual situation demands a hard look at those most affected by the federal estate tax in contemplating the tax's future. The federal estate tax affects two groups with particular severity: small business owners and farmers.<sup>22</sup> The burden of the federal estate tax is rarely felt by the nation's wealthiest individuals because they are the ones with the “means and motive” to completely evade the federal estate tax.<sup>23</sup> The truly wealthy can avoid paying significant federal estate taxes by utilizing estate reduction tools such as taking the marital deduction or

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12. See Congressional Budget Office, Effective Federal Estate Tax Rates Under Current Law, 2001 to 2014, Aug. 2004, <http://www.cbo.gov/doc.cfm?index=5746&type=0&sequence=1>. The EGTRRA, enacted in 2001, was not a permanent provision. *Id.*

13. See Govtrack.us, *Overview of H.R. 4853: Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*, <http://www.govtrack.us/congress/bill.xpd?bill=h111-4853> (last visited July 31, 2011) [hereinafter Overview].

14. *Id.*

15. *Id.* The House passed H.R. 4853 on March 17, 2010. *Id.*

16. *Id.* The Senate passed H.R. 4853 on September 23, 2010. *Id.*

17. *Id.* The House voted again on December 2, 2010 and the Senate again on December 15, 2010 on changes made throughout the process. *Id.*

18. See TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010, Pub. L. No. 111-312 (Dec. 17, 2010) [hereinafter 2010 Tax Relief Act].

19. *Id.*

20. *Id.*

21. *Id.*

22. Lee Lytton, *Save the Land from Uncle Sam: Using Life Insurance Premium Financing in Estate Planning*, 2 ES. PLAN. & COMMUNITY PROP. L.J. 421, 424 (2010).

23. Weber, *supra* note 1, at 117.

making inter vivos gifts and charitable contributions.<sup>24</sup> Often, the wealthy are “well educated about and willing to engage in extensive tax avoidance strategies.”<sup>25</sup> Former Republican Representative Jennifer Dunn said the very-wealthy “[stuff] away money here and there at the suggestion of high priced accountants.”<sup>26</sup> Dunn, a zealous advocate for a complete repeal of the federal estate tax, insisted it was the “working rich” who fear the effects of the tax.<sup>27</sup>

## I. BACKGROUND: THE TAX AND THE DEBATE

Although the term “estate tax” is sometimes used interchangeably with the term “inheritance tax” the federal estate tax is not paid by each beneficiary but from the decedent’s estate.<sup>28</sup> The concern thus becomes whether the decedent’s estate has enough cash assets to pay federal estate taxes or whether the estate will be forced to sell its most liquid assets to raise the necessary amount.<sup>29</sup> This aspect is particularly concerning to farmers and ranchers. Why is that? Have you ever heard the saying “land rich, cash poor” used to describe a farmer’s financial position?

Farmers’ “wealth” is frequently tied up in illiquid assets; 80% of farm and ranch assets are land based.<sup>30</sup> This means farmers and ranchers often do not leave significant cash or liquid assets at death.<sup>31</sup> While many wealthy families wish to pass along cash, stocks, bonds, etc. to their heirs, farmers and ranchers want to pass along non-liquid assets

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24. *Federal Estate Planning: Uncertainty in Planning Under the Current Law: Hearing Before the Comm. on Finance*, 110TH CONG. 2 (2007) (statement of Hon. Max Baucus, Chairman, Comm. on Finance), available at <http://permanent.access.gpo.gov/lps116568/51778%5B1%5D.pdf> [hereinafter *Uncertainty in Planning*].

25. See *Economics of the Estate Tax Before the Joint Econ. Comm.*, 105TH CONG., 2D SESS., 14 (1998) (concluding that avoidance strategies typically occur by transferring assets from parents to children prior to death), available at <http://www.house.gov/jec/fiscal/tx-grwth/estattax/estattax.htm> [hereinafter *Economics of the Estate Tax*].

26. GRAETZ & SHAPIRO, *supra* note 2, at 42 (citing Dunn’s 1999 *Insight* magazine editorial).

27. *Id.*

28. Weber, *supra* note 1, at 111.

29. CONGRESSIONAL BUDGET OFFICE, *EFFECTS OF THE FEDERAL ESTATE TAX ON FARMS AND SMALL BUSINESS* 12 (2005), <http://www.cbo.gov/ftpdocs/65xx/doc6512/07-06-EstateTax.pdf> (noting that farm estates have a small proportion of liquid assets, suggesting that federal estate tax liability is more likely to exceed liquid assets and therefore force liquidation) [hereinafter *EFFECTS OF THE FEDERAL ESTATE TAX*].

30. See AMERICAN FARM BUREAU FEDERATION, *ESTATE TAX REFORM* (2010), <http://www.fb.org/issues/docs/estatetax10.pdf> [hereinafter *ESTATE TAX REFORM*].

31. See generally CHRISTIAN RAMSEY, *LAND RICH, CASH POOR* (2007).

such as land, buildings and livestock.<sup>32</sup> Therefore, many agriculturalists fear the federal estate tax hinders their ability to successfully pass their businesses on to their children, and this prospect is distressing.<sup>33</sup> Testimony delivered by Mr. K.L. Bliss, a Montana cattle rancher, to a congressional committee in 2001 echoes this sentiment:

[W]ith years of hard work and good management, our ranch today is one of the most productive and improved ranches in the county. Hard work should be rewarded, not penalized by a death tax. Our ranch is more than just a business or a home; it is a lifetime commitment by past, present and future. We have worked hard all our life on this ranch, and at some point we'd like to be able to do more than buy fence posts and insurance policies. This is my reality, but could become my son's nightmare if the death tax is not eliminated.<sup>34</sup>

In response to a survey conducted over a decade ago, 37% of farmers said that if forced to pay federal estate taxes tomorrow, they would have to liquidate some assets or sell out completely.<sup>35</sup> In another survey, when asked why family businesses fail, 98% of respondents cited raising funds to pay estate taxes as a catalyst.<sup>36</sup> It is this possibility (the liquidation of numerous family farms) that has prompted agricultural lobbyists to call for an increase in the exclusion amount<sup>37</sup> or a permanent repeal of the federal estate tax.<sup>38</sup> Data demonstrates that the EGTRRA tax scheme made it easier for farmers and ranchers to transfer their land and business assets to the next generation by allowing a greater value of assets to pass free of the federal estate tax.<sup>39</sup> While the

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32. *Inheritance Taxes for Farmers and Ranchers – 2011 D Day Approaches*, <http://whatsthebeeffromsouponuts.blogspot.com/2010/08/inheritance-taxes-for-farmers-and.html> (Aug. 18, 2010, 8:31 AM).

33. ESTATE TAX REFORM, *supra* note 30, at 1. The American Farm Bureau Federation, a grassroots lobbying organization, considers the federal estate tax a “priority issue” for American farmers and ranchers. *Id.*

34. *Preserving and Protecting Family Business Legacies: Hearing Before the Subcomm. on Taxation and IRS Oversight of the Sen. Finance Comm.*, 107TH CONG. 2, 5 (2001) (statement of K.L. Bliss, National Cattlemen’s Beef Association), available at <http://finance.senate.gov/031501kbtest.pdf>.

35. Economics of the Estate Tax, *supra* note 25, at 14.

36. *See id.* It is important to note that some states impose a state estate tax and business owners may have included this prospect in their consideration of the issue.

37. The call for a higher exclusion amount was successful. *See* 2010 Tax Relief Act, *supra* note 18.

38. *See* ESTATE TAX REFORM, *supra* note 30, at 1. The American Farm Bureau Federation calls for a permanent repeal of the federal estate tax. *Id.*

39. RON DURST, U.S. DEP’T OF AGRIC. FEDERAL TAX POLICIES AND FARM HOUSEHOLDS, 3 (2009), <http://www.ers.usda.gov/Publications/EIB54/EIB54.pdf>.

specific effects of the 2010 Tax Relief Act remain to be seen, common sense says the higher exclusion amount and lower tax rate indicate positive results for farmers and ranchers.

Conversely, proponents of the federal estate tax question the protection afforded to farmers and ranchers and argue the outlook is not as bleak as portrayed by agricultural lobbyists.<sup>40</sup> Nor, they argue, is there anything wrong with the effects of the federal estate tax burden because “equal treatment of equals requires wealth taxation.”<sup>41</sup> In 1906, in endorsing a form of an estate tax, Theodore Roosevelt said the “primary objective should be to put a constantly increasing burden on the inheritance of those swollen fortunes, which it is certainly of no benefit to this country to perpetuate.”<sup>42</sup> Today’s federal estate tax advocates continue to agree with Roosevelt’s ideas, arguing that “large concentrations of wealth should be collected and redistributed to the government.”<sup>43</sup> A fine idea, perhaps, but it comes at what cost? Even its supporters concede the federal estate tax in its current form is “wreaking havoc” on farmers and small business owners.<sup>44</sup>

This Note first examines the demographics of modern American agriculture by exploring data collected by the United States Department of Agriculture (USDA). This data is relevant to discussing the effects—past, current and potential—of the federal estate tax on farmers and ranchers. Second, this Note discusses the general mechanics and effects of both the EGTRRA and the 2010 Tax Relief Act. Next, I analyze the impact various tax schemes may have on American agriculture. This will be accomplished via an illustration predicting the tax liability of two different farmers for a range of exemption or exclusion values and tax rate combinations. Then, I will take a cursory look at six estate value reduction tools which may be useful to farmers and ranchers. Finally, I will present arguments as to why agriculture, particularly the large-scale family farm, merits special federal estate tax treatment.

## II. AMERICAN AGRICULTURE: BY THE NUMBERS

It is imperative to understand the current landscape of American agriculture. The terms “farm” and “ranch” are often used interchangeably.<sup>45</sup> The USDA defines a “farm” as “any place from

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40. See generally SLEMROD & BAKIJA, *supra* note 3.

41. COMPARATIVE TAX STUDIES: ESSAYS IN HONOR OF RICHARD GOODE 143 (Sijbren Cnossen et al. eds.1983).

42. GRATEZ & SHAPIRO, *supra* note 2, at 8.

43. Weber, *supra* note 1, at 114.

44. *Id.* at 115.

45. U.S. DEP’T. OF AGRIC., FARMS, LAND IN FARMS, AND LIVESTOCK OPERATIONS 2008

which \$1,000 or more of agricultural products were produced and sold, or normally would have been sold, during the year.”<sup>46</sup> Ranches are included in the definition of farms.<sup>47</sup>

Every five years, the USDA conducts a Census of Agriculture to collect revealing data and statistics about the nation’s farming and ranching industry.<sup>48</sup> After data is collected, the Economic Research Service (ERS) analyzes land use and ownership, operator characteristics, production practices, and cash flow.<sup>49</sup> This helps develop a holistic picture of U.S. agriculture.<sup>50</sup>

At the time of the 2007 Census of Agriculture, 922,096,840 acres were classified as farmland.<sup>51</sup> This represents a loss of over six million acres since 2002 as a result of rapid urban development.<sup>52</sup> The national average value of this land is \$2,140 per acre.<sup>53</sup> This value, of course, varies widely by geographic location.<sup>54</sup>

America’s farms continue to be family owned and operated, organized as sole proprietorships, partnerships or family corporations.<sup>55</sup> A family farm is defined as one in which “the majority of the business is owned by the operator and individuals related to the operator by blood, marriage or adoption.”<sup>56</sup> In 2007, 98% of U.S. farms were classified by the USDA as “family farms,”<sup>57</sup> Family farms account for

SUMMARY 29-30 (2009), <http://usda.mannlib.cornell.edu/usda/current/FarmLandIn/FarmLandIn-02-12-2009.pdf>.

46. *Id.*

47. *Id.* at 31.

48. U.S. Dep’t. of Agric. Census of Agriculture Frequently Asked Questions, *What is the Census of Agriculture?*, [http://www.agcensus.usda.gov/Help/FAQs/General\\_FAQs/index1.asp](http://www.agcensus.usda.gov/Help/FAQs/General_FAQs/index1.asp) (last visited Apr. 4, 2011).

49. *Id.*

50. *See generally id.*

51. U.S. DEP’T OF AGRIC., 2007 CENSUS OF AGRICULTURE: AMERICAN FARMS, RANCHES AND THE PEOPLE WHO RUN THEM (2007), <http://www.farmland.org> (last visited Nov. 12, 2010).

52. *Id.*

53. U.S. DEP’T OF AGRIC., LAND VALUES AND CASH RENTS 2010 SUMMARY 4 (2010), <http://usda.mannlib.cornell.edu/usda/current/AgriLandVa/AgriLandVa-08-04-2010.pdf>. This value is the national average in 2010, inclusive of farm buildings, with no distinction between pastureland and crop land. *Id.*

54. *Id.* Rhode Island boasts the most expensive farmland, valued at \$13,600 per acre. *Id.* New Mexico is home to the cheapest farm land, at \$480 per acre. *Id.* Florida’s agricultural land is worth an average of \$5,000 per acre. *Id.*

55. *See* ROBERT A. HOPPE ET AL., STRUCTURE AND FINANCES OF U.S. FARMS: FAMILY FARM REPORT TABLE 1 (2007) [http://www.ers.usda.gov/Publications/eib24/eib24\\_report\\_summary.pdf](http://www.ers.usda.gov/Publications/eib24/eib24_report_summary.pdf).

