



## 2006 FARM CONSERVATION TAX UPDATE

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**I**n January 2003, American Farmland Trust published an updated and revised estate planning guide to help farmers, ranchers and their families plan for the future of their farms and ranches. Frequent changes in the tax laws highlight the need for sound estate planning that is tailored to individual circumstances and addresses the uncertainty about future tax legislation. Knowledge of basic strategies and conservation options is essential; estate planning continues to be important for farm and ranch families, their businesses and their land.

Recently, President Bush signed the Pension Protection Act of 2006, which significantly increases the ability of individuals and corporations, especially farmers and ranchers, to use income tax deductions from donations of conservation easements that meet the requirements of the Internal Revenue Code. Effective only for tax years 2006 and 2007, the Pension Act increases the allowable deduction for the value of the easement from 30 percent to 50 percent of Adjusted Gross Income (AGI). In addition, the Pension Act allows individuals to carry forward the excess value for up to 15 years.

The tax benefits included in the Pension Act for donating conservation easements are even more significant for “qualified farmers and ranchers”, defined as taxpayers who earn more than 50 percent of their gross income from the business of farming in the taxable year in which the conservation easement is donated. These qualified farmers and ranchers can deduct up to 100 percent of their AGI and carry the unused deduction forward for up to 15 years. These easements must cover property that is available for agricultural or livestock production and must contain provisions requiring land to remain available for these uses. Additionally, corporations that meet the above requirements (50 percent of gross income from farming) can deduct up to 100 percent of AGI, a tenfold increase. While the window for these opportunities is short—just 2006 and 2007 — this legislation provides an important incentive for farmers and ranchers who want to conserve their agricultural land.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 continues to impact farm estate planning and transfer primarily because it decreased taxes on capital gains from 20 to 15 percent for higher-bracket taxpayers through 2008 and from 10 to 5 percent for lower-bracket taxpayers with a capital gains tax holiday in 2008. The reduced rates are retroactive to January 1, 2003. The legislation also accelerated income tax reductions and dramatically reduced taxes on dividends to match the reduced capital gains tax rates—a reduction in rates by half for some taxpayers.

Previously, the Economic Growth and Tax Relief Reconciliation Act of 2001 reduced estate and gift tax rates, increased exemptions for estate and gift taxes, and repealed the estate tax for 2010. A sunset provision in the law means that the estate tax is effectively repealed *only* for 2010.

### **Lower Estate Tax Rates**

Estate tax rates will be 46 percent in 2006 and 45 percent in 2007–2009.

### **Increased Exemptions**

The estate tax exemption will gradually increase to \$3.5 million in 2009. For 2006–2008 the estate tax exemption will be \$2 million and in 2009 it will be \$3.5 million. The gift tax exemption will remain at \$1 million. As a result, for the next several years (until 2009) there will no longer be a “unified” exemption system that applies to both estate and gift taxes.

### **Lower Income Tax Rates**

As of 2003 the top tax rates are 25 percent, 28 percent, 33 percent, and 35 percent, accelerating the reduction in rates by several years. Because regular income tax rates have been reduced without a major reduction in the alternative minimum tax (AMT), the AMT may become more of a factor in future years.

### **Elimination of Credit for State Death Taxes**

A federal deduction for state death taxes replaced the credit in 2005. The repeal of the state death tax credit shifts much of the revenue costs of the estate tax changes to the states and could lead to increased death taxes in states that rely on such taxes for revenue.

### **Repeal for 2010**

The estate tax repeal for 2010 brings two major changes: a system of modified carryover basis to tax capital gains on inherited property and a reduction of the highest gift tax rate to 35 percent. There is no change in the basis rules until the estate tax is repealed in 2010. At that time, property transferred at death, similar to a lifetime gift, will receive the adjusted basis of the decedent/donor. In 2010, an estate may increase the basis of appreciated assets up to \$1.3 million in value. In addition, \$3 million in assets transferred directly to a surviving spouse or to a qualified trust will also receive a “stepped-up” basis at death. These structural changes are intended to maintain a transfer tax system that captures revenue from transfers of appreciated assets. However, carryover basis will create record keeping challenges and may prove unpopular with taxpayers.

### **Uncertainty After 2010**

The sunset provision in the law has made it unclear what will happen to estate and transfer taxes after 2010. Following the passage of the 2001 legislation, Professor Roger A. McEowen of Kansas State University stated in the *Agricultural Law Update*, “Certainly what has been accomplished has been the injection of tremendous uncertainty in estate planning for perhaps the next 10 years.”

*Estate planning remains a critical farmland conservation issue* because estate taxes (reduced or repealed) are only part of farm and ranch transfer equations. The issues of developing management capacity, transferring management and ownership of the agricultural operation, treating children fairly and ensuring financial security all remain critical components of comprehensive transfer and estate plans. As a result, good estate planning will continue to be essential for farmers and ranchers who want to keep their land in agriculture and pass it on to the next generation.