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## FEDERAL TAX POLICY AND FARMERS: A CURRENT PERSPECTIVE AND OUTLOOK

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The enactment of the Jobs and Growth Tax Relief Reconciliation Act of 2003 and the tax relief measures enacted in 2001 and 2002 have significantly reduced Federal income and estate and gift taxes for farmers. Changes in Federal income tax policies in the 2003 Act are expected to provide farm households with about \$4 billion in tax relief in 2004, reducing average income tax rates to about 14 percent from about 18 percent in 2000. Changes to Federal estate tax policies in the 2001 Act, primarily an increase in the amount that can be transferred free of tax, has significantly reduced both the number of farm estates required to file an estate tax return and the number that owe tax. As a result of these changes, in 2004 only about 2 percent of all farm estates will owe any Federal estate taxes. While current law provides for the phase-in of additional reductions in Federal estate taxes, considerable uncertainty exists due to the one-year repeal of the tax in 2010 and a reversion to 2001 law in 2011.

### Introduction

Federal tax policies not only influence the financial well-being of the farm household but can also have important effects on the number and size of farms, their organizational structure, and their use of land, labor, and capital inputs. The most significant Federal taxes paid by farmers are the income tax, the self-employment tax, and the estate tax. In recent years, Federal income taxes on both farm and nonfarm income accounted for nearly two thirds of farmers' total Federal tax burden. Social Security and self-employment taxes represented nearly all of the remaining one third. In contrast, Federal estate taxes accounted for just over 1 percent but still are of considerable importance to the farm community due to the potential impact on the transfer of the farm to the next generation.

The enactment of the Jobs and Growth Tax Relief Reconciliation Act of 2003 represented the third consecutive year that major tax legislation was enacted. This legislation has primarily focused on Federal income and estate and gift tax policies. As a result of this legislation, total Federal income tax receipts in 2004 as a share of Gross Domestic Product (GDP) are expected to be the lowest since 1942 while the share of all estates that owe Federal estate taxes has been reduced to less than two percent.

Since the Federal individual income tax imposes the largest tax burden on the broadest group of farmers and there has been considerable concern regarding the impact of the estate tax on the ability to transfer the farm to the next generation, the fact that the sweeping changes that have occurred over the last three years have focused on the individual income tax and the estate and gift tax is of considerable importance to the farm community. This paper reviews the current Federal tax environment for farmers and

identifies some of the most significant Federal tax policy issues facing the farm community over the next few years.

## **Tax Legislation Creates Favorable Federal Income Tax Situation for 2004**

The Jobs and Growth Tax Relief Reconciliation Act of 2003, signed into law by President Bush on May 28<sup>th</sup>, 2003 provided significant Federal income tax relief for most taxpayers. The Act accelerated marginal tax rate reductions and other relief that was scheduled to be phased in under the 2001 Act, reduced the tax rate on dividends and capital gains and increased the amount of capital investment that can be expensed by small businesses. Since most farmers operate as sole proprietors, partnerships or small business corporations, most farm income is taxed under the individual income tax rather than the corporate income tax. Thus, farmers and other small businesses are major beneficiaries of the new law since they not only benefit from the lower tax rates and other changes aimed at all taxpayers but they are also the primary beneficiaries of the faster write-off of investment in machinery, equipment and other eligible capital purchases.

Since the household is the typical unit of taxation, farm and nonfarm income are commingled when computing income taxes. In fact, most Federal income tax paid by farm households can be attributed to nonfarm income. Since 1980, IRS data indicate that farmers have reported negative aggregate net farm income for tax purposes. In 2000, all farm sole proprietors reported over \$91 billion in taxable gross farm business income but reported an aggregate net farm operating loss of \$9.0 billion. The net loss consisted of \$8.3 billion in profits reported by about one third of all farm sole proprietors and \$17.3 billion in losses reported by the remaining two thirds. Examining these losses by ERS farm typology<sup>1</sup> provides some additional insight. Nearly \$10 billion of this loss can be attributed to rural residence farms with 3 out of every 4 farms reporting a loss (figure 1). Despite these losses, these farms on average reported an adjusted gross income of just over \$73,000. In contrast, over half of all intermediate and commercial farms reported a profit with over 90 percent of all farm profits reported by these farms.

Thus, despite the farm losses for tax purposes, the 2003 Act will provide farm households with over \$4 billion in Federal income tax relief in 2004. Over 86 percent of all farm households will realize some tax savings. The average tax savings for all farm households is estimated at about \$2,000, a 16-percent reduction compared to prior law. As a result of the 2003 Act and the previous legislation, the average tax rate is expected to drop from about 18 percent in 2000 to about 14 percent for 2004. The most significant provisions for farmers are described below.

- *Reduced Marginal Tax Rates*

The 2003 Act accelerated the 2001 Act individual marginal rate cuts that were not scheduled to be phased in until 2006 and beyond. The prior rates of 10, 15, 27, 30, 35, and 38.6 were replaced with rates of 10, 15, 25, 28, 33, and 35 percent retroactive to January 1, 2003. Farm sole proprietors, partners in partnerships, and shareholders in Subchapter S corporations benefited from these rate reductions since they pay tax at the individual marginal income tax rates.

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<sup>1</sup> *Rural residence farms*: lifestyle, retirement, and limited resource farms, *Intermediate farms*: sales less than \$250,000 and primary occupation is farming, *Commercial farms*: sales greater than \$250,000.

- *Expanded 10-percent Bracket*

The 2003 Act increased the 10 percent bracket from \$6,000 to \$7,000 for single filers and from \$12,000 to \$14,000 for married couples. The bracket amount was adjusted for inflation in 2004. About 3 out of every 4 farm households will benefit from the expanded 10 percent bracket. The bracket is scheduled to return to the \$6,000 and \$12,000 levels in 2005.