56. U.S. DEP’T OF AGRIC., FARM HOUSEHOLD ECONOMICS AND WELL BEING: GLOSSARY DEFINITION OF FAMILY FARM (2009), <http://www.ers.usda.gov/Briefing/WellBeing/glossary.htm#familyfarm> [hereinafter GLOSSARY].

57. *Id.*



86% of U.S. food and fiber production.<sup>58</sup>

The USDA classifies family farms based on the owner's stated occupancy and annual farm receipts.<sup>59</sup> First, the family farms are broken into two main categories: small-scale family farms and large-scale family farms.<sup>60</sup>

Small-scale family farms are those with annual sales of \$249,999 or less.<sup>61</sup> Within this broad class are five sub-categories: (1) limited-resource, (2) retirement, (3) residential/lifestyle, (4) farming occupation low-sales and (5) farming occupation medium-sales.<sup>62</sup> Nearly two million farms in 2007 were classified as small-scale family farms.<sup>63</sup> Of these, 837,542 were described as "residential/lifestyle."<sup>64</sup> This group includes an assortment of operators who have major occupations away from the farm or who view their farms merely as hobbies.<sup>65</sup>

Large-scale family farms are sub-divided into two categories: large farms (those with sales over \$250,000 but below \$499,999) and very large (sales greater than \$500,000).<sup>66</sup> Only 4.1% of all U.S. family farms are large farms and only 3.4% are very large family farms.<sup>67</sup> Yet, large-scale family farms (both large and very large) together account for 60% of all U.S. agriculture production.<sup>68</sup>

The ERS also uses a "collapsed" classification system in some of its analytical work.<sup>69</sup> This condensed method breaks U.S. farms into three categories: (1) rural residence farms (non-farming occupation; includes retirement/lifestyle farms), (2) intermediate family farms (annual sales less than \$250,000 with farming as a primary occupation; generally small family farms) and commercial farms (annual sales greater than \$250,000; includes large and very large family farms).<sup>70</sup>

Farming in America yields significant sales. Cash receipts for U.S. farms are predicted to total \$301.8 billion this year, an increase of nearly 6.5% from 2009.<sup>71</sup> But large capital expenditures and high

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58. ESTATE TAX REFORM, *supra* note 30, at 1.

59. See HOPPE ET AL., *supra* note 55, tbl. 1.

60. See GLOSSARY, *supra* note 56, definition of farm typology

61. See HOPPE ET AL., *supra* 55, tbl. 1.

62. *Id.*

63. *Id.*

64. *Id.*

65. U.S. DEP'T OF AGRIC., STRUCTURAL AND FINANCIAL CHARACTERISTICS OF U.S. FARMS: 2001 FAMILY FARM REPORT 4 (2001) <http://www.ers.usda.gov/publications/aib768/aib768.pdf>

66. HOPPE ET AL., *supra* note 55, tbl. 1.

67. *Id.*

68. *Id.*

69. GLOSSARY, *supra* note 56, definition of Collapsed Farm Typology.

70. *Id.*

71. See U.S. Dep't of Agric., *Indicators Farm, Rural, and Natural Resource Indicators Table*, <http://www.ers.usda.gov/AmberWaves/September10/Indicators/Indicators.htm> (last

production costs reduce predicted net cash income down to \$85.3 billion.<sup>72</sup> The average farm household income in 2010 is expected to be \$81,670, up 5.8% from 2009.<sup>73</sup> But consider that, on average, only 11% of this income comes from agriculture—a majority of it comes from off-farm jobs or investments.<sup>74</sup> Still, the median wealth of farm households is about five times that of all U.S. households.<sup>75</sup>

In 2009, the value of farm assets rose 1.4% to \$2.043 trillion and is expected to increase again in 2010 to \$2.095 trillion.<sup>76</sup> Farm debt rose from \$242.7 billion in 2008 to \$245.4 billion in 2009.<sup>77</sup> Despite the increase in farm debt, farm equity rose from \$1.773 trillion in 2008 to \$1.798 trillion in 2009. This is largely due to a 1.4% increase in the value of farm land.<sup>78</sup> However, farm debt is expected to decline to approximately \$245 billion in 2010.<sup>79</sup> Taking into account a 2.9% predicted increase in the value of farmland, farm equity should rise to \$1.861 trillion in 2010.<sup>80</sup>

Finally, the average age of the American farmer in 2007 was 57.1 years old,<sup>81</sup> an increase of almost two years over the average age in 2002.<sup>82</sup> Many of today's farm operators are Baby Boomers.<sup>83</sup> The increase in the average age of the American farmer heightens the concern over the federal estate tax's imminent future.

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visited Apr. 4, 2011) [hereinafter *Indicators*]. Cash Receipts in 2009 totaled \$283.4 billion. *Id.*

72. *Id.* Cash Receipts in 2009 totaled \$283.4 billion. *Id.* Cash expenses in 2009 totaled \$248.5 billion and are expected to rise to \$251.3 billion in 2010. See U.S. Dep't of Agric., *Farm Income: Data Files*, <http://www.ers.usda.gov/Data/FarmIncome/Finfidmu.htm>. (last visited July 31, 2011) [hereinafter *Farm Income and Costs*].

73. See Durst, *supra* note 9.

74. William Neuman, *Strong Exports Lift U.S. Agriculture Sector*, N.Y. TIMES (Aug. 31, 2010), <http://www.nytimes.com/2010/09/01/business/economy/01exports.html>.

75. See Durst, *supra* note 9.

76. See U.S. Dep't of Agric., *Farm Income and Costs: Assets, Debt and Wealth*, <http://www.ers.usda.gov/Briefing/FarmIncome/Wealth.htm> (last visited July 31, 2011).

77. *Id.*

78. *Id.*

79. *Id.*

80. *Id.*

81. U.S. DEP'T. OF AGRIC., 2007 CENSUS OF AGRICULTURE: FARMERS BY AGE FACT SHEET (2009), [http://www.agcensus.usda.gov/Publications/2007/Online\\_Highlights/Fact\\_Sheets/farmer\\_age.pdf](http://www.agcensus.usda.gov/Publications/2007/Online_Highlights/Fact_Sheets/farmer_age.pdf)

82. U.S. DEP'T OF AGRIC., 2002 CENSUS OF AGRICULTURE: U.S. SUMMARY AND STATE DATA (2004), <http://agcensus.usda.gov/Publications/2002/USVolume104.pdf> (noting the average age was 55.3 years in 2002).

83. See U.S. CENSUS BUREAU, SELECTED CHARACTERISTICS OF BABY BOOMERS 42 TO 60 YEARS OLD IN 2006 (2006), <http://www.census.gov/population/www/socdemo/age/2006%20Baby%20Boomers.pdf>. The U.S. Census Bureau recognizes the Baby Boomer generation as consisting of individuals born between 1946 and 1964. *Id.*

### III. THE DATA: AMERICAN FARMERS AND THE FEDERAL ESTATE TAX

The federal estate tax uses “exemption” or “exclusion” values to establish a tax base.<sup>84</sup> A unified credit effectively excludes the value of the estate that is under the exclusion value.<sup>85</sup> Any excess value in an estate over the exclusion value is taxed at the prevailing rate.<sup>86</sup>

Prior to 2001, the federal estate tax only affected individuals with assets of more than \$650,000 or married couples with assets of more than \$1.3 million.<sup>87</sup> In 1999, 2.3% of all estates paid federal estate taxes with an average estate value of \$2.5 million.<sup>88</sup> These estates incurred an average federal estate tax bill of \$469,000, resulting in a total collection of \$24.4 billion by the federal government.<sup>89</sup>

In 2001, the year the EGTRRA became effective, 51,766 estates owed federal estate taxes.<sup>90</sup> Eight years later, due to the EGTRRA’s schedule of increasing exemption values, only about 0.4% of all estates were expected to owe federal estate taxes in 2009<sup>91</sup> for a total of 9,600 estates.<sup>92</sup> This represents a decrease of 81.46% from 2001 conditions.<sup>93</sup> Despite the sharp decline from 2001 in terms of the number of estates taxed, the 2009 federal estate tax revenue only declined by 25%.<sup>94</sup> This suggests the bulk of this revenue is generated by “super-wealthy” estates—those with \$20 million plus in assets.

As for farm estates specifically, the USDA estimated about 2.9% of the 38,234 farm estates projected for 2009 would have estate values of \$3.5 million or greater based on simulations of data collected by the ERS.<sup>95</sup> With an average net worth of \$7.0 million, these estates were predicted to have, on average, federal estate tax liability of \$1.1 million under the EGTRRA.<sup>96</sup>

Large and very large family farms are the most vulnerable to federal

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84. See GRATEZ & SHAPIRO, *supra* note 2, at 6. See also 2010 Tax Relief Act, *supra* note 18.

85. CONGRESSIONAL BUDGET OFFICE, FEDERAL AND GIFT TAXES 2 (2009), [http://www.cbo.gov/ftpdocs/108xx/doc10841/12-18-Estate\\_GiftTax\\_Brief.pdf](http://www.cbo.gov/ftpdocs/108xx/doc10841/12-18-Estate_GiftTax_Brief.pdf); see also 26 I.R.C. §§ 2010, 2015 (2010) [hereinafter FEDERAL & GIFT TAXES].

86. See GRATEZ & SHAPIRO, *supra* note 2, at 6.

87. *Id.*

88. *Id.*

89. *Id.*

90. DURST, *supra* note 39, at 13.

91. Durst, *supra* note 11, at 12.

92. DURST, *supra* note 39, at 13.

93. See *id.*; see also Durst, *supra* note 11, at 12. The difference is calculated using the following formula: (amount of decrease/initial value) 100. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

estate taxes. With the average value of farm assets at just under \$3 million in 2007 for this category, large and very large family farms are ten times more likely to owe federal estate taxes than smaller farms.<sup>97</sup> As mentioned earlier, these large-scale family farms account for a majority of U.S. agricultural production which means their preservation is vital to sustaining American food production.<sup>98</sup>

#### IV. WHERE WE STAND TODAY: TAX RELIEF ACT OF 2010

As we progressed toward the end of 2010, a number of proposals were introduced to suggest what Congress should do with the federal estate tax.<sup>99</sup> These proposals included permanently repealing the estate tax or raising the exemption value to various points over \$1 million.<sup>100</sup> The final result was the 2010 Tax Relief Act, which did the latter.<sup>101</sup> The Tax Relief Act significantly affects the estate, gift and generation-skipping transfer tax laws for 2010-2012.<sup>102</sup>

In order to understand the current federal estate tax landscape, it's important to note the changes implemented by the new Act. The following sections briefly explore the most relevant of the new provisions of the Act and, when applicable, compares them to those of the EGTRRA.

##### A. Reinstatement of the Estate Tax

Varying Exclusions Amounts from 2009-2012		
Year	Circumstances	Exclusion Amount
2009	EGTRRA, 2009	\$3.5 million
2011	Absent Congressional action and sunset of EGTRRA	\$1 million
2011, 2012	2010 Tax Relief Act	\$5 million

Under the provisions of the EGTRRA, no federal estate tax existed

97. See Durst, *supra* note 9.

98. HOPPE ET AL., *supra* note 55, tbl. 1.

99. JANE G. GRAVELLE, CONGRESSIONAL RESEARCH SERVICE, ESTATE TAX OPTIONS 4 (2010), <http://www.ombwatch.org/files/budget/CRS%20-%20Estate%20Tax%20Options%20-%20R41203%20-%202004-23-2010.pdf>; see also Edward J. McCaffery, *Through the Looking Glass: the Politics of Estate Tax Reform*, 35 ACTEC J. 121 (2009).

100. See GRAVELLE, *supra* note 99.

101. 2010 Tax Relief Act, *supra* note 18.

102. Jonathan G. Blattmachr et. al, *Estate Planning After the 2010 Tax Relief Act: Big Changes, But Still No Certainty*, 114 J. TAX 68, 68 (2011).

in 2010.<sup>103</sup> This meant that the estates of Decedents dying between December 31, 2009 and January 1, 2011 could pass tax-free to the beneficiaries.<sup>104</sup> The 2010 Tax Relief Act, however, retroactively reinstates the federal estate tax as of January 1, 2011.<sup>105</sup> The Act also provides for an increased exclusion amount (\$5 million; see below) and a maximum federal estate tax rate of 35%.<sup>106</sup> This means decedents dying after January 1, 2011 will potentially incur federal estate tax liability. As you will see below the decedents who died in 2010 may also encounter federal estate tax liability. This new federal estate tax scheme will remain in effect for decedents dying before January 1, 2012.<sup>107</sup>

### B. Raised Exclusion Amount

One of the most significant changes implemented by the 2010 Tax Relief Act is the increased basic exclusion amount.<sup>108</sup> In 2009, the EGTRRA provisions reached their highest exclusion amount at \$3.5 million.<sup>109</sup> The exclusion amount of the Act increases this figure by \$1.5 million to \$5 million.<sup>110</sup> This represents a \$4 million increase over the exclusion amount we would have faced had the EGTRRA expired without Congressional action.<sup>111</sup> What's more is that the applicable exclusion amount is now referred to as the "basic exclusion amount" by the Code.<sup>112</sup> The provisions contain a built-in inflation adjustment for decedents dying in calendar years after 2011.<sup>113</sup> The exclusion amount will be increased by an amount equal to \$5 million multiplied by the cost of living adjustment as determined under I.R.C. § 1(f)(3) for 2012.<sup>114</sup>

The \$5 million basic exclusion amount reduces federal estate tax liability as a credit under I.R.C. § 2010.<sup>115</sup> Instead of a direct, dollar-for-dollar reduction in the taxable estate, the credit reduces a taxpayer's

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103. GRAETZ & SHAPIRO, *supra* note 2, at 5.

