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The Effect on Family Farms of Changing Capital Gains Taxation at Death

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Abstract

This report presents a method for assessing impacts of changes to capital gains taxation at death for family farm estates, an approach which accounts for the structural changes in a person's wealth portfolio that often occurs as a person ages. The method is applied to the American Families Plan, which proposes to eliminate stepped-up basis for inherited assets greater than $1 million for individuals' estates and $2 million for married couples' estates while deferring capital gains tax liability on business assets as long as the business remains family operated. The results suggest that of the estimated 32,174 family farm estates in 2021, 1.1 percent would owe capital gains taxes at death, 18.2 percent would not owe capital gains taxes at death but could have deferred tax liability if the farm assets do not remain family-owned and operated, and 80.7 percent would have no change to their capital gains tax liability.

Keywords: Capital gains tax, family farms, estates, stepped-up basis, carry-over basis

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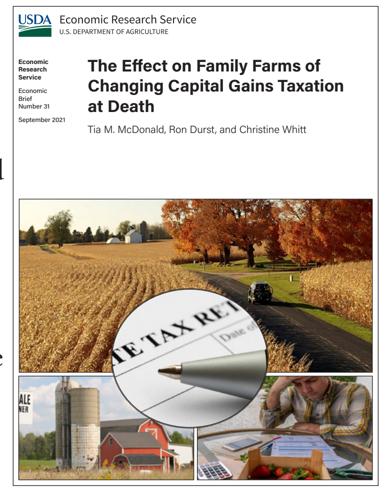

Overview

The American Families Plan (AFP)—announced on April 28, 2021, by President Joe Biden—proposed changing the treatment of capital gains taxation on inherited assets.[1] Information used to develop this report comes from the White House Fact Sheet[2] and a USDA press release.[3] The proposed changes in AFP would make accumulated gains (in asset value) subject to capital gains taxation at death whereas—under current law—these gains can be passed on to heirs without being subject to capital gains taxation. Although these changes could possibly impact the intergenerational continuity of family farms, the proposal includes an exemption for family-owned business assets (including farms) inherited by a family member who continues operating the business.[4,5] For these assets, heirs could defer any taxes owed on unrealized gains as long as the business remains family operated. AFP also includes a provision to exempt from capital gains taxation $1 million in gains for the estates of individuals and $2 million in gains for the estates of married couples. An additional exemption for gains on a personal residence of $250,000 for individuals and $500,000 for married couples is also included. Capital gains taxation is distinct from the estate tax.[6] AFP does not propose any change to existing estate tax policy.

The estimated impact of the AFP's proposed changes presented in this Economic Brief depends on the amount of gain, the types of assets held by a farm estate, as well as the continuity of the family farm. Estates with total unrealized gains (combined farm and nonfarm assets) less than the exemption amount would not owe additional

[1]AFP represents one set of policy parameters regarding the issue of capital gains taxation at death which may evolve over time. This report presents a methodology for analyzing the AFP as well as any future versions of related policies.

[2]White House. 2021. "Fact Sheet: The American Families Plan," The White House, Washington, DC. (accessed June 28, 2021)

[3]USDA. 2021. "The American Families Plan Honors America's Family Farms," USDA, Washington, DC. (accessed July 27, 2021)

[4]Details regarding implementation are not known at this time. These details include time required to operate the business and who qualifies as a family member. This report adheres to the language laid out by the White House and USDA which states that the business must remain family operated.

[5]Because the focus is on family farms, the analysis assumes any nonfarm business assets owned by a farm family would not qualify for deferred taxation. By doing so, the estimates presented here may overestimate share of farm estates that would be impacted by the AFP.

[6]For more information on the estate tax, see ERS estate tax topic page on ERS's website.

capital gains taxes as a result of the proposed changes. Estates that have nonfarm gains greater than the exemption amount would owe tax at death on nonfarm gains. This analysis assumed a family member inherits the farm assets and continues to operate the farm, which would qualify the heir for deferred capital gains tax on farm gains as long as the farm remains family-owned and operated. Therefore, estates that have nonfarm gains less than the exemption amount, but have farm gains that raise total gains to greater than the exemption amount, would owe no tax at death. Instead, the heir-proprietor(s) would be subject to a potential deferred capital gains tax on farm gains if the family farm does not remain family-owned and operated.[7]

This analysis used data from USDA's 2019 Agriculture Resource Management Survey (ARMS)—a nationally representative survey of farm operations and the principal operators' households—and a model of estate and capital gains taxation to estimate both the number of estates generated and the impact of changes to capital gains taxation on those estates in 2021. The USDA considers a farm to be any place that produced and sold—or normally would have produced and sold—at least $1,000 of agricultural products during a given year. The analysis was limited to principal operator family farms but is representative of the diversity of family farms' sizes and structures. The analysis did not include the impact of changes on non-operator landlords.

Researchers estimated of the 1.97 million family farms in the United States from 2019 ARMS, 32,174 estates would result from principal operator deaths. From these farm estates, model results suggested under the proposed plan 1.1 percent would owe a capital gains tax at death; 18.2 percent would owe no tax at death but could potentially have a deferred tax on farm gains (which would be avoided if a family member inherited and continued to operate the farm); and 80.7 percent would owe no tax at death while also receiving stepped-up basis on all assets (see box, "Tax Terminology"). The distribution of impact varied by farm size; the percent of estates owing no tax at death and receiving stepped-up basis on all assets (no change in capital gains tax liability) ranged from 83.4 percent of small farm estates (less than $350,000 gross cash farm income) to 3.6 percent of very large farm estates (greater than $5 million gross cash farm income). The share of farm estates with no tax at death and a potentially deferred capital gains tax on farm assets increased with farm size, ranging from 15.5 percent of small farms to 93.9 percent of very large farms. The estimated 32,174 estates accounted for only 1.0 percent of the total value of production of all family farms. Estates owing no capital gains tax at death and receiving stepped-up basis on all assets accounted for 34.6 percent of farm estates' value of production. Those with no capital gains tax at death and a potential deferred tax on farm asset value gains if the farm does not remain family-owned and operated accounted for 63.2 percent of farm estates' value of production. Those with a tax at death accounted for 2.1 percent of estates' value of production. The average tax rate was estimated to be 11 percent of total nonfarm assets for the 1.1 percent of farm estates owing capital gains taxes on nonfarm assets at death.

[7]Deferred capital gains taxes could potentially affect the farm operation's ability to obtain financing.