- *Increased Child Tax Credit*

Under the 2001 Act, the child tax credit that is provided to households with children under age 17 was scheduled to gradually increase to \$1,000 by 2010. The 2003 Act immediately increased the credit from \$600 to \$1,000 for 2003 and 2004. The credit continues to be phased out for joint filers at \$110,000 of modified adjusted gross income. It can be used to offset both regular and alternative minimum tax liability and is refundable to the extent of 10 percent of earned income in excess of \$10,000. The amount refundable increases to 15 percent of earned income over \$10,000 in 2006. For 2004, the \$1,000 credit will provide farmers with nearly \$1 billion in tax benefits, including a refundable portion of about \$200 million. About one third of all farm households are eligible to receive an average child tax credit of about \$1,500. The child tax credit is scheduled to drop to \$700 in 2005.

- *Marriage Penalty Relief*

The 2003 Act provided relief from the marriage penalty by increasing the standard deduction and expanding the 15 percent tax bracket for married couples. Under the Act, the standard deduction for married couples was increased to twice the amount for single taxpayers and the 15 percent tax bracket for joint filers was increased to twice the width of the bracket for single filers. Over half of all farmers will benefit from this marriage penalty relief. However, the relief is temporary, only for tax years 2003 and 2004 after which the law reverts to the phase-in schedule established in the 2001 Act.

- *Reduced Tax Rate on Dividends*

Under the Act, dividends paid to individuals are taxed at 15 percent (5 percent for taxpayers in the 15 percent or lower income tax brackets). About one third of all farm households, including over half of all households with a farmer over 65, receive dividend income that is taxable.

- *Reduced Tax Rate on Capital Gains*

The Act also reduced the tax rate on capital gains to 15 percent and 5 percent, the latter for taxpayers in the 15 percent or lower income tax brackets. Capital gains are an important component of income for many farmers since assets used in farming are eligible for capital gains treatment. According to Internal Revenue Service (IRS) data, 40 percent of all farmers report some capital gains. This is nearly double the share for all taxpayers and the average amount of capital gain reported by farmers is nearly 50 percent higher than the average capital gain reported by other taxpayers.

- *Increased Expensing of Capital Investment*

Prior to the 2003 Act, capital purchases were eligible for a 30 percent first-year depreciation bonus and an immediate expensing of \$25,000. The Act increased the bonus first-year depreciation from 30 to 50 percent of eligible investment (for purchases after May 5, 2003) and raised the amount of investment

that can be expensed from \$25,000 to \$100,000. While the expensing provision applies to both new and used property, the bonus depreciation only applies to new property. Increasing the bonus first-year depreciation and the amount of capital investment that can be expensed will reduce the effective tax rate on farm capital, resulting in increased purchases of farm machinery, equipment and other eligible property. For 2004, farmers are expected to purchase over \$20 billion in eligible capital expenditures. Over 90 percent of these expenditures can be immediately deducted. Ninety eight percent of all farmers will be able to deduct their entire 2004 capital investments, greatly simplifying the record-keeping burden associated with the depreciation of capital purchases. For 2004, the amount of farm machinery and equipment that can be immediately deducted is estimated to increase by about \$3.5 billion or nearly 25 percent.

- *Self-employed Health Insurance Deduction and Healthcare Savings Accounts*

Although not part of the 2003 legislation, following a multi-year phase-in period, farmers and other self-employed taxpayers are now eligible to deduct 100 percent of the cost of purchasing health insurance for themselves and their families. About 15 percent of all farmers claim the deduction. These farmers will be eligible to deduct over \$1.1 billion in health insurance premiums.

In addition, as a result of the new Medicare legislation just recently signed into law, farmers who elect certain high-deductible policies (\$1,000 for single and \$2,000 for family) are eligible to contribute up to 100 percent of the deductible (maximum \$2600 for single and \$5,150 for family) to a health savings account. The contribution is tax deductible and withdrawals will not be taxed if used for eligible medical expenses or for any purpose once the account holder reaches age 65. These are important benefits to those farmers that must purchase health insurance on their own rather than through an employer.

### **Federal Income Tax Policy Issues: A Look Ahead**

The cumulative effect of these Federal tax policy changes has resulted in the lowest Federal tax burden on farm income and investment in decades. Beyond 2004, however, the Federal income tax environment looks a little less certain. Many of the tax relief provisions are set to expire at the end of 2010 while others are phased out even sooner in order to keep revenue loss under the tax bill below certain targets (table 1). For 2005, these expiring provisions include the child tax credit, the expanded 10-percent bracket, marriage penalty relief, and the 50-percent bonus depreciation.

While these are important policies, perhaps the most significant issue facing farmers as well as many other taxpayers is the alternative minimum tax. The individual alternative minimum tax is a parallel tax system that has a broader income base, fewer deductions and a different rate structure. Taxpayers are required to pay the greater of the regular individual income tax or the alternative minimum tax. Although the AMT was originally designed to prevent high income taxpayers from utilizing available tax preferences to greatly reduce or even completely avoid paying any income tax, its reach has expanded in recent years primarily due to the lack of indexing of the tax rates and exemption amounts. Absent changes to the AMT rate structure or exemption amounts, individual income tax rate reductions could greatly increase the number of taxpayers subject to the AMT.

Under the 2003 Act, the AMT exemption amount was increased by \$9,000 to \$58,000 for married taxpayers and by \$4,500 to \$40,250 for single taxpayers for 2003 and 2004. This AMT relief is important to farmers since, compared to other taxpayers, slightly more farmers are subject to the AMT with just under 2 percent of farmers currently paying the AMT. The additional exemption amounts

provided under the 2001 and 2003 Acts (\$6,500 for single and \$13,000 for married) ensured that most farmers were able to benefit from the tax cuts without being subject to the alternative minimum tax.