104. *Id.*

105. Blattmachr et al., *supra* note 102, at 68.

106. I.R.C. § 2010(c).

107. 2010 Tax Relief Act, *supra* note 18.

108. See I.R.C. § 2010(c). The exclusion amount rose from \$3.5 million in 2009 to \$5 million in 2011 after the enactment of the 2010 Tax Relief Act. See generally Blattmachr et al., *supra* note 102.

109. See Durst, *supra* note 9.

110. See I.R.C. § 2010(c).

111. Durst, *supra* note 11, at 12 (noting that the exclusion amount is set to fall to \$1 million in 2011 in the absence of Congressional action).

112. I.R.C. § 2010.

113. *Id.*

114. *Id.*

115. *Id.*

tentative federal estate tax liability by the amount of a tentative tax calculated on \$5 million.<sup>116</sup> A brief example shows, however, that the credit has the same effect as excluding \$5 million from the taxable estate. If Farmer A has a taxable estate of \$6 million, Farmer A's tentative tax liability at a 35% rate is \$2,080,800. The I.R.C. § 2010 credit amount is \$1,730,800, which leaves Farmer A with a federal estate tax liability of \$350,000. This is 35% of \$1 million.

### C. *Established Maximum Rate*

The 2010 Tax Relief Act establishes a new maximum federal estate tax rate.<sup>117</sup> Previously, under the EGTRRA, the lowest maximum rate was 45%.<sup>118</sup> Under the new Act, the maximum rate is 35%.<sup>119</sup> This is the lowest maximum estate tax rate since 1931.<sup>120</sup>

### D. *Portability*

Previously, if a decedent left all of their estate to their surviving spouse, it passed tax-free and the decedent's exclusion amount went unused.<sup>121</sup> The 2010 Tax Relief Act prevents such waste and allows a surviving spouse to "port" this unused exclusion.<sup>122</sup> If the first spouse to die does not use any or all of their basic exclusion amount, the Act allows the surviving spouse to add the unused amount to their own basic exclusion amount, at most doubling this figure.<sup>123</sup> Known as portability,<sup>124</sup> this concept adds new dimension to estate planning and is considered by some to be one of the "most important changes under the new law."<sup>125</sup>

Is this mechanism automatically employed for surviving spouses?

116. *Id.*

117. I.R.C. § 2001(c).

118. Jeff Rohaly, *Wealth Transfer Taxes: What did the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) Do to the Estate, Gift, and Generation-skipping Transfer Taxes?*, Tax Policy Center, Urban Institute and Brookings Institute, Sept. 21, 2007, <http://www.taxpolicycenter.org/briefing-book/key-elements/estate/EGTRRA.cfm>

119. I.R.C. § 2001(c).

120. Darrien B. Jacobson et al., *IRS, The Estate Tax: Ninety Years and Counting*, IRS, (2008), <http://www.irs.gov/pub/irs-soi/ninetyestate.pdf>

121. *See* I.R.C. §§ 2010, 2056. Section 2056 provides that bequests and devises to surviving spouses pass tax-free. I.R.C § 2056. This reduces the taxable estate. *Id.* The credit in § 2010 is only available to offset the amount of the taxable estate. *See generally* I.R.C. § 2010.

122. I.R.C. § 2010(c).

123. *See id.*

124. *See* Marc. S. Bekerman, *What Portability Means to Trust and Estate Professionals*, Sept./Oct. 2009, at 39.

125. Blattmachr et al., *supra* note 102, at 79.

No, its use is only activated by election.<sup>126</sup> The first spouse to die (or rather their estate's executor) must make an election on the decedent's estate tax return to allow the surviving spouse to take into account any of the decedent's unused exclusion amount.<sup>127</sup> Once made, this election is irrevocable.<sup>128</sup> The Internal Revenue Service (IRS) Service can later audit the first deceased spouse's estate solely for the purposes of determining the deceased spouse's unused exclusion amount, even if the surviving spouse dies many years or even decades after the first spouse.<sup>129</sup>

Once the election is properly made, the surviving spouse may add the "deceased spousal unused exclusion amount" to their own exclusion amount.<sup>130</sup> "Deceased spousal unused exclusion amount" is defined by the Act to mean the lesser of the basic exclusion amount (\$5 million) and the exclusion amount minus the decedent's taxable estate.<sup>131</sup> In layman's terms, the latter is the amount of exclusion the decedent does not use.

A few basic examples may help illustrate this concept:

**Example 1:**

*Husband and Wife each own assets worth \$5 million. Husband dies in 2011 with an estate worth \$5 million. Husband leaves the estate in its entirety to Wife. The estate passes tax-free by virtue of the § 2056 marital deduction, so Husband's estate tax liability is \$0 and he used \$0 of his basic exclusion amount. Husband's executor makes an election on the estate tax return under § 2010(c)(5) to allow portability of the unused exclusion amount to Wife. Wife dies in 2012 with an estate worth \$10 million. Under § 2010(c)(4), Wife may use Husband's unused exclusion amount, \$5 million, with her own exclusion amount, \$5 million, for a total exclusion amount of \$10 million. Wife's estate will pass tax-free to her beneficiaries.*

**Example 2:**

*Husband and Wife each own assets worth \$5 million. Husband dies in 2011 with an estate worth \$5 million. Husband leaves \$3 million to his Wife outright, \$2 million to their Child. The \$3 million bequest to his*

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126. I.R.C. § 2010(c)(5).

127. *Id.*

128. *Id.*

129. Blattmachr et al., *supra* note 102, at 79.

130. I.R.C. § 2010(c)(4).

131. *Id.* "Deceased spousal unused exclusion amount" is "the lesser of (A) the basic exclusion amount or (B) the excess of the (i) the basic exclusion amount of the last such deceased spouse of such surviving spouse, over (ii) the amount with respect to which the tentative tax is determined under § 2001(b)(1) on the estate of such deceased spouse." *Id.*

*Wife passes tax-free under § 2056. The \$2 million gift to Child, however, is a taxable gift under § 2001. Husband uses \$2 million of his exclusion amount to exempt the gift from taxation. Husband's executor makes an election on the estate tax return under § 2010(c)(5) to allow portability of the unused exclusion amount to Wife. Wife dies in 2012 with an estate worth \$8 million. She may now use her own exclusion amount, \$5 million, and Husband's unused exclusion amount (\$5 million less \$2 million, or \$3 million) for a total exclusion amount of \$8 million. Wife's estate may now pass tax-free to her beneficiaries.*

One concern about portability is the issue of remarriage because “[a] surviving spouse cannot take advantage of a deceased spousal unused exclusion amount from more than one predeceasing spouse.”<sup>132</sup> Only the unused exclusion amount of the “last such deceased spouse” may be used.<sup>133</sup> The remarriage of a surviving spouse to an individual who then uses their basic exclusion amount in its entirety at their death will prevent the surviving spouse from using their first spouse's unused amount.<sup>134</sup> It is suggested that this may become a point of contention in pre-nuptial agreement negotiations.<sup>135</sup>

Remarriage considerations aside, this may be of great benefit to American farmers. A farmer may now leave substantial assets to his wife, tax-free, and his unused exclusion can be added to her exclusion amount at her death. This would increase the value of assets which could then pass tax-free to their children. Alternatively, if the farmer's spouse is the first to die, they can leave their assets to the farmer tax-free and then the farmer may use the spouse's exclusion amount, coupled with his own, to pass the farm on to the next generation with minimized federal estate tax liability.

#### E. *Decedents Dying in 2010: the Election*

For estate executors of decedents who died between December 31, 2009 and January 1, 2011, the 2010 Tax Relief Act poses an interesting conundrum.<sup>136</sup> As mentioned above, the Act retroactively reinstates the federal estate tax, which means 2010 decedents may now face federal estate tax liability when there previously was none.<sup>137</sup> However, the 2010 Tax Relief Act gives executors of these particular estates the

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132. Blattmachr et al., *supra* note 102, at 79.

133. I.R.C. § 2010(c)(4).

134. Blattmachr et al., *supra* note 102, at 81.

135. *Id.*

136. *See id.*

137. *See generally id.*



power to choose which of the two tax schemes to apply.<sup>138</sup> The executor may elect to treat the decedent's estate as though the 2010 Tax Relief Act was never enacted.<sup>139</sup> This would permit the estate to be treated as it would be under the EGTRRA—meaning no federal estate tax liability.<sup>140</sup> In the absence of making such an election, the provisions of the new Act apply and those estates with gross estate values exceeding \$5 million may have to pay federal estate taxes.<sup>141</sup>

The election is not all positive; it comes at a cost. Choosing to apply the EGTRRA treatment means the recipients of the decedent's property receive a straight carryover basis, not a stepped up basis.<sup>142</sup> If an executor chooses to instead pay the estate tax under the provisions of the new Act, in the majority of circumstances, beneficiaries will receive the stepped-up basis equal to fair market value.<sup>143</sup> As this Note later discusses in greater detail, the stepped-up basis is one of the most positive benefits of the federal estate tax scheme.<sup>144</sup> Professor Dennis A. Calfee of the University of Florida suggests that estates which are composed largely of depreciable assets, like farm estates, should not take the election.<sup>145</sup> Instead, they should pay the federal estate tax liability under the new provisions and reap the benefits of the stepped-up basis.<sup>146</sup>

To compensate for the choice they must now make, executors received an extended filing deadline under the new Act.<sup>147</sup> Executors of estates of decedents dying after December 31, 2009 but before December 17, 2010 have until September 19, 2011 to file returns regardless of what month the date of death occurred.<sup>148</sup> This is just over nine months after the enactment of the 2010 Tax Relief Act.<sup>149</sup>

How do executors make this election? The presumption is that the

138. *Id.* at 68.

139. *Id.*

140. *Id.*

141. *Id.*

142. I.R.C. § 1014; *see also* *Charting a Course: Estate Planning 2009-2011*, JOURNAL OF ACCOUNTANCY, July 2009, available at <http://www.journalofaccountancy.com/web/chartingacourse.htm> (noting the EGTRRA eliminated the stepped-up basis starting in 2010).

143. I.R.C. § 1014. Note that there are some exceptions to the stepped-up basis rule in various situations. *Id.*

144. Interview with Dennis Calfee, Alumni Research Scholar and Professor of Law, U. FLA. Levin College of Law, in Gainesville, FL (Oct. 19, 2010).

145. Interview with Dennis Calfee, Alumni Research Scholar and Professor of Law, U. FLA. Levin College of Law, in Gainesville, FL (Dec. 16, 2010).

146. *Id.*

147. 2010 TAX LEGISLATION, TAX RELIEF, UNEMPLOYMENT INSURANCE REAUTHORIZATION, AND JOB CREATION ACT OF 2010, RIC MODERNIZATION ACT OF 2010, AND OTHER RECENT TAX ACTS, LAW EXPLANATION AND ANALYSIS 357 (2010) [hereinafter LAW & EXPLANATION].

148. *Id.*

149. Overview, *supra* note 13; *see also* LAW & EXPLANATION, *supra* note 147, at 357.

IRS will issue a special form solely for this purpose.<sup>150</sup> It is important to note that once the election is made, it is revocable only with the consent of the Secretary of the Treasury Department.<sup>151</sup> Therefore, executors must carefully analyze the composition of these estates to determine the most advantageous tax regime on a case-by-case basis and consult with beneficiaries before making this decision.

#### F. *Expires on December 31, 2012*

While the 2010 Tax Relief Act is welcomed assistance for many taxpayers, American farmers included, it is only a short-term solution.. The Act may be “good news for most clients” but it is easy to see that its “largest problem . . . is that the provisions are temporary.”<sup>152</sup> Taxpayers are once again threatened with the same circumstances as in 2009-2010—the possibility that sunseting tax relief provisions will bring back pre-EGTRRA conditions. These circumstances make estate planning for American farmers increasingly challenging. As one author notes, an “unfortunate feature of our tax system is that it is riddled with uncertainty .”<sup>153</sup>

### V. WHERE DO WE GO FROM HERE? THE UNCERTAINTY PERSISTS

If the federal estate tax reverts to its pre-2001 conditions, the number of farm estates expected to owe federal estate taxes will increase significantly.<sup>154</sup> Since farm equity has more than doubled since 2000, due in part to increasing land values and rising input costs, some forecast that one out of every ten farm estates will owe federal estate taxes if the exemption value ever falls to \$1 million.<sup>155</sup> The USDA predicts the amount owed in federal estate taxes by all estates will triple under pre-2001 conditions, increasing total liability to \$2.55 billion.<sup>156</sup>

So what does this mean for farmers with assets exceeding \$1 million who die after 2012? It is documented that the estates of farmers are less likely than other estates to have sufficient liquid assets to meet their

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150. Blattmachr et al., *supra* note 102, at 69. The IRS has already issued a draft of such a form for comment, known as Form 8939 “Large Transfers at Death.” *Id.*

151. I.R.C. § 2010(c)(5).

152. *Id.* at 88.