Tax terminology

- Estate: An estate consists of the assets an individual owns at the time of death. It is considered a separate entity for tax purposes.
- Capital gain: The amount an asset increases in value, calculated as the difference between an asset's fair market value and an asset's basis.
- Tax basis: The value of an asset when purchased or acquired used to determine gain or loss when the asset is sold.
- Stepped-up basis: Tax basis increased to fair market value when inherited. Eliminates capital gains tax liability on any gains prior to inheriting.
- Carry-over basis: The individual inheriting the asset has the same tax basis as the prior owner. Unrealized gains accrued during the prior owner's control are not taxed when the prior owner dies but are deferred.
- Exemption: Eliminates tax liability on a specified amount of income or capital gain.
- Depreciation deduction: A method of allocating the cost of an asset over its useful life. For tax purposes, the cost of an asset can generally be written off as a business expense at a much faster rate than the actual decline in the value of that asset.

The Effect on Family Farms of Changing Capital Gains Taxation at Death

Introduction

The American Families Plan (AFP), proposed by the Biden Administration, would make a number of changes regarding the taxation of capital assets at death. Under current law, the tax basis—the amount for determining gain or loss—of property transferred to an heir at death is increased to its current fair market value at the date of death. Often referred to as a "step-up in basis," this means any appreciation in property value that occurred during the previous owner's life goes untaxed. If the heir chooses to sell the property, any tax would be determined with reference to the new basis, meaning that only asset appreciation after the asset had been inherited would be subjected to capital gains tax.

For heirs of farm assets (i.e., farm heirs) under current law, the tax basis for farmland and other assets such as farm machinery, equipment, and livestock are increased (decreased) to their fair market value at the date of death.[8] As a result, the gain in the value of farm assets that occurred during the prior owner's life is not taxed. Also, the farm heir who continues operating the farm has a lower tax burden on the farm's operating income. The lower tax burden is due to increased depreciation deductions and lower taxable income on the sale of livestock and other farm products. Thus, holding all other factors constant, the farm heir's inherited farm operation has the potential to generate higher after-tax income than the same farm operated by the prior owner. For a continuing operation for which any farmland sale may not occur for many years, the step-up in basis for farm machinery, equipment, livestock, and other products may have a greater short-term impact than an increase in the basis for their farmland.

AFP proposes to end the step-up of an asset's basis to fair market value at death for increased asset values (or gains) in excess of $1 million for estates of individuals ($2 million for estates of married couples). Gains on a personal residence of $250,000 for estates of individuals ($500,000 for estates of married couples) would also be exempt from capital gains taxes.[9] Gains above these exemption amounts would be subject to tax at death. However, if a family farm is bequeathed to a family member(s) who continues to farm the inherited operation, they would not have to pay the capital gains tax on farm gains when the assets are inherited. Thus, if the family farm is not sold and the heir continues to operate the farm, the heirs can avoid the proposed increase in capital gains tax. AFP would also restore the top income tax bracket to the pre-2017 Tax Cuts and Jobs Act (TCJA) level of 39.6 percent for households with income over $1 million annually. Capital gains would also be taxed at the new top marginal income tax rate. Finally, the capital gains would also face a net investment tax rate of 3.8 percent. Thus, the combined top tax rate on capital gains for assets above the exemption threshold would increase from 23.8 percent under current law to 43.4 under AFP.

[8]For the deceased, livestock and crops would have a zero basis in most cases since the cost of raising and maintaining the animals or producing the crops would have been deducted as an expense. For machinery and equipment, accelerated depreciation would also likely result in a basis that is lower than the fair market value of the asset.

[9]Gains up to the relevant exemption level are subject to stepped-up basis and avoid capital gains taxes.

Stepped-up basis for sale of farmland example

This example shows how inherited farmland would be taxed under the current law and the proposed American Families Plan (AFP) if the farmland were sold by the heir. Assume that a person inherits and continues to farm 2,400 acres (from a married couple) that have a current market value of $10 million and were worth $4 million when originally acquired. Since the heir is inheriting from a married couple, the relevant exemption is $2 million.

Under current Law:

- The original basis of $4 million is "stepped up" to the current fair market value of $10 million.
- If the heir sells the land:
  - They pay capital gains taxes on the sale price minus $10 million (basis).
  - The capital gains tax rate is 20 percent plus a net investment tax rate of 3.8 percent.

Under proposed AFP:

- The exemption for a married couple would mean that $2 million gain would be "stepped up" to current fair market value with the remaining value subject to the original basis of $4 million.
- If the heir sells the inherited farm assets:
  - They pay capital gains taxes on the sale price minus $2 million (exemption) minus $4 million (basis).
  - Capital gains tax rate of 20 percent for gains up to $1 million, 39.6 percent for income above $1 million plus net investment tax of 3.8 percent.

This report estimated the number of farm estates likely to be created in 2021, the share of farm estates that are expected to owe capital gains tax at death under AFP, and for this subset of estates the taxes owed as a share of nonfarm assets inherited. The report also presents estimates of the share of farm estates that could have a deferred capital gains tax liability because their gains exceed the relevant capital gains exemption; this tax liability could result if the heirs do not continue to farm. The amount of unrealized gains that are potentially subjected to future capital gains taxes was also estimated. The estimates presented represent the effects for 2021 based on current asset values. If exemption levels are not adjusted for inflation or increases in asset values exceed the rate of inflation, the share of estates owing tax at death or the share of estates with potential tax liability due to a carry-over basis on some farm assets could increase in future years.

Method of Analysis

Eliminating stepped-up basis could increase the likelihood of either capital gains taxes owed at death or after death if the assets qualified for carry-over basis. Carry-over basis means the heir has the same tax basis as the prior owner, and unrealized gains accrued by the prior owner are not taxed at death but are deferred as long as the heir is a family member who continues to farm. Since the focus of the study is to estimate the impact on the continuity of the family farm from changes to capital gains taxation at death, the analysis assumed that the farm is transferred to a family heir that continues to operate the farm. In practice, not all farm assets would be transferred at death and of those transferred at death some would go to nonfamily heirs or family heirs that opt not to continue the farm operation. This could affect both the amount and type of assets transferred at death and increase the share of farm estates taxable at death while reducing those eligible for carry-over basis and deferred taxation.

To assess the impact of the proposed changes to capital gains taxation for family farms, this study estimated: (1) the number of family farm estates created in 2021; (2) the asset value gains for each estate; and (3) the tax liability generated at death from the proposed changes. The estimates presented in this analysis are representative of 1 year (2021) and may not be representative of future years if exemption levels are not adjusted for inflation or increases in asset values exceed the rate of inflation.