For 2005, the increased exemption amounts provided in 2003 and 2004 will expire. Allowing this exemption amount to revert back to the original amount or failing to take other action would subject nearly 1 out of 6 farmers to the alternative minimum tax. Furthermore, even if the increased exemption amount is extended, the number of farmers as well as other taxpayers subject to the tax will gradually increase unless the AMT is indexed for inflation similar to the tax rates and bracket amounts under the regular income tax.

## **Federal Estate and Gift Taxes**

Federal estate and gift tax receipts have historically accounted for a relatively small share of total Federal revenues, accounting for a little over one percent of total revenue in 2001. Although the number of estates subject to tax has more than doubled over the last decade, only 51,840 or about 2 percent of all estates (farm and nonfarm) were taxable in 2001. Nevertheless, while the aggregate importance of Federal estate and gift taxes is small relative to other Federal government revenue sources, the potential impact of these taxes on an individual or group of individuals, such as farmers and other small business owners, can be substantial. Providing relief to farmers and other small business owners was the primary impetus for the 1997 and 2001 changes to Federal estate and gift tax policies and is a major objective of the current effort to permanently repeal Federal estate and gift taxes.

## **Current Impact of Federal Estate Taxes on Farmers**

The appreciation in land values, the increase in farm size, and the rising investment in farm machinery and equipment have increased farm estate values and taxes. Over the years, Congressional concern that the farm sector's increasing estate and gift tax liability might cause the break-up of some family farms and other small businesses has led to the enactment of a number of targeted provisions to provide tax relief to farmers and other small business owners. These targeted provisions include the special use valuation of farmland, the installment payment of estate taxes, and a new deduction for family-owned business interests. An overview of these provisions is provided below.

*Special Use Value.* In general, the value of property for estate tax purposes is the fair market value at the date of death. However, if certain conditions are satisfied, real property included in the estate that is devoted to farming may be valued at the property's value as a farm rather than at its fair market value. In order to be considered qualified property, the property must be transferred to a qualified heir and must satisfy certain participation, use and relative value requirements. For most farms, the use valuation law can reduce the value of the real property portion of qualifying estates by 40 to 70 percent, with the largest reductions occurring for farmland which has residential or commercial development potential. The maximum reduction in value is currently limited to \$850,000 but is indexed for inflation. All or a portion of the special use value benefits are recaptured if the property is sold to a nonfamily member or if the property ceases to be used for farming within 10 years of the decedent's death.

*Installment Payment of Estate Tax.* A second special provision currently available to farmers and other small business owners is aimed at the liquidity problem that these businesses can face as a result of having a large portion of the estate in land and other relatively illiquid business assets. While Federal estate and gift taxes generally must be paid within 9 months of the date of death, if at least 35 percent of an estate's value is a farm or closely held business, estate taxes on these assets can be paid over a 14-year period. The interest rate on the first \$1 million in taxable value (above amounts exempted by the

unified credit) of the farm or other closely-held business is 2 percent with the rate on amounts above \$1 million equal to 45 percent of the normal rate applicable to underpayments of tax.

*Deduction for Qualified Family-Owned Business.* Beginning in 1998, a new deduction for qualified family-owned business interests was enacted. This \$675,000 deduction was in addition to any benefits from special use valuation and the unified credit. However, the deduction combined with the amount exempted by the unified credit was limited to \$1.3 million. Participation and recapture provisions similar to those applicable to the special use value provision also apply to this deduction. This provision provided additional relief for the 1998 to the 2003 period when the amount exempted by the unified credit was less than \$1.3 million. However, with the increase in the amount exempted by the unified credit to \$1.5 million, the deduction was repealed for 2004 and beyond.

Despite these favorable provisions, in recent years nearly twice as many farm estates have been taxable compared to all other estates. The unified credit was increased to \$600,000 in 1987 but remained at that level for over a decade. As a result, the number of farm estates required to file a return and/or pay tax increased substantially. By 1997, about 1 out of every 6 farm estates was required to file a return with about one third of these estates owing tax. This increasing burden was a factor in the 1997 legislation.

The 1997 Taxpayer Relief Act contained a gradual expansion of the amount exempted by the unified credit. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) reduced tax rates and accelerated the increase in the unified credit, increasing the exemption amount to \$1.5 million for 2004 with larger increases in later years followed by repeal in 2010. These changes have resulted in a substantial reduction in the number of farm estates affected by the Federal estate tax.

Based on simulations using farm-level survey data, of the 32,879 projected farm estates for 2004 only about 6 percent are estimated to have assets in excess of \$1.5 million and would be required to file an estate tax return (figure 2). After deductions, including special use value, only about one third of these farm estates would be taxable. The total amount of Federal estate taxes is estimated at \$522 million. The average tax due for those who owe tax is about \$737,000 on an average net worth of \$3.8 million.

The Federal estate tax burden can be further analyzed by the size and type of farm. Using the ERS farm typology, it is clear that the Federal estate tax should be of most concern to commercial farms. While only 1.5 percent of all rural residence and intermediate farms are projected to owe any Federal estate taxes in 2004 (figure 3), just over 14 percent of all commercial farm estates will owe Federal estate taxes. In most instances, the tax owed is significant with taxable commercial farms on average expected to owe over \$1.5 million in Federal estate taxes. While these farms represent only about 4 percent of all farm estates, they account for over half of all Federal estate taxes paid by farmers.

### **The Outlook for Federal Estate and Gift Taxation**

Over the next several years concerns regarding the potential impact of the Federal estate tax on the ability to transfer the farm to the next generation should be greatly diminished. Under current law, farmers as well as other taxpayers can expect additional reductions in Federal estate and gift taxes. The current phase-in schedule for the unified credit will result in an increase in the amount exempted from tax to \$3.5 million by 2009 (table 2). This should reduce the number of farm estates required to file a return to about 1 percent with only about half of those actually owing any Federal estate tax. The estate tax is to be repealed completely in 2010.

