Taxation Tidbits: The Estate Tax Debate

The debate to reform or repeal federal estate tax is raging again in congress. First, there are valid pros and cons for reforming or repealing the federal estate tax. However, some arguments being rallied just do not hold water. For example, it is frequently stated that repealing estate tax will eliminate the need and expense of estate planning. If saving estate tax was the only goal in estate planning that would be true. However, in practice other goals and objectives are identified with equal or greater importance. Some of the frequently identified goals include: providing for income and security for life; treating heirs equitably; providing for special needs; transferring a family business; and making provisions for long-term care.

Repealing estate tax does little or nothing to help resolve or accomplish these goals. Yes, the thought of saving taxes is what motivates many people to begin the estate planning process – however, it is not what motivates people to finalize and implement their plan.

The fact is that very few estates currently have to pay any estate tax. In 2001, less than 2.3 percent of the people who died owed any federal estate tax at all, and only a tiny fraction of that 2.3 percent were farmers. Neil Harl, a prominent farm estate and business planning attorney in Iowa, is quoted as saying, “I have never seen a farm business that had to be sold in order to pay federal estate tax.”

Yes, settling an estate can take a financial toll. There are creditors to be paid, attorney’s fee for settling the estate, off-farm heirs as well as on-farm heirs want their fair share of the assets, and frequently there are probate costs. These expenses of settling an estate will continue even if federal estate tax is repealed.

How much wealth can a farmer have and avoid federal estate tax? For 2005 the equivalent exemption from estate tax is set at $1,500,000. Additionally, most family farm estates with real estate are eligible to utilize a special-use valuation provision that can reduce the estate up to a maximum of $870,000. Thus, a farmer with a substantial wealth in farmland could die with up to $2,370,000 and not owe any federal estate tax. For 2006 the equivalent exemption increases to $2,000,000 and the indexed special-use valuation should be at least $880,000. Given a moderate effort and expense of estate planning, a farm couple could shield $4.74 million from estate tax in 2005 and $5.76 million in 2006.

Nearly everyone agrees that federal estate tax laws need to be reformed or repealed. As we debate the issues – we will be better served if we challenge perceptions against facts and analyze the long-term consequences of any suggested changes. For example, if estate tax laws are repealed – what impact will that have on the method and timing of transferring a family business from the senior generation to the junior generation? Many business planners do not believe the impact will be positive.

Remember the ole saying: Be careful of what you ask for – you might get it!

(Author: Parman R. Green, Ag Business Management Specialist)