This report specifically focused on the impact of changes to capital gains taxation for family farms. USDA defines a farm as any place that produced and sold—or normally would have produced and sold—at least $1,000 of agricultural products during a given year. Family farms are defined as any farm where the majority of the business is owned by the principal operator—the person who is most responsible for making day-to-day decisions for the farm—and by individuals who are related to the principal operator. Information regarding a farm household's nonfarm assets was only available for households associated with the principal operator. The analysis did not include information about operators who were not identified as the principal operator or the spouse of the principal operator. In 2019, 10 percent of farms had operators in addition to the principal operator and the spouse. Households associated with non-principal operators may also have a capital gains tax liability at death depending on the size of the assets and the ability to pass on their share of the operation to a family member who continues to operate the farm. The average ownership share for principal operators ranges from 96 percent for small farms (farms with gross cash farm income (GCFI) less than $350,000) to 75 percent for very large farms (farms with GCFI greater than $5 million).

The analysis included family farms regardless of structure (e.g., sole proprietorship, partnerships, corporations, and trusts) where farm assets were allocated to the principal operator based on their ownership share. Family farms accounted for 98 percent of all farms in 2019. The analysis also did not cover the tax implications for non-operator landlords. According to the most recently available data from 2014, non-operator landlords own approximately one-third of all farmland, and there may be impacts to farmland markets not covered in this report (Bigelow et al., 2016).[10]

The main source of data was the 2019 Agricultural Resource Management Survey (ARMS), which is USDA's primary source of information on the production practices, resource use, and economic well-being of farms and ranches in the United States. ARMS has been designed to represent the diversity of farms and farm households making up the agriculture production sector. Therefore, an advantage of ARMS is that it enables analysis across different kinds of farms, types of farm households, and farm regions of the country.

Estimation of the number of estates in 2021

The method used to estimate capital gains was an extension of USDA, Economic Research Service's (ERS) estate tax model.[11] The estate tax model uses mortality estimates from the Social Security Administration's Actuarial Life Tables to report the probability of a person's death in the next year given their age. Probabilities from the most recently available 2017 Actuarial Life Table were matched to each principal operator in the ARMS dataset according to their reported age, which subsequently provided an estimation of estates likely

[10] There may be additional impacts to land markets due to a change in incentives arising from AFP. For example, there may be a decreased incentive to hold land until death since it would no longer be possible to pass untaxed gains to heirs who do not plan to continue to farm. There may also be an incentive for farm heirs to continue farming to avoid capital gains taxes, which may result in land being diverted to less profitable types of production.

[11] For more information related to the USDA, ERS Estate Tax Model, see Documentation for Estate Tax Model available on the Federal Tax Issues topic page on the USDA, ERS website.

to be created.[12,13] The probabilities were also used to weigh estimates of asset value, taxable gain, and tax liability to provide aggregate values for farm estates. The advantage of this approach—relative to estimating the tax implications for all existing farms—is that farm structure and asset accumulation change over the life of the farm operator, and this is explicitly accounted for by giving more weight to assets held by older principal operators (Mishra et al. 2002; Gale 1994; Ahearn 1993).

Estimation of capital gain

Capital gain is the difference between the current fair market value and the basis of an asset. The current fair market value of farm and nonfarm assets for each farm estate was available in the ARMS dataset. Information regarding the asset's basis—which is primarily determined by the value of the asset when purchased or acquired—was not readily available. Therefore, this study employed two strategies—one for farm assets and one for nonfarm assets—to estimate asset value gains.

Farm assets are primarily comprised of farm real estate (e.g., land and buildings), equipment, livestock, and crop inventory. Since farm real estate gains were not observable for individual operators, this study utilized three known pieces of information to estimate these gains: (1) current real estate value; (2) the year the operator began farming; and (3) average State gain in real estate value between the year the operator began farming and the current year. The year the operator began farming served as a proxy for the year the real estate was acquired, which overestimates the gains for operators who acquired land over time. Therefore, for most farm estates, it serves as an upper bound for estimates of impact.

Since the current farm real estate value was observed in ARMS, this study required researchers to estimate the value gained since the operator acquired the land as a share of the current value. To estimate this, researchers used the State farm real estate values in 2020 and the year the operator began farming to ultimately calculate the value of gain as a share of the current State land value, as shown in equation 1. State farm real estate values for the relevant years came from the annual Agricultural Land Values reports produced by USDA, National Agricultural Statistics Service (NASS).[14] The gain in farm real estate value as a share of current land value was multiplied by the current value of farm real estate reported by each principal operator in ARMS to calculate the share of current value that was estimated to be a gain.

$$\textit{Gain in farm real estate value as a share of current land value} = \frac{\textit{State land value in 2020 - State land value in year began farming}}{\textit{State land value in 2020}}$$

The average farm real estate gain, as a percentage of its current value, was 55 percent. However, the gain varied by geographic location and farm size. Results were examined across farm size, where small farms have gross cash farm income (GCFI) less than \$350,000, midsize farms have GCFI between \$350,000 and \$1 million, large farms have GCFI between \$1 million and \$5 million, and very large farms have GCFI greater than \$5 million. Small farms included farms where the operator reported being retired,[15] the operator reported having a primary occupation other than farming, and where the farm operator reported their primary occupation as farming but had low to moderate

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[12] The probability of death likely changed in 2021 due to the effects of the Coronavirus (COVID-19) pandemic. While the analysis presented in this report may underestimate the total number of estates created in 2021, assuming the distribution of deaths due to COVID-19 was independent of farm size, the distribution of impact should be consistent with results reported herein.

[13] The analysis assumes married couples jointly own assets, and at the death of the principal operator, the entire operation is transferred, and the full exemption for a married couple is applied. Doing so statistically accelerates the death of the spouse but allows the analysis to treat the farm as one whole unit.

[14] State land values were available beginning in 1980. This allowed researchers to capture much of the variability in land values that accompanied the farm crisis years. For principal operators that started farming prior to 1980 (which is 36 percent of all principal operators), this land value is assigned. This simplification potentially underrepresents farm real estate gains for these estates.

[15] These individuals consider themselves retired from farming but are still the principal operator who makes most of the day-to-day decisions of the farm operation.

sales (GCFI less than $350,000). Average percentage gain in farm real estate was lowest for small farm estates (54.3 percent), with estimated gain for midsize, large, and very large farms equal to 61.4 percent, 65.4 percent, and 57.0 percent, respectively. The variation across farm size reflected differences in operator tenure and State level gains in farm real estate. The highest percentage gain in farm real estate (60.0 percent) was in the Midwest production region.[16] The Plains and Atlantic regions had the next highest percentage gains in farm real estate of 57.7 percent and 51.6 percent, respectively. The lowest percentage gains in farm real estate were in the West (50.2 percent) and the South (49.8 percent).[17]

Livestock and crop inventories were assigned a zero basis since the cost of raising and maintaining animals or producing crops would have been deducted as an expense. Other farm assets such as equipment and machinery were assigned the same gain estimate as was applied to farm real estate. This would be consistent with an accelerated depreciation of these assets for tax purposes since depreciation reduces an asset's basis, thus increasing the calculated gain when the asset is sold.[18]

For nonfarm assets—including the principal operator's dwelling, if not owned by the farm business—this study assumed the gain in value was 50 percent of the current value with the exception of retirement assets since retirement assets are not currently eligible for step-up in basis. This assumption was informed by the Internal Revenue Service's (IRS) summary of long-term capital gains from 2012,[19] which has been the most recent report on sale of capital assets. The IRS summary of long-term capital gains from 2012 showed a gain for all assets was 49.7 percent of the value of the asset at the sale. The relevant residential exemption was applied to the family dwelling. Any residential capital gains exceeding the residential exemption were applied to the general exemption.