Despite the prospect for significantly lower Federal estate taxes over the next several years, there is a great deal of uncertainty regarding the longer-term future of the Federal estate tax. Like many of the income tax provisions contained in EGTRRA, the estate tax provisions are scheduled to sunset at the end of 2010. Thus, without further legislation, in 2011 Federal estate tax law will revert to the law as it existed prior to the 2001 Act. Such a reversion would result in a significant increase in the scope and impact of the tax on farmers as well as other taxpayers (figure 4). Although the House approved permanent estate tax repeal in 2003, the Senate did not take up the legislation. Additionally, while the administration has repeatedly proposed that the estate tax repeal be made permanent, there is increasing opposition in Congress to additional tax cuts that would substantially increase the Federal deficit.

The uncertainty surrounding the estate tax is further compounded by the fact that permanent repeal would generally require that inherited assets retain a carryover basis rather than a basis that is stepped-up to fair market value at the date of death. This stepped up basis provision currently allows heirs to sell inherited assets without recognizing any gain for income tax purposes on the appreciation that occurred prior to death of the individual from whom the property was inherited. Under the scheduled estate tax repeal with carryover basis, heirs would be allowed to increase the basis of appreciated property by \$1.3 million plus an additional \$3.0 million for transfers to a spouse. However, some estates that would be exempted from the estate tax by the \$3.5 million unified credit in 2009 could face income tax upon the sale of inherited assets due to the modified carryover basis rules that will apply in 2010. In addition to the potential tax liability, carryover basis requires extensive record keeping and can significantly increase the complexity of administering an estate. Thus, as long as repeal of the estate tax is accompanied by modification to the stepped-up basis rules, support for repeal is unlikely to be uniform, especially among those that may face added administrative complexities and income tax on appreciated property sold but who would be exempted from the estate tax by the unified credit.

### References

*Durst, R., and J. Monke. 2001. Federal Taxes Briefing Room.*

[www.ers.usda.gov/briefing/Federaltaxes](http://www.ers.usda.gov/briefing/Federaltaxes)

*Durst, R., J. Monke and D. Maxwell. How Will the Phaseout of Federal Estate Taxes Affect Farmers?, AIB No. 751-02, U.S. Department of Agriculture, Economic Research Service, Feb. 2002.*

**Table 1: Applicable Tax Rates and Other Provisions After the Jobs and Growth Tax Relief Reconciliation Act of 2003**

	Year								
<b>Provisions</b>	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Income Tax Rates</b>									
-- 10% Bracket Amount									
---- Single	\$7,000	\$7,000 <sup>1</sup>	\$6,000	\$6,000	\$6,000	\$6,000	\$7,000 <sup>1</sup>	\$7,000 <sup>1</sup>	0
---- Joint	\$14,000	\$14,000 <sup>1</sup>	\$12,000	\$12,000	\$12,000	\$12,000	\$14,000 <sup>1</sup>	\$14,000 <sup>1</sup>	0
--15%	15%	15%	15%	15%	15%	15%	15%	15%	15%
-- 27%	25%	25%	25%	25%	25%	25%	25%	25%	28%
-- 30%	28%	28%	28%	28%	28%	28%	28%	28%	31%
-- 35%	33%	33%	33%	33%	33%	33%	33%	33%	36%
-- 38.6%	35%	35%	35%	35%	35%	35%	35%	35%	39.6%
<b>AMT Exemption Amount</b>									
-- Single	\$40,250	\$40,250	\$33,750	\$33,750	\$33,750	\$33,750	\$33,750	\$33,750	\$33,750
-- Joint	\$58,000	\$58,000	\$45,000	\$45,000	\$45,000	\$45,000	\$45,000	\$45,000	\$45,000
<b>Marriage Penalty Relief</b>									
-- Standard deduction <sup>2</sup>	200%	200%	174%	184%	187%	190%	200%	200%	167%
-- 15% bracket <sup>2</sup>	200%	200%	180%	187%	193%	200%	200%	200%	167%
<b>Child Tax Credit</b>	\$1,000	\$1,000	\$700	\$700	\$700	\$700	\$800	\$1,000	\$500
<b>Qualifying Dividend Rates</b>									
--10/15% Bracket	5%	5%	5%	5%	5%	0%	10-15%	10-15%	15%
--Higher Brackets	15%	15%	15%	15%	15%	15%	28-39.6%	28-39.6%	28-39.6%
<b>Long-Term Capital Gains</b>									
-- 10/15% Bracket	5% <sup>3</sup>	5%	5%	5%	5%	0%	10% <sup>4</sup>	10% <sup>4</sup>	10% <sup>4</sup>
-- Higher Brackets	15% <sup>3</sup>	15%	15%	15%	15%	15%	20% <sup>4</sup>	20% <sup>4</sup>	20% <sup>4</sup>
<b>Capital Cost Recovery</b>									
-- Bonus Depreciation	30/50% <sup>5</sup>	50%	0%	0%	0%	0%	0%	0%	0%
-- Expense Amount	\$100,000	\$100,000 <sup>1</sup>	\$100,000 <sup>1</sup>	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000	\$25,000

1/ Adjusted for inflation.

2/ Amounts applicable to joint filers as a percentage of amounts applicable to single filers.

3/ Applies to gains recognized on or after May 6, 2003.

4/ Gains on 5-year property is taxed at 8 and 18 percent.

5/ Applicable to eligible purchases after May 5, 2003.