153. Donald Marron, *2012 Budget is Full of Contradictions*, CHRISTIAN SCI. MONITOR (Mar. 21, 2011), <http://www.csmonitor.com/Business/Donald-Marron/2011/0324/2012-budget-is-full-of-contradictions>.

154. See Durst, *supra* note 9.

155. Durst, *supra* note 11, at 12.

156. DURST, *supra* note 39, at iv.

federal estate tax liability.<sup>157</sup> In 2000, approximately 8% (138) of farm estates had a federal estate tax bill which exceeded the value of the estate's liquid assets.<sup>158</sup> This was before the EGTTTRA, when the exemption value was only \$675,000.<sup>159</sup> If the laws revert to pre-EGTTTRA conditions, we can expect similar results. This means farmers and ranchers with assets exceeding \$1 million should be proactive in their estate planning, to minimize the potential effects of the federal estate tax. But this can be expensive, with compliance costs for all estates at an estimated 7% of federal estate tax receipts.<sup>160</sup> The Joint Economic Committee concluded in their 1998 study that "for every dollar of tax revenue raised by the [federal] estate tax, another dollar is squandered in the economy simply to comply with or avoid the tax."<sup>161</sup> In 1998, before the EGTTTRA, a family business spent an average of \$16,113 on lawyers, \$14,632 on accountants and \$2,392 on other financial advisors.<sup>162</sup> Currently, with the uncertainty surrounding the future of the federal estate tax, families "cannot just have one plan" but need "multiple estate plans" to cope with the speculation.<sup>163</sup> To make matters worse, few individuals involved in agriculture possess advanced degrees in tax, law or finance; meaning any advice sought informally among family or friends will likely not come from a source with a true understanding of the situation.<sup>164</sup>

It is possible that farmers and ranchers themselves do not fully comprehend the mechanics of the federal estate tax.<sup>165</sup> It is documented that opinions about the federal estate tax are subject to great bias.<sup>166</sup> Studies show that a number of Americans believe the federal estate tax is a burden to all individuals, not just the wealthiest of Americans.<sup>167</sup> In a 2003 poll conducted by National Public Radio, 57% of Americans said they advocated the elimination of the federal estate tax.<sup>168</sup> Of those individuals polled, 39% said they were against the federal estate tax because it "might" affect them one day.<sup>169</sup> Nearly half of the

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157. FEDERAL & GIFT TAXES, *supra* note 85, at 6.

158. *Id.*

159. *Id.*

160. *Id.*

161. Economics of the Estate Tax, *supra* note 25, at 14.

162. *Id.*

163. Uncertainty in Planning, *supra* note 24, at 2 (statement of Hon. Max Baucus, Chairman, Comm. on Finance).

164. Lytton, *supra* note 22, at 424.

165. SLEMROD & BAKIJA, *supra* note 3, at 292.

166. *See id.*

167. *Id.* (noting that a "large number" of Americans believe the federal estate tax applies to people who are not particularly wealthy").

168. *Id.*

169. *Id.*

respondents thought that “most families have to pay the federal estate tax when someone dies.”<sup>170</sup> But the numbers collected via such surveys are as inconsistent as the average person’s understanding of the federal estate tax. In a 2000 Gallup poll, only 17% of Americans believed they would pay the tax.<sup>171</sup> Many of the discrepancies in both the poll numbers and Americans’ knowledge may be attributable to choices made in the terminology presented: it has been said that “the key . . . is how you wrap the language.”<sup>172</sup> Do the polls call it a “death tax” or a “billionaire’s tax?”<sup>173</sup> Regardless of the phrasing, the federal estate tax is currently at a crossroads.

## VI. WHITE HOUSE AGENDA: PRESIDENT OBAMA’S NEW PROPOSAL

Following the enactment of the 2010 Tax Relief Act, President Obama said that the “generous treatment” is “temporary.”<sup>174</sup> Already, at the end of 2010’s first quarter, the current administration is touting proposed changes to the federal estate tax landscape via President Obama’s 2012 Budget.<sup>175</sup> President Obama’s new plan calls for further modifications to the exclusion amount and tax rate, while also adjusting the basis rules.<sup>176</sup> Of greatest concern is that the Obama scheme proposes a reversion to the 2009 conditions, with an exclusion amount of \$3.5 million and a rate of 45%.<sup>177</sup> If enacted, Obama’s proposals would be effective starting January 1, 2013.<sup>178</sup>

As discussed extensively later in this Note, exclusion values of \$3 million plus, when coupled with a moderate tax rate, result in a relatively positive outlook for most American farmers. A reduction of the exclusion value to \$3.5 million would not be utterly devastating to American farmers but may raise significant concerns about the future. Would a decrease to \$3.5 million be the first slide down the slippery

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170. *Id.* (49% gave this response). *Id.*

171. DAVID CAY JOHNSTON, PERFECTLY LEGAL 78 (2005).

172. *Id.* at 82 (quoting Frank Luntz).

173. *Id.* at 82-84.

174. See Hani Sarji, *Obama Announces Estate Tax Deal with Republicans: 35% Tax Rate and \$5 Million Exemption, For Two Years*, FORBES (Dec. 6, 2010), <http://blogs.forbes.com/hanisarji/2010/12/06/obama-announces-estate-tax-deal-with-republicans-35-tax-rate-and-5-million-exemption-for-two-years/>.

175. See Tax Policy Center Tax Proposals in the 2012 Budget, <http://www.urban.org/uploadedpdf/1001524-2012-Budget.pdf> (last visited July 31, 2011).

176. *Id.* at 26.

177. *Id.*

178. Hani Sarji, *Obama’s Budget Proposal Sets up Estate Tax Fight*, FORBES (Feb. 26, 2011), <http://blogs.forbes.com/hanisarji/2011/02/26/obamas-budget-proposal-sets-up-estate-tax-fight/>.

slope back to a \$1 million exclusion amount? It is anyone's guess.

But there is some hope for American farmers who dream of keeping the \$5 million exclusion amount. Commentators believe Obama's proposal to once again lower the exemption value and raise the tax rate will face "great difficulty" in Congress.<sup>179</sup> Not only would Republicans oppose this change but many Democrats as well.<sup>180</sup> In fact, in 2009 the Senate rejected a similar proposal, H.R. 4154, Permanent Estate Tax Relief for Families, Farmers, and Small Businesses Act of 2009.<sup>181</sup> It is not far-fetched to expect a comparable result for Obama's newest plan.

## VII. THE NEED FOR COMPROMISE AND PERMANENT CHANGE

With the threat of reversion to the pre-2001 conditions now renewed, it is of great importance that the end of 2012 is met with another compromise between Congress and the White House. After a decade of three different federal estate tax regimes,<sup>182</sup> it should be easy to determine what scheme is most advantageous for farmers and ranchers. The options currently on the table mimic the ideas of past and present: (1) lowered exclusion values, perhaps to as low as pre-EGTRRA levels, (2) preservation of the \$5 million exclusion of the 2010 Tax Relief Act or (3) a complete and permanent repeal of the federal Estate Tax.

On the surface, the latter seems like the best option. But a complete repeal may come with a significant sacrifice. As briefly discussed earlier in this Note,<sup>183</sup> a complete repeal of the federal estate tax would likely result in the elimination of the coveted stepped up basis rule, which is exceedingly helpful to farmers and ranchers.<sup>184</sup> Under I.R.C. § 1014(a)(1), the basis of property acquired from a decedent is the fair market value of the property at the decedent's death.<sup>185</sup> This "stepped up" basis has significant implications for farmers and ranchers. If an heir inherits equipment and machinery subject to an allowance for depreciation at the donor's basis, the decedent's adjusted basis in the property may be as low as \$0.<sup>186</sup> If the heir acquires the property with a

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179. Lewis Saret, *Obama Estate Tax Budget Proposals*, FORBES (Mar. 11, 2011), <http://blogs.forbes.com/lewissaret/2011/03/11/obama-estate-tax-budget-proposals/>.

180. *Id.*

181. *Id.*

182. From 2000 to present-day, three tax schemes have been in effect: (1) Pre-EGTRRA, (2) EGTRRA, (3) 2010 Tax Relief Act.

183. *Supra* notes 143-145 and accompanying text.

184. Interview with Dennis Calfee, *supra* note 144.

185. See I.R.C. §§ 2014, 2022; see also J. MARTIN BURKE, MICHAEL K. FRIEL, *TAXATION OF INDIVIDUAL INCOME* 102 (8th ed. 2007).

186. See I.R.C. § 1022. The basis of a person acquiring property from a decedent shall be the lesser of the donor's adjusted basis or fair market value. *Id.*

basis of \$0 and subsequently sells the property, the heir will likely pay significant taxes on the gains.<sup>187</sup> If the heir acquires the property at fair market value, the probability of paying significant taxes when the property is subsequently sold decreases.<sup>188</sup> If all the depreciable property of an estate is inherited under the stepped-up basis rule, the savings in taxes paid on gains relative to federal estate taxes is significant.<sup>189</sup> Thus, in order to preserve the benefits of the stepped up basis rule, the best solution for farmers and ranchers is to advocate permanently raising the exemption value above \$3 million.<sup>190</sup>

Preserving a high exclusion amount is not a new line of thinking. In fact, even before the EGTTRA and well before the 2010 Tax Relief Act, a higher exemption value was advocated by those on both sides of the debate over repealing the federal estate tax.<sup>191</sup> For example, in 2000, William Gates (father of Microsoft mogul Bill Gates) accumulated signatures of 120 of America's richest individuals on a petition favoring retention of the federal estate tax during a time when permanent repeal was a hot topic.<sup>192</sup> Despite writing op-ed pieces in the *New York Times* and appearing on CNN's "Crossfire" to support retention of the federal estate tax, even Gates urged an increase in the exemption value to \$3.5 million for individuals, \$7 million for couples.<sup>193</sup> Furthermore, Gates specifically suggested adjustments might be necessary to "help farmers leave their farms to their children."<sup>194</sup> Billionaire Warren Buffet had also advocated raising the exemption value so that it focuses on super-wealthy individuals (like himself) and not the "moderately rich."<sup>195</sup>

In 2005, the Congressional Budget Office (CBO) analyzed the potential effects of permanently raising the exemption value.<sup>196</sup> Using the year 2000 as a base, a year in which 4600 farm estates of all sizes filed federal estate tax returns, the CBO concluded that higher exemption values would have a significant positive impact on farmers and ranchers.<sup>197</sup> In 2000, had the exemption value been \$1.5 million instead of the actual \$675,000, only about 1000 farmers would have had

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187. See I.R.C. §§ 1001, 1245.

188. See I.R.C. § 1001. Gains are determined by subtracting the taxpayer's basis from the amount realized. *Id.* If a taxpayer acquires property with a basis of \$100 and sells it for \$100, they will recognize no gain. *Id.*

189. Interview with Dennis Calfee, *supra* note 144.

190. *Id.*

191. See GRAETZ & SHAPIRO, *supra* note 2, at 169-72.

192. *Id.* at 169.

193. *Id.* at 170.

194. *Id.*

195. JOHNSTON, *supra* note 171, at 87.

196. EFFECTS OF FEDERAL ESTATE TAX, *supra* note 29, at 14.

197. *Id.*

to file federal estate tax returns.<sup>198</sup> If the exemption value had been \$3.5 million, only 200 would have been required to file<sup>199</sup> and fewer than fifteen of those estates would have lacked the necessary liquidity to pay their federal estate tax liability.<sup>200</sup> If the exemption value were \$5 million, like it is under the current temporary provisions, only 123 farm estates would have owed federal estate tax.<sup>201</sup> It is easy to see how higher exemption values may help farmers and ranchers successfully pass along their businesses to the next generation.

Although this Note does not advocate a complete repeal of the federal estate tax, it is worth considering the effects exempting farmers and ranchers from the federal estate tax would have on Government revenue. Total federal estate tax and gift revenue was an estimated \$26 billion in 2009.<sup>202</sup> Forecasts predict that a permanent repeal would cost only a small fraction of the current federal estate tax revenue.<sup>203</sup> This is because the bulk of wealth that is actually taxed by the federal estate tax, nearly two-thirds, is liquid portfolio wealth accumulated by some of the nation's richest individuals.<sup>204</sup> Thus, eliminating the number of farmers and ranchers subjected to the federal estate tax is unlikely to have a significant impact on government revenue.<sup>205</sup>

The uncertainty of the future is fueling the pressure to introduce new and permanent legislation- and elevating the fear felt among America's aging farmers and ranchers who expect to survive 2012. Admittedly, the number of farm estates affected by the federal estate tax is small relative to the number of decedents each year. However, for the small percentage of farmers and ranchers who do face significant federal estate tax liability, the consequences are very real.

## VIII. AN ILLUSTRATION: TWO FARMERS

A simple illustration may provide insight as to why farmers and ranchers fear the federal estate tax. This section analyzes the potential federal estate tax scenarios for hypothetical Farmer A and Farmer B.<sup>206</sup>

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198. *Id.*

199. *Id.*

200. *Id.* at 14-15.