Estimation of capital gains tax liability at death

Capital gains tax liability depends on the amount of capital gain, available exemptions, and applicable tax rates for the relevant tax entity. In the case of capital gain taxes due at death, the relevant tax entity would be the final return of the decedent or the estate. This study assumed the estate is the taxable entity. It also assumed sources of continuing income for the estate exceeded $13,050[20] and applied the tax rates that were relevant to those income brackets above this amount. Since it is assumed farm assets are transferred to a family member who continues to operate the farm, only gains on nonfarm assets are taxable at death; this analysis includes an estimate of taxes owed. In the case of capital gains subject to carry-over basis, the relevant tax entity would be the heir, and the applicable tax rates would depend on the heir's income. Since the method and timing of the sale or change in ownership—as well as the heir's tax rate—could vary widely for farm assets, this study is not able to estimate potential taxes owed on inherited farm assets with carry-over basis.

[16] For information about States included in each production region, see USDA, National Agricultural Statistics Service. Charts and Maps: ARMS III Farm Production Regions Map (2019).

[17] Average percentage gain by region was calculated as a simple average, not weighted by farm size.

[18] Researchers also estimated the effect of increasing the assumed gain for equipment and machinery. Increasing the assumed gain to 75 percent only changed result of the share with carry-over basis by less than 1 percent since equipment and machinery tend to be a small portion of total assets.

[19] Internal Revenue Service, Statistics of Income Division, Sales of Capital Assets Data, Tax Years 2007–2012, February 2016.

[20] Under the income tax rate schedule for an estate, the top marginal income tax rate and a capital gains tax rate of 20 percent are applicable to income above $13,050 in 2021, however the AFP proposes to increase the tax rate to 39.6 percent for those with income greater than $1 million.

Three outcomes for farm estates under the proposed AFP

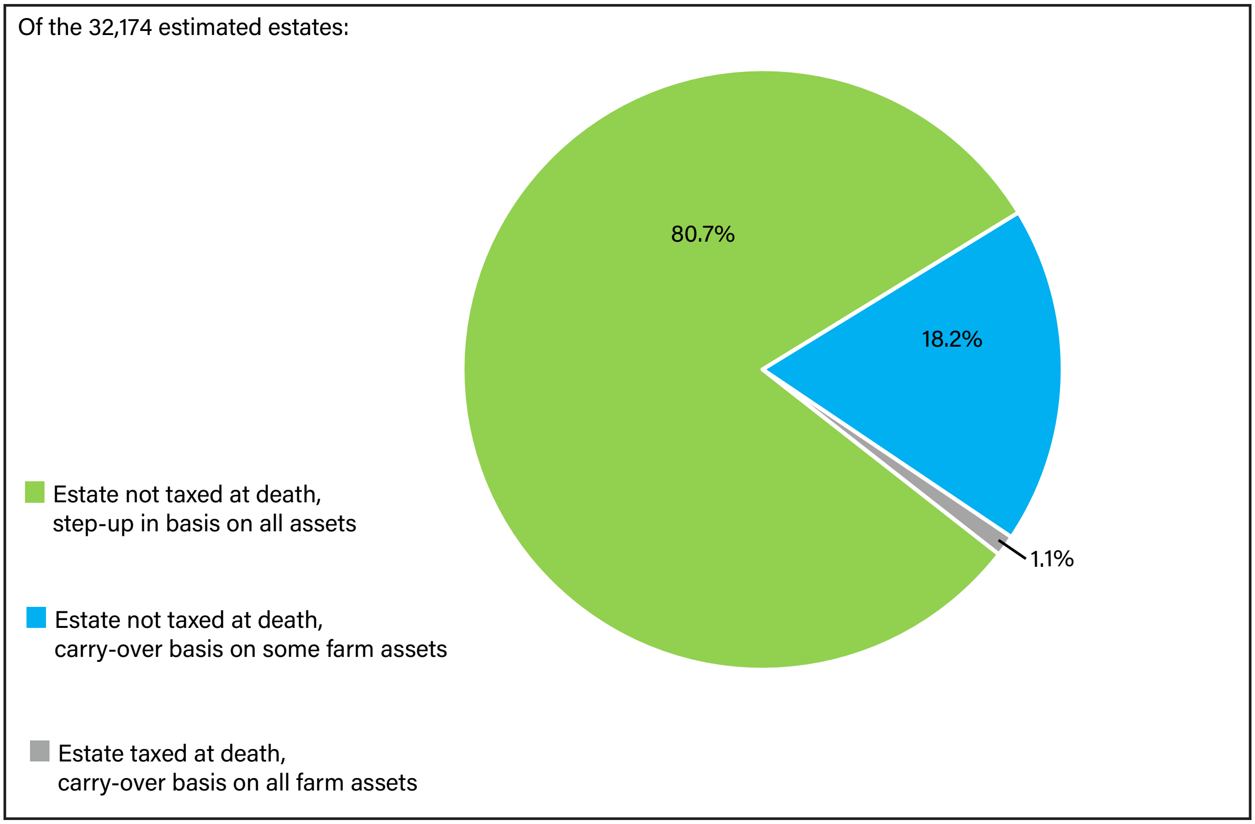
The elimination of stepped-up basis along with the proposed exemption levels and carry-over basis on farm gains could result in three possible outcomes for farm estates, depending on the amount of gain and type of assets held by the estate and assuming farm assets are transferred to a family member who continues to farm. Using 2019 ARMS data, this study estimated that approximately 32,000 estates would result from deaths of principal operators in 2021, of which:

- 80.7 percent would owe no tax at death and receive stepped-up basis on all assets by the proposed changes to capital gains taxation at death (figure 1). Thus, this group of heirs would not owe any tax at death because capital gains fall below the exemption relevant to the decedent's marital status and would receive stepped-up basis on all inherited assets.
- 18.2 percent of farm estates would not owe taxes at the time of death; however, they could be subject to a future potential capital gains tax obligation if the heirs stop farming, since they would only receive carry-over basis on some farm assets inherited.[21]
- 1.1 percent of estates would owe tax at death and receive a carry-over basis on all farm assets transferred, net of the exemption.[22]

[21]Farmers acquire additional land over time. To test the sensitivity of these results to this pattern of land acquisition, researchers used an alternative method to estimate farm real estate gains where it was assumed that operators acquired half their land the year they began farming and acquired the other half mid-tenure. This assumption is consistent with research that shows growth in owned acres is highest for young farmers and, on average, nears zero for farmers around age 50 (Katchova and Ahearn, 2016). Using this estimate for farm gains, the percent of estates with no tax at death and receive stepped-up basis on all farm assets increased to 83.9, and the percent not taxed at death but with carry-over basis on farm assets decreased to 15.0.