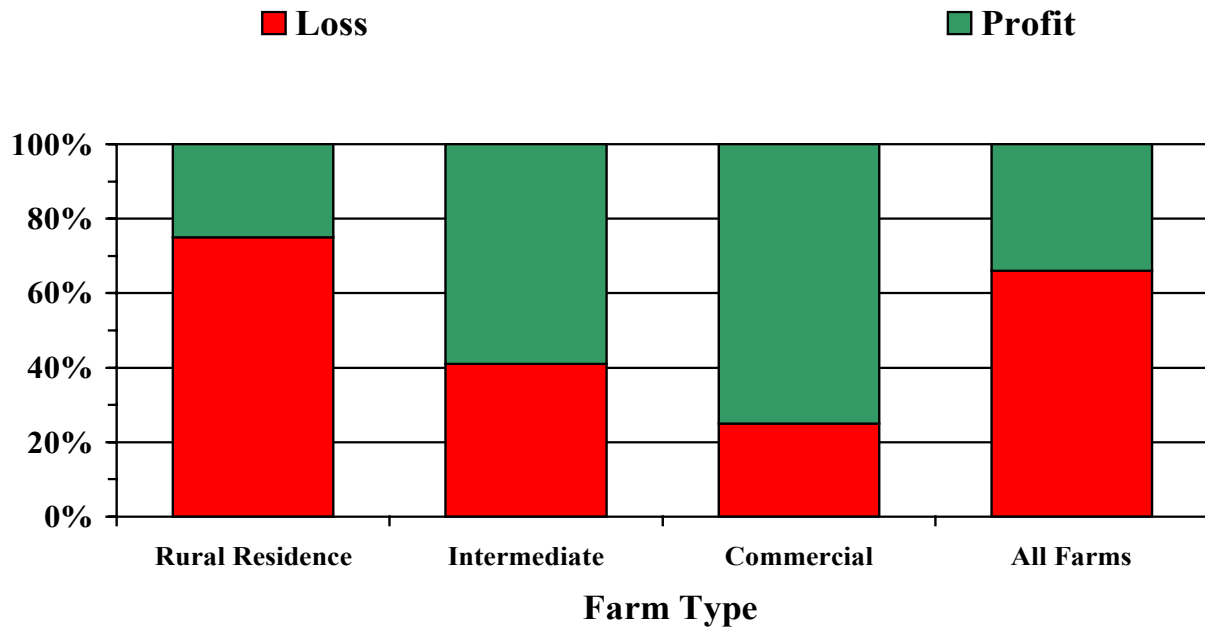
**Table 2. Estate tax exemption amount and tax rates, 2001-2011  
phase-in schedule and sunset**

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Year	Estate tax exemption amount (\$)	Highest marginal estate and gift tax rate (%)
2001	675,000	55
2002	1,000,000	50
2003	1,000,000	49
2004	1,500,000	48
2005	1,500,000	47
2006	2,000,000	46
2007	2,000,000	45
2008	2,000,000	45
2009	3,500,000	45
2010	Estate tax repealed	35 (gift tax rate)
2011 (sunset of Act)	1,000,000	55

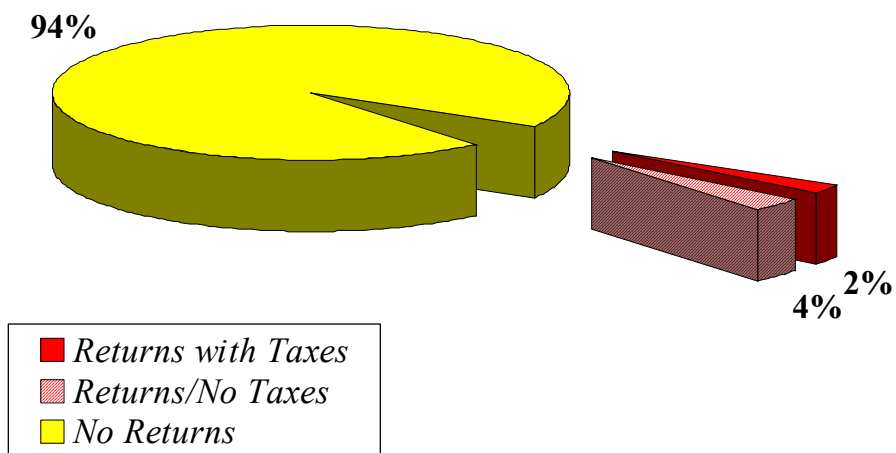
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Figure 1. Farm Sole Proprietors with Profit and Loss by Farm Type, 2000



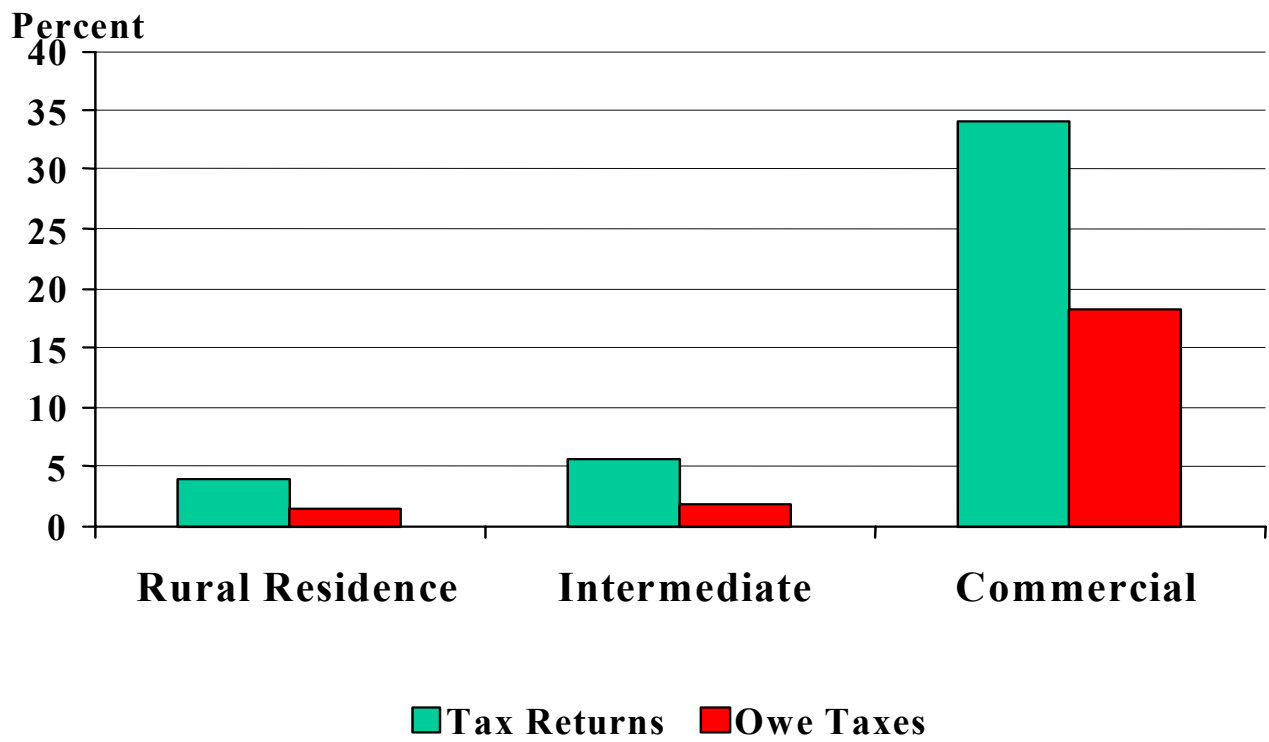
Source: Internal Revenue Service, 2000.