201. GRAVELLE, *supra* note 99.

202. DURST, *supra* note 39, at 13.

203. GRAETZ & SHAPIRO, *supra* note 2, at 215.

204. *Id.*

205. *Id.*

206. The illustrations used in this Note are for demonstrative purposes only. Assets of Farmer A and Farmer B have been greatly simplified to allow for ease of understanding and calculations. However, the assortment of equipment, land and livestock is a realistic depiction of American farmers.

Both estate values have been calculated without regard to any estate value reduction techniques for simplicity's sake.<sup>207</sup> Furthermore, assume that neither Farmer A nor Farmer B have engaged in any estate planning.<sup>208</sup> The federal estate tax liability and resulting deficiencies for each farmer are analyzed below and the consequences of electing to use I.R.C. Section 6166 are discussed for each farmer. Essentially, I.R.C. Section 6166 allows an estate, in connection with a closely held business, to elect to pay federal estate tax liability in as many as ten annual installments.<sup>209</sup> The first installment must be paid within five years of the due date for payment (interest only is due during the first four years).<sup>210</sup> This discussion is particularly interesting when you take into account that when the majority of farmers and ranchers earn a profit, they reinvest the profits back into the operation by purchasing additional farm assets.<sup>211</sup> If farmers have no capital with which to increase yields, meeting federal estate tax liability payments will be even more difficult.

Both Farmer A and Farmer B work full-time (no other source of income) on their respective Florida cattle ranches and each have two children to whom they would like to leave their business. Assume that both are sole proprietors of large family farms (with annual sales of \$250,000 or more).

Farmer A owns 700 acres of improved pastureland with various permanent structures, 400 head of cattle and an assortment of necessary machinery and equipment. He has approximately \$45,000 in other personal property including his personal vehicle and some miscellaneous assets.<sup>212</sup> Farmer A's annual sales receipts total \$250,000 with an average net income of \$160,000. If Farmer A died today, his estate would be valued at \$2,803,000.<sup>213</sup>

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207. No consideration has been given to estate reduction techniques such as spousal transfers, or special valuation methods for family farmers, inter vivos gifts, charitable contributions, spousal transfers or special valuation methods for farmland.

208. Assume that neither Farmer A nor B has employed any inter vivos gifts or charitable contributions which may offset their estate value.

209. See I.R.C. § 6166

210. See *id.*

211. 106 CONG. REC. (daily ed. Nov. 4, 1999) (statement of Mr. Rod Grams, Senator from Minnesota).

212. Personal property is meant to include personal effects, household furniture, etc.

213. See Table 1.



<b>Table 1: Asset Schedules of Farmers A and B<sup>214</sup></b>			
<b>Farmer A's Asset Schedule</b>		<b>Farmer B's Asset Schedule</b>	
Land	\$2,100,000	Land	\$4,500,000
Equipment and Machinery	\$108,000	Equipment and Machinery	\$216,000
Livestock (cattle)	\$400,000	Livestock (cattle)	\$600,000
Cash assets (bank accounts)	\$150,000	Cash assets (bank accounts)	\$250,000
Other personal property	\$45,000	Other personal property	\$55,000
<b>Total Estate Value</b>	<b>\$2,803,000</b>	<b>Total Estate Value</b>	<b>\$5,571,000</b>

Farmer B owns 1500 acres of improved pastureland with various permanent structures, 600 head of cattle and an assortment of necessary machinery and equipment. He has approximately \$55,000 in other personal property including his personal vehicle and some miscellaneous assets.<sup>215</sup> Farmer B's annual sales receipts total \$375,000 with an average net income of \$135,000. If Farmer B died today, his estate would be valued at \$5,571,000.<sup>216</sup>

#### **Farmer A:**

If Farmer A died in 2011 or 2012, when the exclusion amount is \$5 million, Farmer A would have no federal estate tax liability because the value of the estate is less than the exclusion amount. The same is true if Farmer A had died in 2009, when the exemption value was \$3.5 million with a rate of 45. But if Farmer A dies in 2013, and the federal estate tax returns to a \$1 million exemption value and a 55% rate, Farmer A's estate will owe \$595,650 in federal estate taxes. With only \$150,000 in cash assets, the deficiency would be \$445,650. If you increase the exclusion by a mere \$500,000 to \$1.5 million, Farmer A's tax liability decreases to \$320,650 (at a 55% rate), \$262,350 (45% rate) and \$204,050 (35% rate). If the exclusion amount was \$2 million, Farmer A's federal estate tax liability would be reduced again- \$45,650 (55% rate), \$37,350 (45% rate) or \$29,050 (35% rate).

214. Land, livestock and equipment/machinery values based on present day markets in Southwest Florida. Values derived with assistance from Hugh Taylor, Chief Property Appraiser, Farm Credit of SouthFlorida, October 20, 2010. Taylor has more than thirty years experience as a property appraiser and manages his family's commercial cattle operation.

215. The value of Farmer B's personal residence has been included in his land value.

216. See Table 1.

		<b>Liability</b>	<b>Deficiency<sup>1</sup></b>
Exemption Value: \$1 million	Rate: 55%	\$991,650	\$841,650
Exemption Value: \$1.5 million	Rate: 55%	\$716,650	\$566,650
Exemption Value: \$1.5 million	Rate: 45%	\$586,350	\$436,350
Exemption Value: \$1.5 million	Rate: 35%	\$456,050	\$306,050
Exemption Value: \$2 million	Rate: 55%	\$441,650	\$291,650
Exemption Value: \$2 million	Rate: 45%	\$361,350	\$211,350
Exemption Value: \$2 million	Rate: 35%	\$281,050	\$131,050
Exemption Value: \$3.5 million	Rate: 45%	\$0	\$0
Exemption Value: \$5 million	Rate: 35% <sup>2</sup>	\$0	\$0

1 After \$150,000 in cash assets are applied towards Farmer A's total federal estate tax liability.

2 Exclusion amount and tax rate of 2010 Tax Relief Act.

At certain exemption values (\$1 million to \$2 million) and various rates (35% to 55%), Farmer A's estate would face a deficiency in its federal estate tax liability, even after applying readily available cash assets.<sup>217</sup> At this point, the estate may either (a) pay the federal estate tax liability in a maximum of ten annual installments or (b) liquidate assets to pay the federal estate tax liability now.<sup>218</sup>

Farmer A's annual sales receipts total \$250,000 as a result of selling 400 head of cows and calves at an average price of \$625 per head. After deducting expenses of \$400 per head, Farmer A's net income is \$90,000. With an allowance of \$50,000 for living expenses, this leaves \$40,000 for debt service.

<b>Income</b>	400 head of cattle @ \$625 each	\$250,000
<b>Expenses</b>	\$400 per head sold	(\$160,000)
	Living expenses	(\$50,000)
<b>Total Available for Debt Service</b>		<b>\$40,000</b>

As Table 4 shows, employing I.R.C. § 6166 is a viable option at some of the lower federal estate tax liability points for Farmer A's estate but is not feasible at higher deficiencies. In only one instance does Farmer A's available debt service income exceed the annual payment amount. It is arguable that the estate could find an additional

217. See Table 2.

218. See I.R.C. § 6166.

\$28,105 each year to afford the payments at the \$2 million exempt value, 35% rate level. But when Farmer A's federal estate tax liability is at its greatest (\$991,650 at the 2013 scheduled exemption value of \$1 million with a 55% tax rate) Farmer A's estate would have to make ten payments of \$99,165—more than double the amount available for debt service. As evidenced by the significant levels of total farm debt, agricultural expansion is heavily dependent on borrowed capital.<sup>219</sup> If Farmer A's estate must allocate all of its resources available for debt service to its federal estate tax payments, it will have no monetary resources to devote to debt for expansion.

<b>Table 4: Farmer A's Estate: Payments under I.R.C. § 6166</b>		
	<b>Liability</b>	<b>Payments<sup>1, 2</sup></b>
Exemption Value: \$1 million   Rate: 55%	\$991,650	\$99,165
Exemption Value: \$1.5 million   Rate: 55%	\$716,650	\$71,665
Exemption Value: \$1.5 million   Rate: 45%	\$586,350	\$58,635
Exemption Value: \$1.5 million   Rate: 35%	\$456,050	\$45,605
Exemption Value: \$2 million   Rate: 55%	\$441,650	\$44,165
Exemption Value: \$2 million   Rate: 45%	\$361,350	\$36,135
Exemption Value: \$2 million   Rate: 35%	\$281,050	\$28,105
Exemption Value: \$3.5 million   Rate: 45% <sup>3</sup>	\$0	\$0
Exemption Value: \$5 million   Rate: 35% <sup>4</sup>	\$0	\$0

1 Payments calculated without regard to the \$150,000 in readily available cash payments

2 Payments calculated exclusive of interest

3 Exemption value and rate at height of EGTRRA (2009)

4 Exemption value and rate under 2010 Tax Relief Act

Alternatively, Farmer A's estate may choose to immediately (after death) liquidate assets to alleviate the burden of the long-term payment plan discussed above. For Farmer A's estate to currently meet its federal

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219. See Farm Income and Costs, *supra* note 72. Farm debt is expected to increase in 2010 to \$2.095 trillion. *Id.*

estate tax liability, a series of liquidation events would have to occur. For purposes of this simulation, five liquidation events were devised. These liquidation events are used to show what the estate would need to sell to meet its federal estate tax liability at the different exemption values and rates. The first liquidation event involves selling the estate's most liquid assets—his machinery and equipment, worth \$108,000. The second liquidation event involves selling Farmer A's livestock—400 head of cattle at \$1,000 a head, proceeds totaling \$400,000. The third, fourth and fifth liquidation events involve selling 50 acres of Farmer A's land. At \$3,000 per acre, these liquidation events yield \$150,000 each. In order to meet Farmer A's projected federal estate tax liability in 2011 (assuming a \$1 million exemption value and a 55% tax rate), Farmer A's estate would have to sell the machinery, equipment, livestock and 150 acres of land. The essential assets required for the operation of the business would be sold. Farmer A's heirs would be left with land only. In order to establish a productive business again, the heirs would likely have to (a) sell more land to generate capital or (b) borrow against the land which remains.

Table 5: Farmer A's Liquidation Events to Meet Federal Estate Tax Deficiency<sup>1</sup>

Exemption Value Tax Rate	Deficiency	First Liquidation Proceeds <sup>2</sup>	Deficiency	Second Liquidation Proceeds <sup>2</sup>	Deficiency	Third Liquidation Proceeds <sup>2</sup>	Deficiency	Fourth Liquidation Proceeds <sup>2</sup>	Deficiency	Fifth Liquidation Proceeds <sup>2</sup>	Deficiency
\$1 million 55%	\$841,650	\$108,000	\$733,650	\$400,000	\$333,650	\$150,000	\$183,650	\$150,000	\$33,650	\$150,000	\$0
\$1.5 million 55%	\$566,650	\$108,000	\$458,650	\$400,000	\$58,650	\$150,000	\$0	N/A	\$0	N/A	\$0
\$1.5 million 45%	\$436,350	\$108,000	\$328,350	\$400,000	\$0	N/A	\$0	N/A	\$0	N/A	\$0
\$2 million 55%	\$291,650	\$108,000	\$183,650	\$400,000	\$0	N/A	\$0	N/A	\$0	N/A	\$0
\$2 million 45%	\$211,350	\$108,000	\$103,350	\$400,000	\$0	N/A	\$0	N/A	\$0	N/A	\$0

<sup>1</sup> Deficiency after \$150,000 cash assets are applied to Farmer A's Federal estate tax liability

<sup>2</sup> Proceeds estimated using fair market value of assets in the Southwest Florida market

**Farmer B:**

With an estate value exceeding \$5.5 million, Farmer B's estate cannot reduce its federal estate tax liability to zero, but higher exemption values help decrease the burden. If Farmer B died in 2011 or 2012, when the exclusion amount is \$5 million, Farmer B's estate would have federal estate tax liability of \$199,850. With \$250,000 in cash assets, Farmer B's estate would have \$0 deficiency. But this is the best case scenario. Even if Farmer B died in 2009, when the exemption value was \$3.5 million with a rate of 45%, Farmer B's estate would have had federal tax liability of \$931,950 and a deficiency of \$681,950. Worst case scenario? If the 2010 Tax Relief Act expires in 2012 and the exemption value decreases to \$1 million and a 55% rate is applied, Farmer B's federal estate tax liability would total a staggering \$2,514,050. Offsetting the total liability with Farmer B's \$250,000 cash assets does little to improve this bleak situation. The deficiency would still be \$2,264,050, over 40% of the estate's total value. With exemption values of \$1.5 million and \$2 million, Farmer B's federal estate tax liability would range from \$1,249,850 (\$2 million exemption value, 35% rate) to \$2,239,050 (\$1.5 million exemption value, 55% rate). After applying the value of the cash assets, the deficiency would range from \$999,850 to \$1,989,050. Even at an exemption value of \$3 million, Farmer B's estate faces significant federal estate tax liability: \$1,414,050 (55% rate), \$1,156,950 (45% rate), and \$899,850 (35% rate) with deficiencies of \$1,164,050 \$906,950, and \$649,850 respectively. The only way to prevent any significant federal estate tax liability for Farmer B is to maintain the current exclusion amount of \$5 million.

