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Publisher/Editor

Robert P. Achenbach, Jr.

Contributing Editor

Dr. Neil E. Harl, Esq.

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Issue Contents

Bankruptcy

Chapter 12

Automatic stay **34**

Dismissal **34**

Federal Farm Programs

No items

Federal Estate and Gift Taxation

Gift **35**

IRA **36**

Portability **36**

Federal Income Taxation

Accounting period **36**

Alimony **36**

Capital gains **36**

Disaster losses **37**

Partnerships

Election to adjust partnership basis **37**

Passive activity losses **37**

Returns **37**

Safe harbor interest rates

March 2017 **38**

Social security benefits **38**

Tax protester **38**

Withholding taxes **38**

In the News

Earned income tax and child tax credit
refunds **39**

Tax scams **39**

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Repealing the Federal Estate Tax: A Good Idea for Most Farmers and Ranchers?

-by Neil E. Harl*

The mass media, including several agricultural publications, are at it again – the super wealthy want the federal estate tax to be repealed and they are trying to get the farm sector to support the move. Studies have shown repeatedly that farmers and ranchers are more highly regarded by the general public than multi-billionaires. The cold, hard facts are that repealing the federal estate tax, for more than 98 percent of the farmers and ranchers, would be a loser.

Let's review the facts

The number of estates subject to the federal estate tax has been quite modest in recent years. Of the roughly 2.5 million deaths in 2014, 5,158 incurred estate tax liability (approximately 0.21 percent of all deaths). For that year, \$16,390,024,000 was paid in federal estate tax which averaged about \$3,177,218 per estate. Of the 5,158 taxable estates in 2014, 1,674 decedents with taxable estates reported "some" farm property. The data indicate that the 192 estates in that group reporting \$20,000,000 or more in value of farm property averaged \$4,256,933 each of farm property. The 288 decedents in the \$10,000,000 to \$20,000,000 category averaged \$3,661,045 in value of farm property. Clearly, the federal estate tax burden rests with those with very large estates, not with typical farm or ranch operations. Fewer than one percent of the farm or ranch decedents have to worry about paying federal estate tax and the bulk of those who are required to pay federal estate tax are large, mostly speculative, operations, not family operations.

One of the reasons for relatively few family farm or ranch operations paying federal estate tax is that, in 2017, each spouse (of a married couple) has an exclusion of \$5,490,000 or \$10,980,000 for the couple.¹ That is for all estates, not just for farm and ranch estates. However, beyond that, in 1976 Congress approved an additional deduction, named "Special Use Valuation," for farm and ranch estates which adds up to another \$1,120,000 reduction of the taxable estate for deaths in 2017.² Although the Internal Revenue Service has announced procedures to reduce the benefits from other discounts, such as lack of marketability, no action has been taken to curb those involving primarily family transactions.³

In the more than 50 years this author has been involved in publishing materials for use by lay individuals as well as lawyers and CPAs,⁴ I have never seen a farm that had to be sold to pay federal estate tax.

* Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.

This is not the first time Congress has considered repealing the federal estate tax and in each of those actions, from 1976 to the present, the repeal was paired with legislation to reduce or eliminate new basis at death for eligible assets. Unlike repeal of the federal estate tax (which would have a beneficial impact on only those with large estates), repeal of the “new basis at death” would affect every decedent holding assets that have appreciated in value.⁵ The elimination of “new basis at death” was targeted as a way to help to pay for repeal of the federal estate tax. However, it would have a draconian effect on small estates (which do not pay federal estate tax) but virtually all estates hold assets that have appreciated in value. Thus, those taxpayers ending up in the small estate category, currently too small to be subject to federal estate tax, would be major losers as a group as virtually every estate benefits from the new basis at death which has been highly beneficial for small and medium sized estates.

As an example of the “new basis at death,” assume a farm couple purchased a 320 acre farm in 1950 for \$100,000. At their deaths in 2017, the half-section is valued at \$2,560,000. The gain on the 320 acres figured with a fair market value of \$8,000 per acre or \$2,560,000, would be \$2,460,000. Applying the rules long available which allow a new income tax basis at death equal to the date of death value, the gain of the \$2,460,000 would be wiped off the books. To the extent that the new basis at death is eliminated to pay for repeal of the federal estate tax, the income tax basis of the farm in question would remain at \$100,000 for all time (until there was a sale or taxable exchange).

The loss of the new income tax basis at death would constitute a devastating blow to those holding farm land in particular in light of the appreciation in value in recent years.

Even more importantly, the low income tax basis that would remain, presumably for all time, would discourage taxable transactions which would have a highly negative effect on economic activity.

ENDNOTES

¹ Rev. Proc. 2016-55, 2016-2 C.B. 707.

² Rev. Proc. 2016-55, 2016-2 C.B. 707.

³ See “Transfers Subject to Disregarded Restrictions,” REG-163113-02, 81 Fed. Reg. 51413 (Aug. 4, 2016), interpreting and modifying I.R.C. § 25.2704-3.

⁴ See Harl, *Agricultural Law* (15 volumes) (Matthew Bender 2016); Harl, *Farm Income Tax Manual* (two volumes) (Matthew Bender 2016); and the lead article in *Agricultural Law Digest* for 380 issues of that publication that runs every two weeks.

⁵ I.R.C. § 1014(a).

Note on “small partnership: exception

by Neil E. Harl

It has come to our attention that an article has been published elsewhere (in a blog publication by Roger McEowen) relating to the “small partnership” exception. We disagree completely with the article which ignores the broad statutory basis for the “small partnership” which was enacted in 1982, 35 years ago. Quite frankly, the article is a good example of “sloppy scholarship” at its worst. The concept of the “small partnership” is based on I.R.C. § 6231(a)(1)(B)(i) which states - “The term ‘partnership’ shall not include any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation or an estate of a deceased partner.” (Emphasis added) Thus, a “small partnership” is not a partnership and the three pages of irrelevant language in the cited article needlessly confuse the reader. I was involved in the issues that led to the enactment of the above language in 1982. See Harl, “The “Small Partnership” Exception: The Best Tax Simplification in a Half Century Is In Jeopardy,” 28 *Agric. L. Dig.* 25 (2017).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

CHAPTER 12

AUTOMATIC STAY. The Chapter 12 debtor was an LLC wholly-owned by an individual debtor who had filed for Chapter 13. The other individual had not filed for bankruptcy and was the domestic partner of the individual debtor. The LLC was originally owned by the non-debtor individual and purchased on contract a farm from a creditor in the Chapter 12 case. However, the entire interest in the LLC was transferred to the Chapter 13 debtor who transferred title in the farm to herself, apparently without the knowledge of the other individual. The LLC debtor defaulted on payments to the creditor who sought relief from the automatic

stay to begin foreclosure proceedings against the LLC. The amount owned on the contract exceeded the fair market value of the farm. However, the LLC and non-debtor individual had filed an action in the Chapter 12 case to avoid the transfer of the farm to the Chapter 13 debtor as fraudulent. The court found that the two individuals and LLC were related parties and refused to treat their interrelated bankruptcy actions as separate and *bona fide*. The court held that the farm was titled in the name of the Chapter 13 debtor; therefore, the property was not part of the LLC bankruptcy estate and granted relief from the automatic stay for foreclosure proceedings by the creditor. ***In re Mountain Farms, LLC, 2017 Bankr. LEXIS 424 (Bankr. N.D. Ala. 2017).***

DISMISSAL. The debtors were a family-owned LLC and one of the members of that family. The debtors operated a dairy farm. Both debtors filed for Chapter 12 and the cases were jointly