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

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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. Information used to develop this report comes from the White House Fact Sheet and a USDA press release. 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. 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. 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 taxes. 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. Information used to develop this report comes from the White House Fact Sheet and a USDA press release. 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. For these assets, heirs could defer any taxes owed on unrealized gains as long as the business remains family operated.

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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.


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.

ERS is a primary source of economic research and analysis from the U.S. Department of Agriculture, providing timely information on economic and policy issues related to agriculture, food, the environment, and rural America.
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.  

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.

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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.