[22] To test the sensitivity of these results to assumed nonfarm gains, researchers used data from the Survey of Consumer Finance (2019), which reported average unrealized gains were 40.5 percent of total asset value for U.S. households with assets. Using this value for nonfarm gains, the estimate of estates that owe no tax at death and receive stepped-up basis on all farm assets was 82.3 percent, estimate of estates not taxed at death with carry-over basis on some farm assets was 16.8 percent, and the estimate of estates taxed at death with carry-over basis on all farm assets was 0.87 percent.

Figure 1
Estimated share of principal operator family farm estates by type of impact resulting from the American Families Plan (2021)

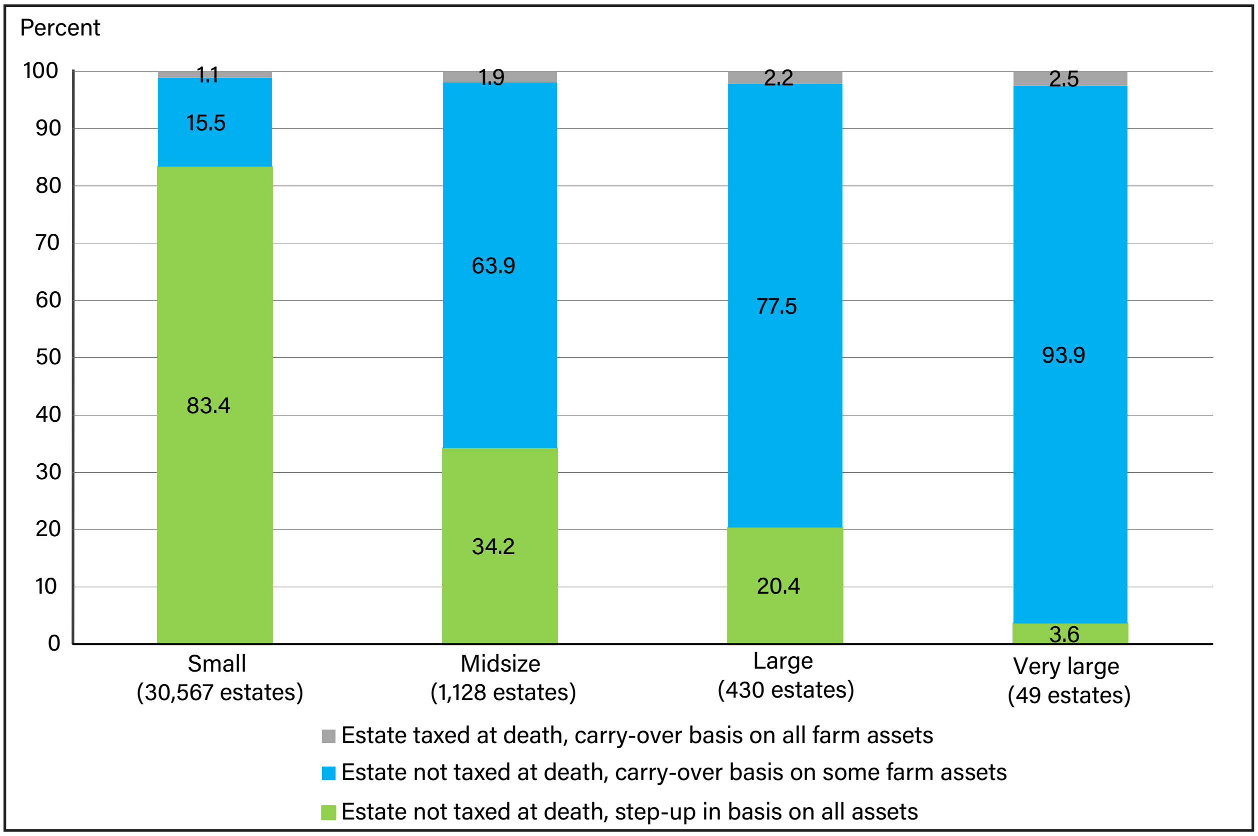


Note: Researchers estimated 32,174 estates would be created in 2021 from approximately 1.97 million family farms. Information in this chart represents estates, not all family farms.

Source: USDA, Economic Research Service (ERS) modeling based on USDA, ERS 2019 Agricultural Resource Management Survey data and U.S. Social Security Administration, 2017 Actuarial Life Table.

As family farm size increased from small to very large, the estimated share of estates owing no tax at death and receiving stepped-up basis on all assets decreased, while the estimated share of estates receiving carry-over basis increased (figure 2). The estimated share of estates owing no tax at death and receiving stepped-up basis on all assets ranged from 83.4 percent of small farms (less than $350,00 in GCFI) to 3.6 percent of very large farms (greater than $5 million in GCFI). For estates that received carry-over basis, there were two possible outcomes: (1) owed tax at death and (2) did not owe tax at death. For estates with carry-over basis that would owe tax at death, the estimated share increased from 1.1 percent for small farms to 2.5 percent for very large farms. For estates receiving carry-over basis and owed no tax at death, the estimated share increased from 15.5 percent for small farms to 93.9 percent for very large farms.