As demonstrated in Table 6, Farmer B's estate would face a deficiency in its federal estate taxes at every exemption value at the various rates, even after applying the \$250,000 in readily available cash assets. Farmer B's estate will have the same decision to make as Farmer A's estate: pay the federal estate tax liability now by liquidating assets or stretch the tax bill out over a maximum of ten annual installments.

<b>Table 6: Farmer B's Federal Estate Tax Liability Simulation</b>		
	<b>Liability</b>	<b>Deficiency<sup>1</sup></b>
Exemption Value: \$1 million   Rate: 55%	\$2,514,050	\$2,264,050
Exemption Value: \$1 million   Rate: 45%	\$2,056,950	\$1,806,590
Exemption Value: \$1 million   Rate: 35%	\$1,599,850	\$1,349,850
Exemption Value: \$1.5 million   Rate: 55%	\$2,239,050	\$1,989,050
Exemption Value: \$1.5 million   Rate: 45%	\$1,831,950	\$1,581,950
Exemption Value: \$1.5 million   Rate: 35%	\$1,424,850	\$1,174,850
Exemption Value: \$2 million   Rate: 55%	\$1,964,050	\$1,714,050
Exemption Value: \$2 million   Rate: 45%	\$1,606,950	\$1,356,950
Exemption Value: \$2 million   Rate: 35%	\$1,249,850	\$999,850
Exemption Value: \$3 million   Rate 55%	\$1,414,050	\$1,164,050
Exemption Value: \$3 million   Rate 45%	\$1,156,950	\$906,950
Exemption Value: \$3 million   Rate 35%	\$899,850	\$649,850
Exemption Value: \$3.5 million   Rate: 45%	\$931,950	\$681,950
Exemption Value: \$3.5 million   Rate: 35%	\$724,850	\$474,850
Exemption Value: \$5 million   Rate 55%	\$256,950	\$6,950
Exemption Value: \$5 million   Rate 45%	\$314,050	\$64,050.00
Exemption Value: \$5 million   Rate 35%	\$199,850	\$0

1 After \$250,000 in cash assets are applied toward Farmer A's total federal estate tax liability

Farmer B's annual sales receipts total \$375,000 for selling 600 head of cattle at average price of \$625 per head. After paying expenses of \$240,000 (\$400 per head of cattle sold), Farmer B's net income is \$135,000. After allowing \$50,000 for living expenses, Farmer B has \$85,000 for debt service.

<b>Income</b>	600 head of cattle \$625 per head	\$375,000
<b>Expenses</b>	\$400 per head of cattle sold	(\$240,000)
	Living expenses	(\$50,000)
<b>Total Available for Debt Service</b>		<b>\$85,000</b>

Estimated annual payments for Farmer B are presented in Table 8, below. Farmer B's estate would likely be able to easily make payments at an exemption value which exceeds \$5 million. But once the exemption values decrease to \$3.5 million and below, Farmer B's estate faces ten annual payments of significant value. When the exemption value is less than \$2 million (and at \$3 million with a 55% rate), the payment amount exceeds Farmer B's average net income even before taking into account living expenses.



<b>Table 8: Farmer B's Estate: Payments under I.R.C. § 6166</b>		
	<b>Liability</b>	<b>Payments<sup>1, 2</sup></b>
Exemption Value: \$1 million   Rate: 55%	\$2,514,050	\$251,405
Exemption Value: \$1 million   Rate: 45%	\$1,806,590	\$180,659
Exemption Value: \$1 million   Rate: 35%	\$1,349,850	\$134,985
Exemption Value: \$1.5 million   Rate: 55%	\$2,239,050	\$223,905
Exemption Value: \$1.5 million   Rate: 45%	\$1,831,950	\$183,195
Exemption Value: \$1.5 million   Rate: 35%	\$1,174,850	\$117,485
Exemption Value: \$2 million   Rate: 55%	\$1,964,050	\$196,405
Exemption Value: \$2 million   Rate: 45%	\$1,609,950	\$160,995
Exemption Value: \$2 million   Rate: 35%	\$999,850	\$99,985
Exemption Value: \$3 million   Rate: 55%	\$1,414,050	\$141,405
Exemption Value: \$3 million   Rate: 45%	\$1,156,950	\$115,695
Exemption Value: \$3 million   Rate: 35%	\$649,850	\$64,985
Exemption Value: \$3.5 million   Rate: 45% <sup>3</sup>	\$931,950	\$93,195
Exemption Value: \$3.5 million   Rate: 35% <sup>3</sup>	\$474,850	\$47,485
Exemption Value: \$5 million   Rate: 55%	\$314,050	\$31,405
Exemption Value: \$5 million   Rate 45%	\$256,950	\$25,695
Exemption Value: \$5 million   Rate 35%	\$0	\$0

1 Payments calculated without regard to the \$250,000 in readily available cash payments

2 Payments calculated exclusive of interest

3 Exemption value and rate at height of EGTRRA (2009)

As with Farmer A, if Farmer B's estate chooses to pay the liability currently, liquidation events would have to occur for Farmer B's estate to meet its tax burden. For purposes of this simulation, eight liquidation events were created and applied. This is the necessary number of liquidation events to eradicate Farmer B's deficiency at some of the exemption values and tax rates. The first two liquidation events match those of Farmer A, only with higher proceeds. Farmer B's machinery and equipment should garner \$216,000 while the 600 head of cattle are worth \$600,000. The third liquidation event is similar to Farmer A in that it involves selling a portion of the estate's land. But to account for Farmer B's significantly larger landholding, Farmer B's third liquidation event will involve selling 100 acres of land. This would bring in \$300,000 in proceeds. The fourth, fifth, sixth, seventh and eighth liquidation events are repetitive of the third liquidation—for each event Farmer B's estate will sell 100 acres at \$3,000 per acre until the deficiency is satisfied. If Farmer B died in 2009, when his federal estate tax liability is \$931,950 with a deficiency of \$681,950, the estate would have to liquidate the machinery, equipment and livestock to meet its obligation. If Farmer B dies in 2013 and the exemption value decreases to \$1 million with a 55% rate, then Farmer B's estate would have to utilize all eight liquidation scenarios. That requires selling the equipment, the machinery, the livestock and 600 acres of land- to satisfy the federal estate tax liability. Table 7 below depicts how many of the simulated liquidation events Farmer B's estate would have to employ at the various exemption values and rates.

<b>Table 9: Farmer B's Liquidation Events to Satisfy Federal Estate Tax Deficiency</b>			
<b>Exemption Value / Tax Rate</b>	<b>Deficiency<sup>1</sup></b>	<b>Number of Simulated Liquidation Events to Satisfy Deficiency<sup>2, 3</sup></b>	<b>Assets Sold to Satisfy Deficiency</b>
\$3.5 million / 45%	\$681,050	2	Equipment and machinery, livestock
\$1 million / 55%	\$2,264,050	8	Equipment and machinery, livestock, 600 acres
\$1.5 million / 55%	\$1,989,050	6	Equipment and machinery, livestock, 400 acres
\$1.5 million / 45%	\$1,581,950	5	Equipment and machinery, livestock, 300 acres
\$2 million / 55%	\$1,714,050	5	Equipment and machinery, livestock, 300 acres
\$2 million / 45%	\$1,356,950	4	Equipment and machinery, livestock, 200 acres
\$3 million / 55%	\$1,164,050	4	Equipment and machinery, livestock, 200 acres
\$3 million / 45%	\$906,950	3	Equipment and machinery livestock, 100 acres
\$5 million / 55%	\$64,050	1	Equipment and machinery
\$5 million / 45%	\$6,950	1	Equipment and machinery

1 Deficiency after \$150,000 cash assets are applied to Farmer A's federal estate tax liability

2 Proceeds estimated using fair market value of assets in the Southwest Florida market

3 Assumes a partial liquidation event is not possible

If the estates choose to pay the federal tax liability currently, it becomes apparent that the estates will sustain significant liquidation events. Liquidating assets may seem like an easy, harmless way to raise income. But these liquidation events involve the irreversible sell of assets vital to the operation of the business.<sup>220</sup> Without these assets, there is essentially no business to pass to heirs. The heirs would have to find ways to raise capital to invest in the business' operation.

It is easy to see why farmers and ranchers advocate repealing the federal estate tax or at the least, setting higher exemption values for farmers. It should also be easy to understand why the EGGTRA and now the \$5 million exclusion under the 2010 Tax Relief Act make it easier for farmers and ranchers to pass along their assets to the next generation without incurring significant obstacles and forcing liquidation events. Furthermore, it is important to note that liquidation events often result in generating proceeds that are less than fair market value because it creates a "buyers market."<sup>221</sup>

## IX. ALTERNATIVES FOR FARMERS

Farmers and ranchers are not completely without defenses against the federal estate tax; but such safeguards can be costly.<sup>222</sup> Proper estate planning can aid farmers in minimizing the severity of the federal estate tax.<sup>223</sup> Reducing the estate tax burden can result in the successful transfer of farm assets from one generation to the next.<sup>224</sup> Six common and popular estate value reduction tools receive a cursory look below: (1) the marital deduction, (2) special valuation for farmland, (3) conservation easements, (4) annual gifts of assets, (5) the use of life insurance policy proceeds and (6) Family Limited Liability Entities, with a focus on the Family Limited Partnership.

### (1) Marital Deduction

The transfer of assets between spouses is tax-exempt whether during life or at death.<sup>225</sup> The line of thought is that a married couple is a "single taxable unit" and a transfer between them "does not constitute a taxable event."<sup>226</sup> Thus, under I.R.C. Section 2056, bequests to a

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220. KEN FOSTER & MIKE BOEHLJE, PURDUE EXTENSION, MANAGING TOUGH TIMES: INCOME ENHANCEMENT STRATEGIES FOR FARMERS 2 (2008), <http://www.ces.purdue.edu/extmedia/AS/FF-5-W.pdf>.

221. Estate Tax Reform, *supra* note 30, at 1.

222. See Economics of the Estate Tax, *supra* note 25, at 14.

223. *Id.*

224. *Id.*

225. See I.R.C. § 1041 (lifetime), § 2056 (estate tax), and § 2523 (gift tax).

226. Karen C. Burke, Grayson M.P. McCouch, *Death Without Taxes?*, 20 VA. TAX REV.

decedent's surviving spouse pass free of the federal estate tax and are not included in the estate's value when calculating federal estate tax liability.<sup>227</sup> It is not surprising that bequests to surviving spouses account for a majority of death time transfers.<sup>228</sup>

Planning to leave an entire estate to a surviving spouse sounds simple and logical. But is it the right move for farmers and ranchers to make? Or is it merely delaying the inevitable taxation which will occur upon that spouse's death? As with anything, there are advantages and disadvantages to planning for the marital deduction.<sup>229</sup> The surviving spouse does get the benefit of the stepped-up basis rule: all property inherited from the decedent will have a basis equal to the assets' fair market value.<sup>230</sup> Additionally, if the decedent and the surviving spouse held property jointly, the surviving spouse also gets a stepped-up basis in their half of the community property.<sup>231</sup> Planning for the marital deduction used to be a source of discord among estate planners with some saying that those who based estate plans on the marital deduction were "failing to maximize" available tax benefits.<sup>232</sup> Still others argue the marital deduction takes a controversial stance on feminism and women's rights.<sup>233</sup>

Regardless, the marital deduction is an easy estate value reduction tool that may, in the least, postpone taxation and allow the eventual heirs more time to plan for a taxable event. With the portability scheme under the 2010 Tax Relief Act, the marital deduction becomes an instrumental tool in increasing the surviving spouse's exclusion amount, allowing more assets to pass tax-free to the next generation.<sup>234</sup>

## (2) Special Valuation of Farmland

A special valuation method is available for farmland under I.R.C. Section 2032A.<sup>235</sup> But to use this value reduction tool, a number of

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499, 521 (2001).

227. See I.R.C. § 2056.

228. Richard Schmalbeck, *Many Unhappy Returns: Estate Tax Returns of Married Decedents*, 21 VA. TAX REV. 361, 364 (2002). In 1995, bequests to surviving spouses accounted for \$41 billion of the \$69 billion left by married decedents. *Id.*

229. See generally *id.*

230. I.R.C. § 1014(a).

231. I.R.C. § 1014(b)(6).

232. See LINCOLN NATIONAL CORPORATION, DON'T WASTE YOUR ESTATE TAX EXEMPTION 1 (2009), <http://besttimesfinancial.com/files/July%2009%20Private%20Wealth.pdf>; see generally John J. McCreesh IV, *Probate and Property*, 15 PROB. & PROP. 34 (2001).

233. See generally Mary Moers Wenig, *Taxing Marriage*, 6 S. CAL. REV. L. & WOMEN'S STUD. 561 (1997). For a more detailed discussion on the intersection of taxes and feminism, see generally EDWARD J. MCCAFFERY, *TAXING WOMEN* (1999).

