ESTATE TAX

ISSUE

Another financial threat to the security of working lands is the estate tax. Often referred to as a "death tax," an estate tax is levied on an estate when its owner dies and it is passed down to heirs. The effect of this tax can be substantial for working lands, with the top tax rate reaching as high as 40 percent.

The tax currently applies to estates valued at more than $5.45 million. While that may sound like a lot, once the value of land, livestock, equipment, and other assets needed to run a farm, ranch, or timber operation are considered, it is not uncommon for many working landowners to reach that limit. After all, a single tractor can easily cost six figures, and that does not even begin to get into the value of land and buildings.[21]

Urban sprawl is also pushing up working-land prices in many parts of the United States, making them more susceptible to reaching the estate-tax threshold.[22] As populations increase and incomes grow, more people are looking to buy agricultural lands for urban expansion or second homes. This demand has driven up the values of working lands near towns and cities. A recent report from the Texas A&M Institute of Renewable Natural Resources found that the average appraised market value of working lands in the state increased more than 35 percent between 2007 and 2012.[23] The average land value for the 25 fastest-growing counties in Texas was $5,266 per acre in 2012, compared to the statewide average of $1,573 per acre, demonstrating just how much population growth can increase land values.[24]

Although operations on working lands may be rich in assets, they generally have little cash flow. Often, farmers, ranchers, and timber harvesters rely on a few major harvests or sales per year for their incomes. Recent increases in land values put working landowners at risk of having to pay estate taxes, but limited cash flows can make it difficult for producers to pay the taxes outright.[25] As a result, many properties are often either developed or sold after the owner's death.[26]

Careful estate planning can be arranged to avoid paying estate taxes, but it is a complex, time-consuming, and expensive process. Estate-planning options that can mitigate taxes generally include a combination of conservation easements, a family limited partnership, and life insurance policies structured to help pay the tax. With conservation easements, heirs can exclude 40 percent of the value of the land in easements from estate tax.[27] A family limited partnership allows the value of an owner's assets to be reduced by transferring the value to the next generation over many years so that the estate tax can either be reduced or avoided altogether. In addition, life insurance policies can be arranged so that cash will be provided to pay estate taxes after death. But negotiating any of these approaches takes significant time and expense, and they can diminish a landowner's use of and authority over his or her land while still alive.[28]

Rancher Diane Holly knows the pressures of skyrocketing land prices and the headache of estate planning all too well. Holly's 1,800-acre ranch was originally homesteaded in 1886 and passed down through generations. Located near the popular vacation town of Steamboat Springs, Colorado, the ranch's value has exploded as more people look to develop the area for vacation homes. When Holly's mother died in 1983, the ranch was appraised at $800,000. Nine years later, the value was up to $1.2 million, and her father was turning down

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Estate taxes threaten the continued functioning of working lands for future generations (left). Working lands often have little cash flow, and many properties are either developed or sold after an owner's death (top right). Urban expansion is pushing up prices of working lands, making them more susceptible to reaching the estate-tax threshold (bottom right).

offers from out-of-towners who wanted a private hunting ranch because he wanted to keep the land in agriculture and was confident he had a good estate plan. Unfortunately, Holly's father died in 1997, and the ranch was valued at $2.3 million—subject to the estate tax requirements of the time—and his estate plan was not enough to cover the tax liabilities. She had nine months to pay $400,000 in estate taxes, and the ranch only brought in $28,000 per year. To cover the tax, she had to sell 200 acres of river bottom.

Though the estate tax limits have since increased to $5.45 million, Holly estimated that the land was worth $22 million in 2008, and that it has only continued to increase since then—making it susceptible to estate tax.[29] After already having to pay estate tax once to keep the ranch in the family, Holly has actively engaged in estate planning, but she's reluctant to put a conservation easement on the property because she is afraid it would be too restrictive on her heirs' use of the land. In the end, Holly is frustrated by an estate planning process that is constantly playing catch-up with the real estate market.

Estate taxes threaten the continued functioning of many working lands. The need to raise cash to pay the tax often means that working lands become fragmented or developed, threatening the environmental benefits that come with large tracts of lands.

REFORM

Repealing the estate tax would not only free landowners from paying the tax but also from the laborious and complicated planning that many go through to avoid the tax. For owners of working lands who have limited cash flows and ancestral roots in their properties, this is a lot to ask. These owners are stuck between a rock and a hard place: either pay the estate tax or give up cash and control in estate planning. Repealing the tax would allow farmers, ranchers, and timberland owners to focus on keeping their operations in business and in the family, rather than spending countless hours and dollars in estate planning.

In fact, abolishing the estate tax would protect working lands with relatively little foregone federal revenue. Due largely to careful estate planning—which eats up resources that could be put to productive uses adding value elsewhere—only 0.18 percent of estates had to pay the estate tax in 2013.[30] In 2014, revenue from the tax made up less than 0.60 percent of the total federal revenue of over $3 trillion.[31]

Abolishing the estate tax would not significantly reduce federal revenue. It would, however, allow owners of working lands to stop spending valuable resources paying the hidden costs of avoiding the tax. They could also stop fearing that their land will be sold or developed if subject to the tax. By getting rid of the estate tax, owners of farms, ranches, and timberlands could preserve their undeveloped spaces that provide valuable wildlife habitat, clean water, and other environmental benefits.

Photo: © Colin Brown

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