Figure 2
Estimated share of principal operator family farm estates by type of impact resulting from the American Families Plan, and farm size (2021)



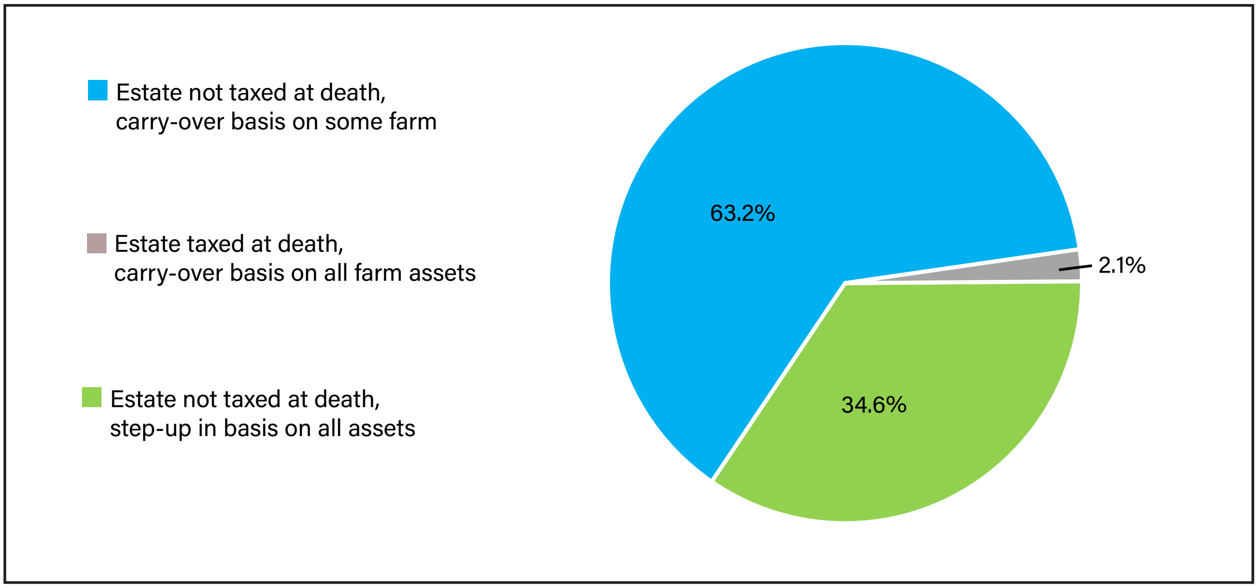
Notes: Researchers estimated 32,174 estates would be created in 2021 from approximately 1.97 million family farms. Information in this chart represents estates, not all family farms. Due to rounding percentages, totals may not sum to 100. Small farms are defined as having gross cash farm income (GCFI) less than $350,000. Midsize farms have GCFI between $350,000 and $1 million. Large farms have GCFI between $1 million and $5 million. Very Large farms have GCFI greater than $5 million.

Source: USDA, Economic Research Service (ERS) modeling based on USDA, ERS 2019 Agricultural Resource Management Survey data and U.S. Social Security Administration, 2017 Actuarial Life Table.

Another perspective this report examined was farm estates' value of production. Value of production for farm estates was estimated using the value of production reported, in dollars, by principal operators in the 2019 ARMS. The estimated 32,174 estates accounted for only 1.0 percent of the total value of production of all family farms. The 18.2 percent of estates not taxed at death with carry-over basis on some farm assets accounted for 63.2 percent of estates' value of production. In comparison, the 80.7 percent of estates that owed no tax at death and received stepped-up basis on all assets accounted for 34.6 percent of estates' value of production. The remaining share of the value of production (2.1 percent) was estimated to be produced by the 1.1 percent of farm estates taxed at death that will have a carry-over basis on all farm assets. The share of the value of production described above is consistent with large-scale family farms—large and very large family farms—accounting for 5.3 percent of all farms and representing the biggest share of the value of production (44 percent). In contrast, small family farms accounted for 14 percent of the total value of production (Whitt et al., 2020).

Figure 3

Estimated share of value of production for principal operator family farm estates by type of impact resulting from the American Families Plan (2021)



Note: Researchers estimated 32,174 estates would be created in 2021 from approximately 1.97 million family farms. Information in this chart represents estates, not all family farms. Due to rounding percentages, the total does not sum to 100.

Source: USDA, Economic Research Service (ERS) modeling based on USDA, ERS 2019 Agricultural Resource Management Survey data and U.S. Social Security Administration, 2017 Actuarial Life Table.

Summary of asset value and taxable gain for farm estates

The average family farm estate in 2021 was estimated to have $1.08 million in farm real estate, $0.17 million in other farm assets, and $0.83 million in nonfarm assets. These amounts differed by farm size, though the largest asset category was consistently farm real estate regardless of farm size (table 1). For small farm estates, the average value of farm real estate was $0.94 million, whereas the average value of farm real estate was $8.96 million for very large farm estates. The average value of other farm assets varied by farm size as well, ranging from $0.12 million for small farm estates to $5.82 million for very large farm estates. The average value of nonfarm assets varied to a lesser extent, ranging from $0.82 million for small farm estates to $1.73 million for very large farm estates.

Table 1

Summary of average asset value for family farm estates, by farm size (2021)

	Small	Midsize	Large	Very large	All estates
Number of estates	30,567	1,128	430	49	32,174
Value of farm real estate assets (million dollars)	0.94	3.34	4.81	8.96	1.08
Value of other farm assets (million dollars)	0.12	0.77	1.62	5.82	0.17
Value of nonfarm assets (million dollars)	0.82	0.98	1.17	1.73	0.83
Total Assets (million dollars)	1.87	5.09	7.59	16.51	2.08

Notes: Researchers estimated 32,174 estates would be created in 2021 from approximately 1.97 million family farms. Information in this chart represents estates, not all family farms. Small farms are defined as having a gross cash farm income (GCFI) less than $350,000. Midsize farms have a GCFI between $350,000 and $1 million. Large farms have a GCFI between $1 million and $5 million. Very large farms have a GCFI greater than $5 million.

Source: USDA, Economic Research Service (ERS) modeling based on USDA, ERS 2019 Agricultural Resource Management Survey data.

Farm estates with no tax at death and step-up in basis on all assets

Estates that were estimated to owe no tax at death and have stepped-up basis on all assets would not be subject to any additional taxes as a result of the proposed policy change. The average value of farm real estate for these family farm estates was $0.53 million, and the average value of all other farm assets was $0.10 million (table 2). The average value of nonfarm assets was $0.59 million. For all estates in this group, the estimated gains from farm and nonfarm assets were less than the proposed exemption ($1 million for individual, $2 million for married couples), meaning they would owe no capital gains tax at death and would not have any deferred capital gains tax liability.