234. I.R.C. § 2010(c).

235. See I.R.C. § 2032A.

requirements must be met.<sup>236</sup> First, the property must be real property acquired from the decedent and at the time of the decedent's death, have been used for a "qualified" purpose, including as a "farm for farming purposes."<sup>237</sup> Then there are two different percentage requirements to meet: (1) the value of the realty itself must account for at least 50% of the gross estate's adjusted value and (2) the land composing at least 25% of the adjusted value of the total estate must have been owned by the decedent or a member of the decedent's family for an aggregate 5 year period in the 8 years preceding the decedent's death and, during that time period, have been used for farming purposes.<sup>238</sup> There must also be material participation by the decedent or a member of his family.<sup>239</sup> The total reduction in the value of the total estate may not exceed \$750,000.<sup>240</sup>

Additionally, the land must be kept in the decedent's family and used as a farm for ten years following the decedent's death.<sup>241</sup> If the property is disposed of or ceases to be used for a qualified use "recapture," in the form of an additional tax, occurs—essentially taking back the difference in tax liability with and without the special valuation.<sup>242</sup>

The value of the farmland is calculated using the formula provided by the Code which says to divide the excess of average annual gross cash rent over average annual State and local taxes by the annual effective interest rate for Federal Land Bank loans.<sup>243</sup> The averages are calculated based on the five year period preceding the decedent's death.<sup>244</sup> This is best explained via an example: assume the farm land is worth \$3,000 per acre, the average annual cash rent over the last five years is \$100 per acre and the property taxes are \$15 per acre. This yields a net return of \$85 per acre.<sup>245</sup> Now, if the current interest rate for Federal Land Bank loans is 6.0%, the productive value of each acre of

236. *Id.*

237. I.R.C. § 2032A(b)(1)(A)(ii).

238. See I.R.C. § 2032A(b)(1)(B). See also Rita Noll, *Taxation: Valuation of Farmland for Estate Tax Purposes, Qualifying for I.R.C. § 2032A Special Use Valuation*, 23 WASHBURN L.J. 638 (1984).

239. I.R.C. §§ 2032A(b)(1)(B), (C).

240. I.R.C. § 2032A(a)(2).

241. I.R.C. § 2032A(c). An exception does exist if the decedent's heir dies. *Id.*

242. *Id.* Partial dispositions of qualified property are also subject to recapture. *Id.*

243. I.R.C. § 2032A(e)(7). In simplified formula notation: [average annual gross cash rent – average annual State and local taxes] / [average annual effective interest rate for Federal Land Bank loans].

244. *Id.*

245. In simplified formula notation: [average annual gross cash rent – average annual State and local taxes] = [[\$100 - \$85] = \$15.

farmland is \$1,416.67.<sup>246</sup> In this example, § 2032A gives the estate a 47% reduction in the value of the farmland. But, this discount could only be applied to 529 acres of farmland before the \$750,000 cap is reached.

The special valuation method can help reduce estate value but does come with its share of downsides. Among the biggest tradeoffs is that the reduced value given to the farmland also becomes the tax basis for the decedent's beneficiaries.<sup>247</sup> If the beneficiaries later decide to sell the farm land, unless the land is sold for a loss, they will face tax liability on the gains.<sup>248</sup> These gains will be greater due to the decrease in valuation under Section 2032A than if the beneficiaries had inherited the land at fair market value under Section 1014(a).<sup>249</sup> In the example above, instead of a tax basis of \$3,000 per acre, the basis will be \$1,416.67. If the fair market value of the property is still \$3,000 the beneficiaries will pay gains taxes on over \$1500 per acre.

### (3) Conservation Easements

Farmers and ranchers may benefit from placing parcels of land in conservation easements. The value of land placed in a "qualified conservation easement" may be excluded from the value of a decedent's gross estate.<sup>250</sup> The limit on the excludable value is the lesser of (a) the applicable percentage<sup>251</sup> and \$500,000 for decedents dying after 2002.<sup>252</sup> A qualified conservation easement is defined as land located in the United States, which was owned by the decedent (or a member of the decedent's family) at all times during the three year period ending on the decedent's death, with which a qualified conservation contribution has been made<sup>253</sup> which includes a prohibition on the use of the land for commercial recreational activity.<sup>254</sup> For the most part, conservation easements allow farmers and ranchers to continue low-

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246. In simplified formula notation: [average annual gross cash rent – average annual State and local taxes] / [average annual effective interest rate for Federal Land Bank loans] = [\$85] / [6%] = \$1416.67

247. Elizabeth Williams, *Discounting Farm Estates*, PROGRESSIVE FARMER (Oct. 12, 2010), [http://www.dtnprogressivefarmer.com/dtnag/view/ag/printablePage.do?ID=NEWS\\_PRINTABLE\\_PAGE&bypassCache=true&pageLayout=v4&vendorReference=9651fce7-bd04-40d1-bb0c-664b762eec1b\\_\\_1286208187522&articleTitle=Discounting+Farm+Estates&editionName=DTNAGFreeSiteOnline](http://www.dtnprogressivefarmer.com/dtnag/view/ag/printablePage.do?ID=NEWS_PRINTABLE_PAGE&bypassCache=true&pageLayout=v4&vendorReference=9651fce7-bd04-40d1-bb0c-664b762eec1b__1286208187522&articleTitle=Discounting+Farm+Estates&editionName=DTNAGFreeSiteOnline).

248. *Id.*

249. *Id.* See also I.R.C. §§ 1014(a), 2032A.

250. I.R.C. § 2031(c).

251. I.R.C. § 2031(c)(2). The applicable percentage is 40% reduced by 2% for each percentage point the value of the qualified conservation easement is less than 30 percent of the value of the land. *Id.*

252. I.R.C. § 2031(c)(3).

253. See I.R.C. § 170(h).

254. I.R.C. § 170(h).

impact farming operations while helping to reduce overall estate value.

Actual tax savings for an individual farmer or rancher will vary greatly.<sup>255</sup> There are a number of factors that play a role in how much a conservation easement may reduce estate value including: (1) the extent that development potential raises land value and (2) the extent of limitations the farmer or rancher is willing to impose on his land.<sup>256</sup> The use of conservation easements by all large landowners, including farmers and ranchers, is well documented.<sup>257</sup>

#### **(4) Annual Gifts of Assets**

Another tool farmers and ranchers may use are the annual gift rules to transfer farm assets to the next generation during their lifetime.<sup>258</sup> Currently, an individual can transfer up to \$13,000 per year to an unlimited number of people tax free.<sup>259</sup> Additionally, individuals could transfer another \$1 million during life.<sup>260</sup> Gifts given in excess of the \$13,000 annual limit reduce the \$1,000,000 lifetime limit.<sup>261</sup> If a taxpayer gifts an individual more than \$13,000 per year, the recipient will pay gift taxes.<sup>262</sup> Assets are valued at fair market value when the gift is made.<sup>263</sup> But while this helps the estate reduce its overall value, it may be a dangerous practice. Gifting is a permanent and irrevocable transfer, resulting in a loss of both control over the asset and any income stream the asset provides.<sup>264</sup> For a more thorough discussion see *Gifting Farm Assets*, published by the University of Minnesota's Extension Service.

#### **(5) Using Life Insurance Premiums to Finance Federal Estate Tax Payment**

As part of an estate plan, life insurance may be used to maintain cash reserves to pay federal estate tax liability.<sup>265</sup> But the proceeds from a

255. See generally David Braun, *Strategies for Using Conservation Easements in Tax and Estate Planning*, PROBATE & PROPERTY, NOV./DEC.2002, <http://www.privatelandownernet.org/plnlo/brauneasements.asp>.

256. *Id.*

257. For a more detailed discussion of conservation easements see generally Nancy A. McLaughlin, *Conservation Easements: Perpetuity and Beyond*, 34 ECOLOGY L.Q. 673 (2007); Francine J. Lipman, *No More Parking Lots: How the Tax Code Keeps Trees Out of a Museum and Paradise Unpaved*, 27 HARV. ENVTL. L. REV. 471 (2003).

258. GARY HATCHFIELD ET.AL, U. MINN. EXTENSION, GIFTING FARM ASSETS 1 (1999), <http://www.extension.umn.edu/distribution/businessmanagement/components/m1177-6.pdf>.

259. *Id.*

260. *Id.*

261. *Id.*

262. *Id.*

263. *Id.*

264. *Id.* at 2.

265. Lytton, *supra* note 22, at 429.



life insurance plan may be counted as part of the decedent's estate, meaning this tool may actually increase an estate's federal estate tax liability by increasing total estate value.<sup>266</sup> Also, the cost of paying premiums over time reduces the capital available to invest in the farm or ranch.<sup>267</sup> It is suggested that experienced attorneys are consulted in seeking to use life insurance policies in this manner.<sup>268</sup> For a detailed discussion of the use of life insurance policies to pay federal estate taxes, see Lee Lytton's *Save the Land from Uncle Sam*.

### (6) Family Limited Partnership

When it comes to choosing a structure for the farm entity, there are several choices which provide various tax benefits.<sup>269</sup> Among these options is the assortment of family limited liability entities (FLEs) including Family Limited Partnerships and Limited Liability Companies (both Family and traditional LLCs).<sup>270</sup> FLEs offer farmers and ranchers pass through taxation.<sup>271</sup> The Family Limited Partnership, a state law vehicle, has become a particularly popular estate planning tool for farmers and ranchers.<sup>272</sup>

In a Family Limited Partnership, the farmer or rancher transfers farm assets, like land, machinery, etc. to a partnership entity.<sup>273</sup> Then, the farmer retains a general interest in the partnership and gifts limited partnership interests to his children.<sup>274</sup> The general interest retained is usually small, the limited interests large.<sup>275</sup> The farmer, via his general interest, retains control of the partnership assets.<sup>276</sup> If done correctly, the farmer or rancher can avoid paying significant gift taxes by discounting the value of the limited interests.<sup>277</sup> Furthermore, the small general

266. *Id.* The life insurance proceeds are included as part of the value of the decedent's estate when the decedent or the decedent's estate is the recipient of the proceeds. *Id.* See also § 2042.

267. EFFECTS OF THE FEDERAL ESTATE TAX, *supra* note 29, at vii.

268. Lytton, *supra* note 22, at 429.

269. Internal Revenue Service, *Farmers ATG – Chapter One: The Audit Flow* (2006), <http://www.irs.gov/businesses/small/article/0,,id=159952,00.html>.

270. Walter D. Schwidetzky, *Family Limited Partnerships: The Beat Goes On*, 60 TAX LAW. 277, 277 (2007).

271. Timothy R. Baumann, *Family Limited Partnerships, Trusts, or Limited Liability Companies: Which Should the Elderly Choose?*, 3 ELDER L.J. 111, 142 (1995) (noting that the government classifies LLCs as partnerships and taxes LLCs only once).

272. *Id.* Family Limited Partnerships are utilized by multiple industries but notably by farmers and ranchers. *Id.*

273. *Id.*

274. *Id.*

275. *Id.*

276. Jeff Schnepfer, *Protect Your Family with a Partnership*, <http://articles.moneycentral.msn.com/Taxes/TaxShelters/ProtectYourFamilyWithPartnership.aspx>.

277. *Id.*

interest is all that remains to enter into the farmer or rancher's gross estate at death, reducing the estate value while effecting little or no change in the beneficial ownership or use of the assets.<sup>278</sup> The children become the general partners at their parent's death.<sup>279</sup> For a comprehensive look at FLPs, see Walter D. Schwidetzky's *Family Limited Partnerships: The Beat Goes On*.

## X. WHY PROTECT AGRICULTURE?

Proponents of the federal estate tax question why agriculture should receive special treatment or consideration.<sup>280</sup> They argue that there is "no compelling ethical or economic reason to provide preferential treatment to someone who has a small business relative to someone with equal wealth who just happened to accumulate it in some other form."<sup>281</sup> I disagree and insist that there are "compelling ethical and economic reasons"<sup>282</sup> to provide preferential treatment to agriculture, even in the federal estate tax realm and despite the great deal of federal support (*i.e.*, subsidies) farms and ranches already receive. Particularly, special relief should be afforded to the large-scale family farms which are responsible for the bulk of American agricultural production and face significant federal estate tax liability.

"Agricultural exceptionalism" is the phrase used to describe the use of legal exceptions to protect the agricultural industry.<sup>283</sup> The concept is "rooted" in labor law<sup>284</sup> but is evident throughout numerous facets of the law, spanning the spectrum from involuntary bankruptcy protection to exemptions from many environmental regulations.<sup>285</sup> Over the years, scholars have attempted to explain this special legal framework, citing noble societal concerns and political and economic power.<sup>286</sup>

Farming has long occupied a unique spot in American history. This country's very beginnings embraced agriculture as a special industry and some of the nation's "founding fathers" were in agriculture themselves.<sup>287</sup> Thomas Jefferson described farmers as the "most

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278. Schwidetzky, *supra* note 270, at 279.

279. Schnepfer, *supra* note 276, at 1.

280. SLEMROD & BAKIJA, *supra* note 3, at 288.

281. *Id.*

282. *Id.*

283. Susan A. Schneider, *A Reconsideration of Agricultural Law: A Call for the Law of Food, Farming, and Sustainability*, 34 WM. & MARY ENVTL. L. & POL'Y REV. 935, 936 (2010).

284. See Guadalupe T. Luna, *An Infinite Distance?: Agricultural Exceptionalism and Agricultural Labor*, 1 U. PA. J. LAB. & EMP. L. 487, 489 (1998).

285. Schneider, *supra* note 283, at 936.

286. *Id.* at 937.