Figure 2. Share of Farm Estates with Returns and Taxes, 2004



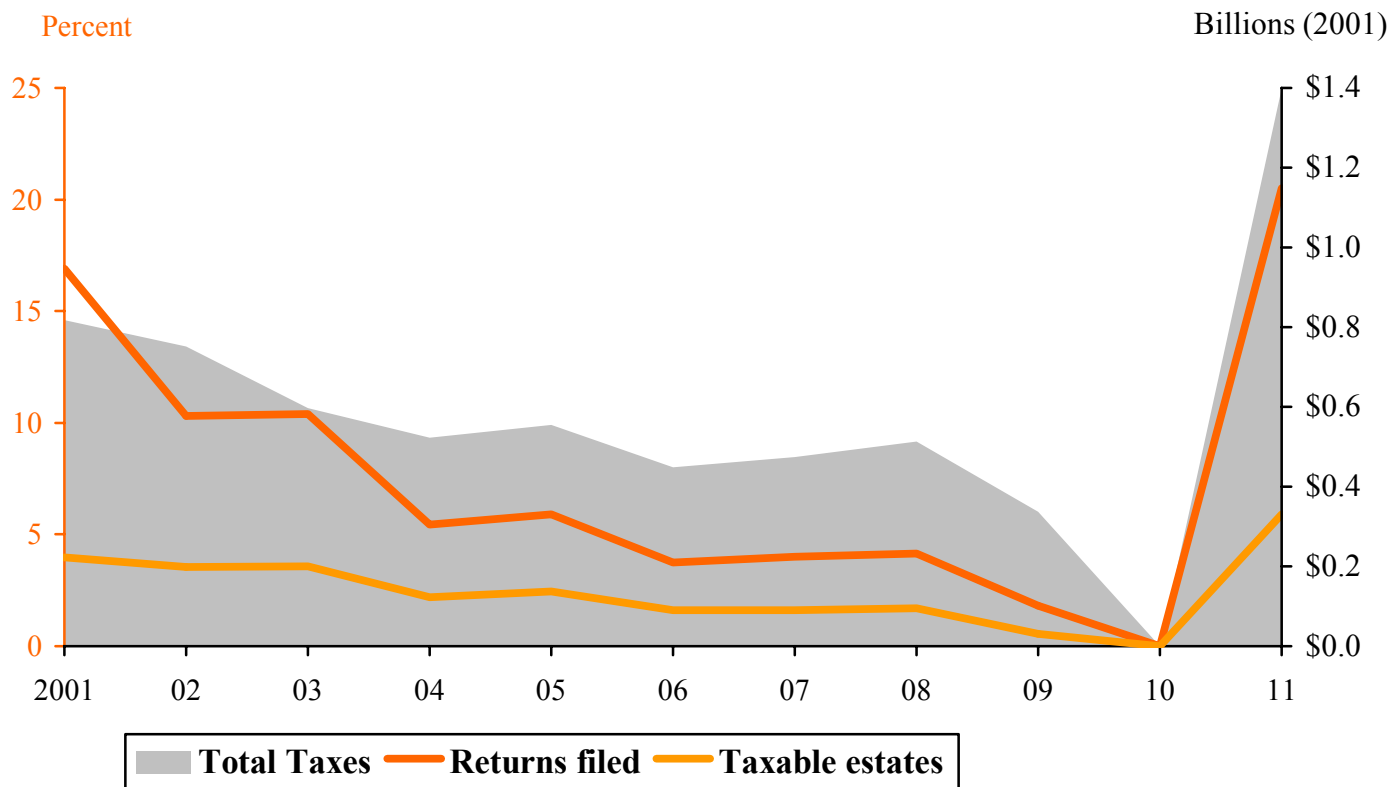
Source: USDA-ERS, estimates based on ARMS data.

Figure 3. Farm Estates with Tax Returns and Taxes by Farm Type, 2004



Source: USDA-ERS, estimates based on ARMS data.

Figure 4. Farm Estate Taxes, Returns and Taxable Estates, 2001-2011



Source: USDA-ERS, estimates based on ARMS data.