Table 2

The 80.7 percent of principal operator family farm estates with no tax at death and stepped-up basis on all farm assets: average asset value, taxable gain, and tax liability (2021)

	Small	Midsize	Large	Very large	All estates
Number of estates	25,485	386	88	2	25,961
Farm assets					
Value of real estate (million dollars)	0.53	0.82	0.74	7.81	0.53
Value of other assets (million dollars)	0.09	0.53	0.79	1.58	0.10
Potential taxable gain (million dollars)	0	0	0	0	0[3]
Nonfarm assets					
Value of assets (million dollars)	0.59	0.74	0.92	0.80	0.59
Taxable gain[1,3] (million dollars)	0	0	0	0	0[3]
Tax liability (million dollars)	0	0	0	0	0
Aggregate tax rate[2] (percent)	0	0	0	0	0
Total assets (million dollars)	1.21	2.08	2.45	10.19	1.22

[1] Excludes retirement assets. [2] Aggregate tax rate calculated as total tax liability from nonfarm assets divided by total value of nonfarm assets. [3] Taxable gain is zero because gains are less than the relevant exemption ($1 million for individual, $2 million for married couples).

Notes: Researchers estimated 32,174 estates would be created in 2021 from approximately 1.97 million family farms. Information in this chart represents estates, not all family farms. Small farms are defined as having a gross cash farm income (GCFI) less than $350,000. Midsize farms have a GCFI between $350,000 and $1 million. Large farms have a GCFI between $1 million and $5 million. Very large farms have a GCFI greater than $5 million.

Source: USDA, Economic Research Service (ERS) modeling based on USDA, ERS 2019 Agricultural Resource Management Survey data and U.S. Social Security Administration, 2017 Actuarial Life Table.

Farm estates with no tax at death but subject to carry-over basis on some farm assets

Farm estate heirs who continue to farm with nonfarm gains below the proposed capital gains exemption amount—but together with farm gains exceed the exemption—would potentially owe capital gains taxes on these unrealized gains if inherited farm assets do not remain family-owned and operated. As table 3 shows, these estates had nonfarm gain below the exemption (on average around $1 million in nonfarm assets, which half is assumed to be gains), allowing these estates to avoid owing taxes at death. The average value of nonfarm assets for small farm estates is $1.02 million and $1.30 million for very large farm estates.

The average total assets for this group was estimated to be $4.98 million. Since the value of total gains on these assets exceeded the exemption, heirs of these estates continuing to farm could ultimately owe taxes on unrealized gains if the inherited farm assets do not remain family-owned and operated. The gains in the value of farm assets subject to future potential tax liability was estimated to be $1.39 million for small farm estates and $10.22 million for very large farm estates. For the average farm estate—with the exception of very large farms—it was estimated that there would be sufficient unused exemptions to provide a step-up in basis for non-real estate farm assets, like livestock and crop inventory, which reduces the tax burden on the operating income of the farm business.

Table 3

The 18.2 percent of principal operator family farm estates with no tax at death and deferred capital gains tax on some farm assets average asset value and potential taxable gain (2021)

	Small	Midsize	Large	Very large	All estates
Number of estates	4,751	721	333	46	5,850
Farm assets					
Value of real estate (million dollars)	3.08	4.68	5.83	9.08	3.48
Value of other assets (million dollars)	0.28	0.90	1.80	5.90	0.49
Potential[4] taxable gain (million dollars)	1.39	2.75	4.38	10.22	1.79
Nonfarm assets					
Value of assets (million dollars)	1.02	0.96	1.06	1.30	1.01
Taxable gain[1] (million dollars)	0	0	0	0	0[3]
Tax liability (million dollars)	0	0	0	0	0
Aggregate tax rate[2] (percent)	0	0	0	0	0
Total assets (million dollars)	4.38	6.54	8.68	16.29	4.98

[1] Excludes retirement assets. [2] Aggregate tax rate calculated as total tax liability from nonfarm assets divided by total value of nonfarm assets. [3] Taxable gain is zero because gains are less than the relevant exemption ($1 million for individual, $2 million for married couples). [4] Taxes are avoided as long as farm remains family-owned and operated.

Notes: Researchers estimated 32,174 estates would be created in 2021 from approximately 1.97 million family farms. Information in this chart represents estates, not all family farms. Small farms are defined as having a gross cash farm income (GCFI) less than $350,000. Midsize farms have a GCFI between $350,000 and $1 million. Large farms have a GCFI between $1 million and $5 million. Very large farms have a GCFI greater than $5 million.

Source: USDA, Economic Research Service (ERS) modeling based on USDA, ERS 2019 Agricultural Resource Management Survey data and U.S. Social Security Administration, 2017 Actuarial Life Table.

Farm estates with tax at death and subject to carry-over basis on all farm assets

Farm estates that were estimated to owe tax at death had nonfarm gains greater than the exemption proposed in AFP—$1 million for individuals, $2 million for married couples. Table 4 summarizes the average asset value, taxable gain, and tax liability for nonfarm assets for inherited estates by farm size. Farm real estate values varied across farm size, with an average real estate value for small farm estates of $1.69 million and for very large farm estates of $6.16 million. Other farm assets varied as well, which included crop and livestock inventories as well as farm equipment. For small farm estates, the value of other farm assets averaged $0.12 million, and very large farm estates averaged $8.69 million. Potential taxable gain on these farm assets ranged from $1.25 million for the average small farm estates to $9.05 million for the average very large farm estate.

Table 4

The 1.1 percent of principal operator family farm estates with tax at death and potential deferred capital gains tax on all farm assets: average asset value, taxable gain, and tax liability (2021)

	Small	Midsize	Large	Very large	All estates
Number of estates	331	21	9	1	363
Farm assets					
Value of real estate (million dollars)	1.69	3.61	6.46	6.16	1.94
Value of other assets (million dollars)	0.12	0.94	2.87	8.69	0.26
Potential[3] taxable gain (million dollars)	1.25	3.32	7.06	9.05	1.54
Nonfarm assets					
Value of assets (million dollars)	15.57	6.13	7.72	19.06	14.83
Taxable gain[1] (million dollars)	4.40	1.04	1.42	5.93	4.14
Tax liability (million dollars)	1.76	0.36	0.49	2.40	1.65
Aggregate tax rate[2] (percent)	11	6	6	13	11
Total assets (million dollars)	17.38	10.68	17.05	33.91	17.04

[1] Excludes retirement assets. [2] Aggregate tax rate calculated as total tax liability from nonfarm assets divided by total value of nonfarm assets. [3] Taxes are avoided as long as farm remains family-owned and operated.

Notes: Researchers estimated 32,174 estates would be created in 2021 from approximately 1.97 million family farms. Information in this chart represents estates, not all family farms. Small farms are defined as having a gross cash farm income (GCFI) less than $350,000. Midsize farms have a GCFI between $350,000 and $1 million. Large farms have a GCFI between $1 million and $5 million. Very large farms have a GCFI greater than $5 million.