287. Fourteen of the fifty-five Constitutional Convention delegates were farmers. See Nat'l

valuable citizens”<sup>288</sup> and “the chosen people of God, if ever he had a chosen people.”<sup>289</sup> Legal scholar Jim Chen insists the oldest example of favoritism toward American agriculture is in the Seventeenth Amendment of the Constitution.<sup>290</sup> The Constitution gives each state the same number of Senators regardless of population.<sup>291</sup> This had the effect of placing the less populated, agrarian states on an even playing field with their more populated counterparts.<sup>292</sup> Agriculture also garnered a prominent place in Congress—the Agricultural Committees were established in the U.S. House and the U.S. Senate in 1820 and 1825 respectively.<sup>293</sup> It is these examples of agrarianism which are used to support an argument that there historically exists a “political duty to preserve and protect farms.”<sup>294</sup> The logic is that agriculture is an engrained part of American’s culture and cannot be ignored or destroyed.

But admittedly American agriculture today is vastly different from the past. Only about 2% of Americans live on farms.<sup>295</sup> Farm size has increased and farmers and ranchers have become more business savvy, employing the latest in science and technology to increase yields.<sup>296</sup> Most farms are located far away from the customers they serve, creating a large gap in consumer knowledge about and emotional attachment to farming.<sup>297</sup> Advocates of increased protection for today’s farmers are faced with an uphill battle to convince American voters (and politicians) that agriculture is still a positive contributor to society and not a “welfare recipient”<sup>298</sup> or harmful to the environment.<sup>299</sup> Despite modern

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Archives, *America’s Founding Fathers: Delegates to the Constitutional Convention*, available at [http://www.archives.gov/exhibits/charters/constitution\\_founding\\_fathers\\_overview.html](http://www.archives.gov/exhibits/charters/constitution_founding_fathers_overview.html).

288. Thomas Jefferson, *Notes on the State of Virginia* 170 (1785), available at [http://avalon.law.yale.edu/18th\\_century/let32.asp](http://avalon.law.yale.edu/18th_century/let32.asp).

289. Letter from Thomas Jefferson to John Jay (Aug. 23, 1785), available at [http://avalon.law.yale.edu/18th\\_century/let32.asp](http://avalon.law.yale.edu/18th_century/let32.asp).

290. See Jim Chen, *Of Agriculture’s First Disobedience and its Fruit*, 48 VAND. L. REV. 1262, 1275 (1995).

291. See U.S. CONST. art. I, § 2, cl. 3. (dictating that each state shall have two representatives in the U.S. Senate).

292. See Chen, *supra* note 290, at 1276.

293. See U.S. DEP’T OF AGRIC., A CONDENSED HISTORY OF AMERICAN AGRICULTURE 1776-1999 (2000), <http://www.usda.gov/documents/timeline.pdf>.

294. WILLIAM B. BROWNE ET AL., SACRED COWS AND HOT POTATOES, AGRARIAN MYTHS IN AGRICULTURAL POLICY 7, 15 (1992).

295. U.S. Env’tl. Prot. Agency, *Demographics*, <http://www.epa.gov/agriculture/ag101/demographics.html> (last visited July 2, 2011).

296. See James M. McDonald et al., *Experience Counts: Farm Business Survival in the U.S.*, AMBER WAVES, Apr. 2007, <http://www.ers.usda.gov/AmberWaves/April07/PDF/Experience.pdf> (noting that agricultural production has been shifting to much larger farms).

297. Schneider, *supra* note 283, at 944.

298. BROWNE ET AL., *supra* note 294, at 15.

299. J.B. Ruhl, *Farms, Their Environmental Harms and Environmental Law*, 27 ECOLOGY

criticism, agriculture does produce positive externalities including sustainable food production and a boost to rural American economies.<sup>300</sup> The mere existence of farmland alone provides scenic, open green spaces and wildlife habitats.<sup>301</sup> Faced with ever decreasing limited resources, farming has aptly been described as “the proper use and care of an immeasurable gift.”<sup>302</sup>

Some argue the federal estate tax threatens the environment when farmland is sold and subsequently developed.<sup>303</sup> Advocates of a complete repeal of the federal estate tax use a Florida example to illustrate their point.<sup>304</sup> In 1981, Marlin Hilliard died and his heirs sold 17,000 acres to a developer to pay federal estate taxes.<sup>305</sup> The Hilliard’s land in South Florida was part of the endangered Florida panther’s habitat.<sup>306</sup> Thus, a concern arose that other farm and ranch families would sell undeveloped lands and ruin natural wildlife habitats.<sup>307</sup> In 2006, the Joint Economic Committee published a study claiming that the federal estate tax threatens endangered species and encourages excess logging.<sup>308</sup>

The most obvious argument for preserving agriculture in the United States is sustainability and independence from foreign food sources.<sup>309</sup> Food is the most basic of human needs and provides justification for a legal system that “nurtures and guides its agricultural sector.”<sup>310</sup> After all, one of the government’s primary roles should be “to ensure its people have sufficient food.”<sup>311</sup> With large-scale family farms producing 60% of the nation’s food and fiber their preservation would,

L.Q. 263, 274-292 (2000) (describing agriculture’s detrimental effects to the environment to include soil erosion, water pollution and wildlife habitat loss).

300. Thornsby et al., *Explaining Multifunctionality in Trade Negotiations: Valuing Non-Traded Commodities 2* (2003), available at <http://www.ecostat.unical.it/2003agradeconf/Contributed%20papers/Thornsby,%20Moss%20and%20Schmitz.pdf>.

301. U.S. Dep’t of Agric., *Conservation Policy: Farmland and Grazing Land Protection Programs* (2009), <http://www.ers.usda.gov/briefing/conservationpolicy/farmland.htm>.

302. WENDALL BERRY, *THE AGRARIAN STANDARD, THE ESSENTIAL AGRARIAN READER, THE FUTURE OF CULTURE, COMMUNITY AND THE LAND 24* (Norman Wirzbza ed. 2003).

303. Daniel W. Matthews, *A Fight to the Death: Slaying the Estate Tax Repeal Hydra*, 28 WHITTIER L. REV. 663, 687 (2006).

304. *Id.*

305. *Id.*

306. *Id.*

307. *Id.*

308. See JOINT ECONOMIC COMMITTEE STUDY, *Cost and Consequences of the Federal Estate Tax* (Comm. Print 2006), available at <http://www.ecostat.unical.it/2003agradeconf/Contributed%20papers/Thornsby,%20Moss%20and%20Schmitz.pdf>. More than 2.5 million acres of forest land must be harvested annually to pay for the federal estate tax. *Id.* at 4(E).

309. See Schneider, *supra* note 283, at 946.

310. *Id.*

311. *Id.*

in turn, preserve America's self-sufficiency.<sup>312</sup>

The United States is not alone in crafting special treatment for agriculture. In fact, in terms of protectionism, the United States ranks far below our global counterparts.<sup>313</sup> Forty-two World Trade Organization (WTO) member countries use a system of tariffs and countervailing duty laws to offer protection to their farmers and ranchers.<sup>314</sup> In 2002, at a press conference discussing the increase in European Union (EU) agricultural subsidies, the then European Commissioner for Agriculture Dr. Franz Fischler said "agriculture is different . . . it does shape our countryside and even more important it does hold a special place in human imagination and affection."<sup>315</sup> The European Union and its policies recognize the valuable end result of agriculture and has actually criticized the U.S. failure to be as progressive.<sup>316</sup> Should the United States recognize the industry's role as the producer of a safe, affordable and abundant domestic food supply? Or should we place our self-sufficiency in jeopardy because of the revenue collected from the federal estate tax?

Additionally, agriculture is a positive contributor to the U.S. economy. As the nation struggles to recover from a hard recession, agriculture is proving itself as a "bright spot."<sup>317</sup> Farming may account for just a small portion of U.S. GDP (only 0.9% in 2009) but has a significant effect on rural economies.<sup>318</sup> Additionally, related industries and suppliers depend upon a strong showing by the agriculture industry.<sup>319</sup>

There is also a compelling argument for the preservation of a unique lifestyle: farming has long been described as more of a way of life than a business.<sup>320</sup> Personal experience from talking to America's farmers and ranchers shows that they are individuals who are very proud of their families and their attachments to particular pieces of land. Tracts of

312. HOPPE ET AL., *supra* note 55, tbl. 1.

313. See U.S. Dep't of Agric., *Global Food Markets: International Trade Policy*, available at <http://www.ers.usda.gov/Briefing/GlobalFoodMarkets/TradePolicy.htm>.

314. *Id.*

315. Dr. Franz Fischler, Remarks at the CAP and WTO Agriculture Negotiations (Oct. 11, 2000), <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/00/371&format=HTML&aged=1&language=EN&guiLanguage=en>.

316. See *id.*

317. See Neuman, *supra* note 74.

318. *Indicators*, *supra* note 71.

319. See Neuman, *supra* note 74.

320. See Wolfegang Saxon, *Don Paarlberg, 94, Agricultural Economics Adviser to 3 Presidents, Is Dead*, N.Y. TIMES (Feb. 20, 2006), <http://www.nytimes.com/2006/02/20/national/20paarlberg.html>. Dr. Don Paarlberg was a farmer, writer and professor of agricultural economics at Purdue University and served as White House assistant to President Dwight D. Eisenhower. *Id.*

farm land are often described as “unique [but] when left purely to economics, it may be hard to explain this phenomenon of uniqueness. Only by taking into account the psychological and sociological aspects of property ownership can non-landowners fully appreciate the relationship that develops between land, landowner and succeeding generations.”<sup>321</sup> This is a concept which may be exceedingly difficult for today’s urban-dwelling population to grasp. However, some commentators believe President Bush was successful in passing EGTRRA because he delivered a powerful message about saving the family farm which “resonat[ed] with deeply rooted cultural values . . . evoking nostalgia among many for a common experience largely lost to a world of urban and suburban office workers.”<sup>322</sup>

The reasons why we should protect the agricultural industry will become increasingly difficult to convey to a generation of American consumers who do not fully understand how the items at their local grocery store reach the shelf. These consumers may not appreciate American agriculture until their imported food becomes too expensive or too sparse. But without federal estate tax reform, there will be no need to ever educate current and future generations of consumers about the vital importance of agriculture in America because it will simply not exist. The preservation of American agriculture will continue to produce positive results: a safe, abundant and affordable food supply, conservation of wildlife habitats, continued economic contributions and preserving the ability of farmers and ranchers to lead their treasured way of life.

## XI. CONCLUSION

With more Americans earning college educations, there is not an overabundance of individuals who set out to be farmers and ranchers. The individuals who are the farmers and ranchers of the future are the direct descendants of today’s farmers and ranchers. Thus, preserving American agriculture must begin with passing along farm assets to the next generation without a heavy federal estate tax burden.

The survival of the 2010 Tax Relief Act’s \$5 million exclusion amount will greatly depend on who has control of the White House and Congress following the 2012 election. Erring on the cautious (and skeptical) side, American farmers should be prepared to confront a new tax scheme in 2013. As this Note states, a complete repeal of the federal estate tax is not necessary, nor is raising the exemption value to levels which would exclude the “super-wealthy” from any tax burden. But

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321. Lytton, *supra* note 22, at 422.

322. JOHNSTON, *supra* note 171, at 6.

continued moderate increases in the exemption values will maintain the positive effects the EGTTA had on farmers and ranchers.<sup>323</sup> The best course of action is to carve out a permanent exception exclusively for large family farms—complete with higher exemption values (\$3 million plus) and a moderate tax rate. The imposition of restrictions similar to those found in the special valuation provision would prevent tax shelter abuse by the “super-wealthy.”<sup>324</sup> Requiring that the land have been in the decedent’s family for a number of years, used for farming purposes and enforcing a commitment to not sell the land for ten years will decrease the exception’s appeal and availability as a tax shelter.

As the age of the average farmer continues to creep upward, the transfer of farm and ranch assets between generations will only become more prevalent. While critics claim that farms and ranches are not sold to meet federal estate tax liability,<sup>325</sup> those in agriculture continue to hear otherwise. Just ask the Barthle family, who sold 1200 acres of their cattle and horse ranch in Central Florida to pay federal estate taxes after an uncle and grandfather passed away within a short time of one another.<sup>326</sup> With four generations of the Barthle family living on their 8000 acre ranch, keeping the land in the family is of vital importance.<sup>327</sup> Having already experienced a loss because of the federal estate tax, they are doubly concerned with what the future holds.<sup>328</sup>

While the 2010 Tax Relief Act gave a much-needed reprieve for American farmers for the near future, the long-term forecast remains volatile. Those who expect to survive 2012 will continue to watch the political arena with great concern. The threat of the pre-EGTTA conditions, particularly the \$1 million exclusion amount, remains. This time around, Congress and the current administration reached a compromise at the last minute to prevent a disaster, but will they be as cooperative at the end of 2012? If the two deadlock and refuse to make concessions, American farmers and their families could see disastrous results.

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323. See DURST, *supra* note 39.

324. See I.R.C. § 2032A.

325. JOHNSTON, *supra* note 171, at 73-75 (claiming that neither the White House nor the American Farm Bureau Federation could find one example of a farm sold to pay tax liabilities in 2000).

326. Interview with Sarabeth Bartle, Barthle Brothers Ranch, on Nov. 5, 2010.

327. *Id.*

328. *Id.*