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# Federal Tax Policy and Farmers: A Current Perspective and Outlook

Ron L. Durst

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# Federal Tax Legislation

- Jobs and Growth Tax Relief Reconciliation Act of 2003 marked the third consecutive year for major tax relief legislation
- Legislation primarily focused on the individual income tax and estate and gift tax
- Federal income tax as share of GDP is lowest since 1942 and less than 2 percent of all estates owe Federal estate tax

# General Income Tax Relief

- Reduced marginal tax rates
- Marriage penalty relief
- Increased child tax credit
- Reduced tax rates on dividends and capital gains

# Small Business Relief

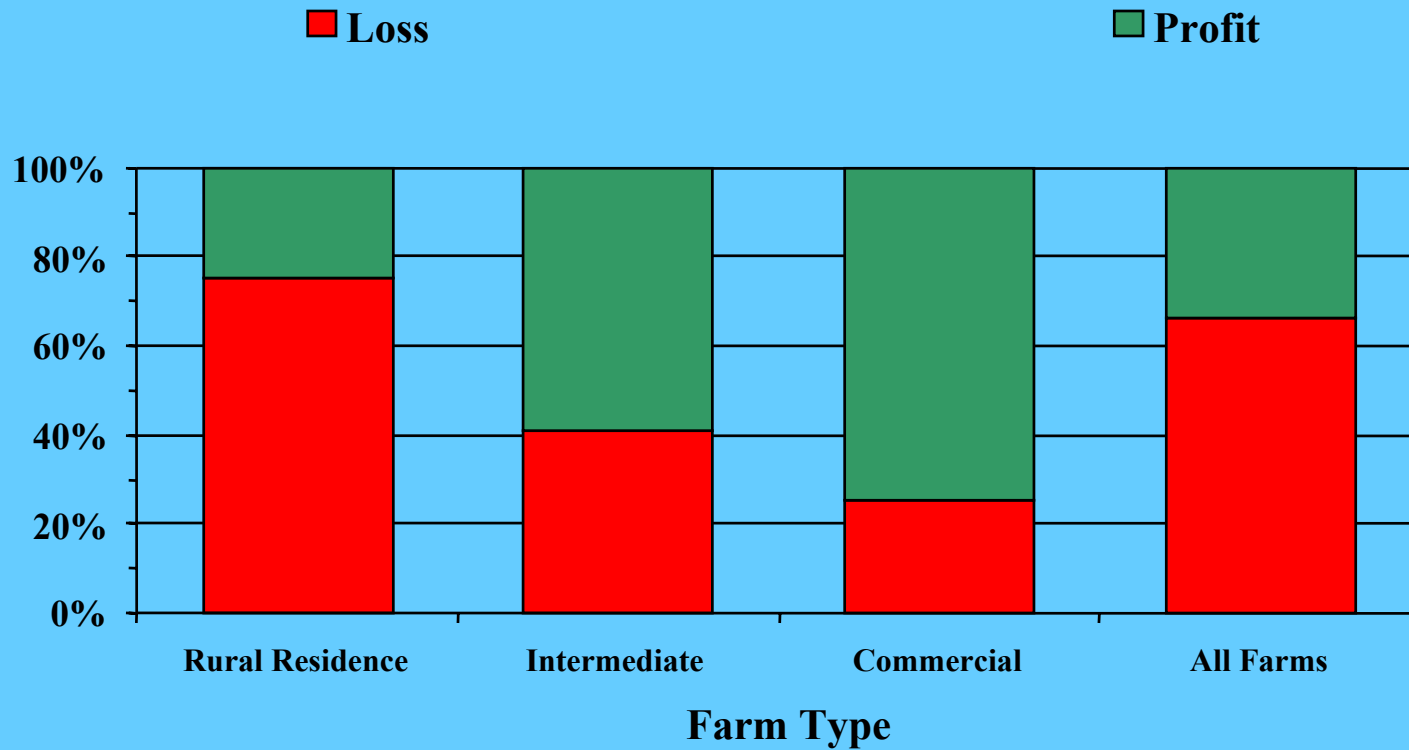
- Increase in amount that can be currently expensed from \$25,000 to \$100,000
- 50 percent additional first-year depreciation
- 100 percent of health insurance premiums are deductible and the new Medicare law provides for the establishment of healthcare savings accounts



# Impact on Farm Household Tax Burdens

- Farm households are expected to save over \$4 billion in Federal income taxes in 2004
- Average tax rate is expected to drop to about 14 percent

# Farm Sole Proprietors with Profit and Loss by Farm Type, 2000



Source: Internal Revenue Service, 2000.

# Federal Income Tax Outlook

- Various provisions are scheduled to expire over the next few years and all others are scheduled to sunset in 2010
- Alternative minimum tax is expected to affect an increasing number of taxpayers, including farmers, unless temporary relief is extended and the tax is indexed for inflation