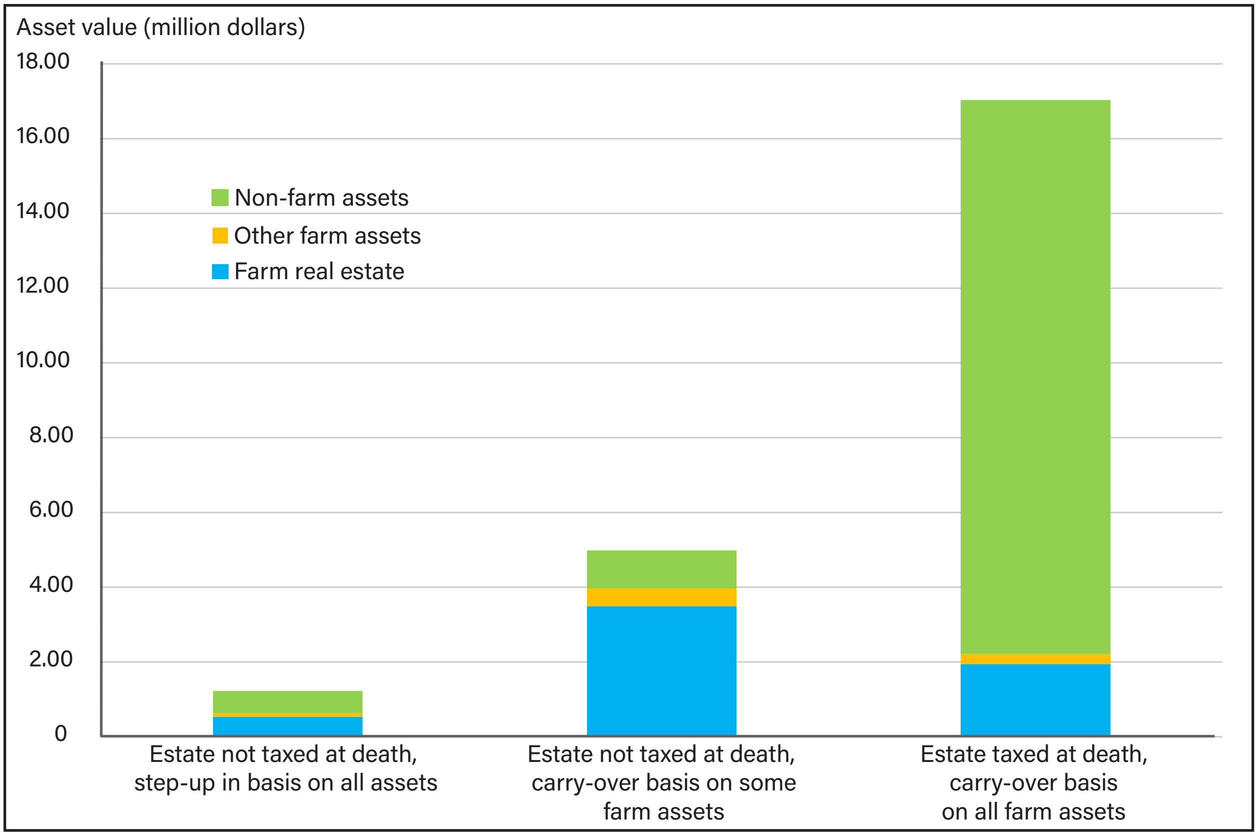
Source: USDA, Economic Research Service (ERS) modeling based on USDA, ERS 2019 Agricultural Resource Management Survey data and U.S. Social Security Administration, 2017 Actuarial Life Table.

Nonfarm assets included the family dwelling unless it was owned by the farm business, as well as stocks, bonds, retirement accounts, nonfarm real estate, and other nonfarm financial assets. The average value of nonfarm assets was highest for small and very large farm estates. The average estimated tax liability generated at death from these nonfarm assets ranged from $0.36 million for midsize farm estates to $2.40 million for very large farm estates. Overall, taxes owed at death on nonfarm assets represented 11 percent of the total value of all nonfarm assets for farm estates that owed a tax at death.

The composition of assets for the three categories of farm estates differed greatly. Figure 4 shows the average value of farm real estate, other farm assets, and nonfarm assets for estates that would owe a tax at death, those that would not owe a tax at death but would be subject to carry-over basis on some farm assets, and those that would not owe a tax at death and would receive a step-up in basis on all assets. Farm estates that would owe tax at death were three times the size and had a greater amount of wealth in nonfarm assets compared with farm estates only subjected to carry-over basis. Additionally, farm estates that would owe tax at death have fewer farm assets compared with farm estates only subjected to carry-over basis.

Figure 4

Average wealth and asset distribution for family farm estates by type of impact resulting from the American Families Plan (2021)



Notes: Researchers estimated 32,174 estates would be created in 2021 from approximately 1.97 million family farms. Information in this chart represents estates, not all family farms.

Source: USDA, Economic Research Service (ERS) modeling based on USDA, ERS 2019 Agricultural Resource Management Survey data and U.S. Social Security Administration, 2017 Actuarial Life Table.

Conclusion

The Biden Administration's AFP proposes changing the treatment of capital gains on inherited assets by making accumulated gains in asset value subject to capital gains taxes at death, while leaving current estate tax parameters unchanged. Although these changes have the potential to impact the intergenerational continuity of family farms, the proposal includes an exemption for family-owned business assets—including farm assets—inherited by a family member who continues operating the business. In addition, AFP includes a general exemption from capital gains taxation of $1 million for individuals and $2 million for married couples. These exemptions reduce both the number of estates affected and the magnitude of impact on the affected estates.

In this report, researchers presented a capital gains tax model. Using this model and 2019 ARMS data, researchers evaluated the impact of the proposed AFP changes on family farm estates. Due to data limitations, this report only included estates of principal operators of family farms; estates generated from non-principal operators and non-operating landlords are excluded. This analysis demonstrated 80.7 percent of principal-operator family farm estates would have no change to their capital gains tax obligation. Those that would experience a change in capital gain tax obligation include 18.2 percent of principal-operator family farm estates that would have a deferred tax liability on their farm gains as long as the farm remains family operated and 1.1 percent that would owe a tax at death. Estates with a deferred tax liability and no tax liability at death varies greatly by farm size. The results show 15.5 percent of small farm estates (GCFI less than $350,000), 63.9 percent of midsize farm estates (GCFI between $350,000 and $1 million), 77.5 percent of large farm estates (GCFI between $1 million and $5 million), and 93.9 percent of very large farm estates (GCFI greater than $5 million) would have a deferred capital gains tax liability but no tax at death assuming an heir continues to operate the farm. About 1.1 percent of all primary-operator family farm estates would owe capital gains tax at death. For these farm estates that would owe capital gains taxes on nonfarm assets at death, the average tax rate was estimated to be 11 percent of the value of total nonfarm assets.

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