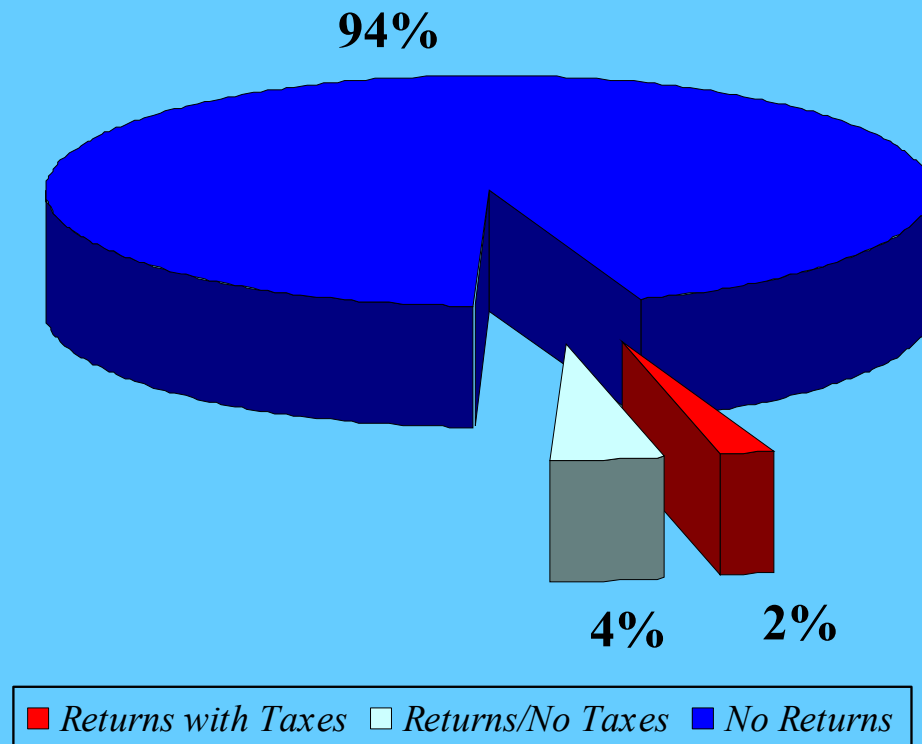
# Federal Estate Tax Developments

- Rising estate and gift tax burdens, especially for farmers and small businesses, led to the gradual expansion of the amount exempted by the unified credit in the 1997 Taxpayer Relief Act
- 2001 Act accelerated the phase-in, increased the exempt amount, reduced tax rates, provided a special deduction for family-owned businesses and scheduled the repeal of the tax in 2010

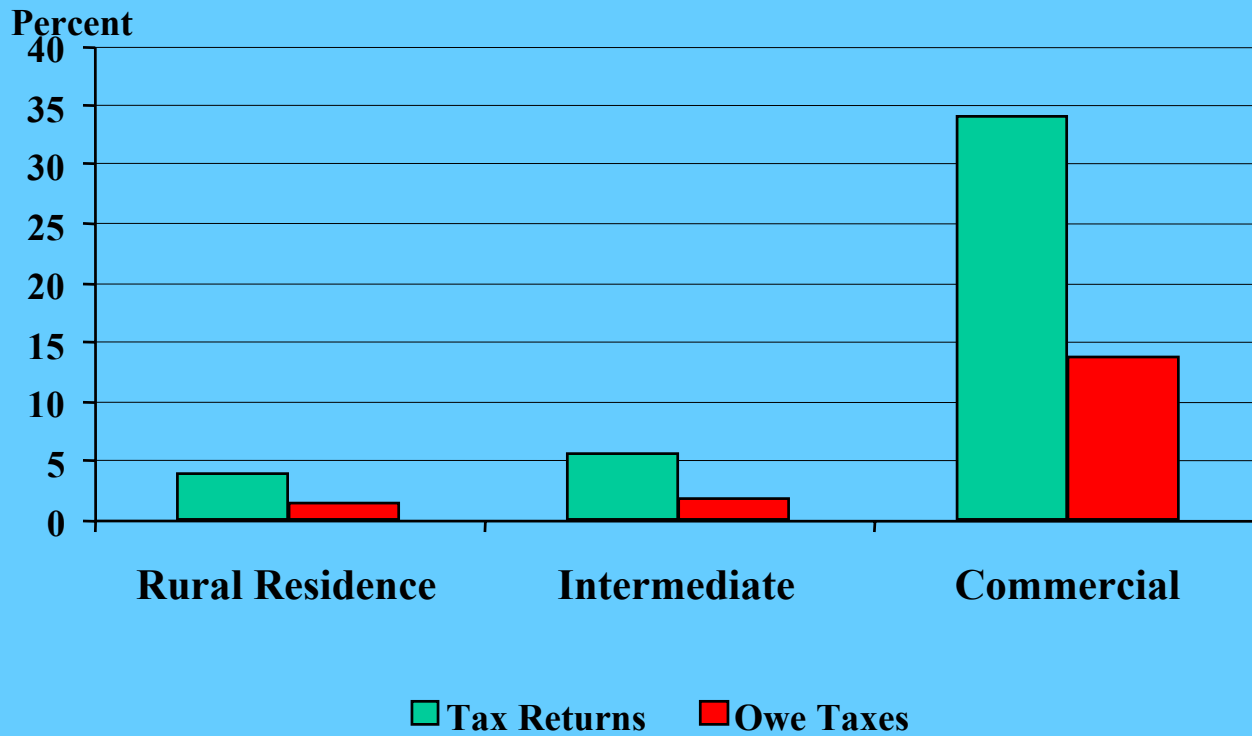
# Federal Estate Taxes in 2004

- Amount exempted by unified credit increased to \$1.5 million
- Family business deduction repealed
- Special use value can provide additional reduction of \$850,000

## Share of Farm Estates with Returns and Taxes, 2004



## *Farm Estates with Tax Returns and Taxes by Farm Type, 2004*



Source: USDA-ERS, estimates based on ARMS data.

# Federal Estate Tax Outlook

- Under current law, the amount that can be transferred tax free is scheduled to more than double by 2009



**Estate tax exemption amount and tax rates, 2001-2011  
phase-in schedule and sunset**

Year	Estate tax exemption amount (\$)	Highest marginal estate and gift tax rate (%)
2001	675,000	55
2002	1,000,000	50
2003	1,000,000	49
2004	1,500,000	48
2005	1,500,000	47
2006	2,000,000	46
2007	2,000,000	45
2008	2,000,000	45
2009	3,500,000	45
2010	Estate tax repealed	35 (gift tax rate)
2011 (sunset of Act)	1,000,000	55

# Significant Reduction in Farm Estate Taxes

- By 2009, when the amount exempted by unified credit reaches \$3.5 million, the share of farm estates that owe Federal estate tax is expected to be less than 1 percent
- The tax is repealed in 2010

# Future Issues Create Uncertainty

- One year repeal with reversion to pre-2001 law unless extended or made permanent

# Farm Estate Taxes, 2001-2011



# Future Issues Create Uncertainty

- One year repeal with reversion to pre-2001 law unless extended or made permanent
- Current repeal requires a carryover basis

# Summary

- Current Federal income and estate and gift tax environment is very favorable for farmers and small businesses
- Number of factors create uncertainty concerning the tax situation beyond 2004