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Federal Tax Policies and Farm Households

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Significant changes in Federal individual income and estate tax policies have occurred over the last 10 years. Since the Federal individual income tax affects a broad group of farmers and the Federal estate tax can affect the ability to transfer the Nation's farm businesses to the next generation, these changes are of considerable importance to the farm community. Modifications to Federal income and estate tax policies affect not only the financial well-being of farm households but also the number and size of farms, their organizational structure, and their use of land, labor, and capital inputs.

What Is the Issue?

A number of changes to Federal income and estate tax policies are scheduled to expire in 2010. As the expiration date approaches, the debate regarding the future of these policies is likely to intensify, especially in light of the increasingly challenging Federal budget environment. This report evaluates the impact of Federal income and estate tax policies on the tax burdens and financial well-being of farm households.

What Did the Study Find?

Over the last decade, Federal income tax changes affecting both individual and business income taxes have reduced average tax rates for all farm households. While nearly all farm households have benefited from the changes, commercial farm (annual sales greater than \$250,000) households are the primary beneficiaries of many of the business tax provisions, including increased expensing of capital purchases, reduced tax rates on business assets, and a new deduction for manufacturers, which is defined to include farmers.

The cumulative effect of these changes to Federal tax policy has resulted in the lowest Federal tax burden on farm income and investment in a decade. The average tax rate for farm sole proprietors was reduced from 17.1 percent in 1994 (and 17.8 percent in 2000) to about 14.8 percent in 2004. Federal income taxes paid by farm sole proprietors dropped from \$24.9 billion in 2000 to \$21 billion in 2004, a reduction of nearly 16 percent. Current average tax rates are estimated to be at or below the 2004 levels.

Changes to Federal estate tax policies have increased the value of property that can be transferred to the next generation free of the estate tax and have reduced tax rates on estates still subject to the tax. Special tax provisions targeted to farmers and other small business owners have provided additional benefits. Those changes have reduced the number of farm estates required to file an estate tax return as well as the number required to pay tax and the amount of Federal estate taxes owed. Based on simulations using farm-level survey data, about 2.9 percent of the 38,234 project-

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ed farm estates in 2009 are estimated to have enough assets to necessitate filing an estate tax return. After deductions, only about half of those farm estates will be taxable. The total amount of Federal estate taxes owed by farm estates in 2009 is estimated at \$683 million.

The estate tax is scheduled to be repealed completely in 2010 before reverting to 2001 law in 2011. If allowed to go into effect, the reversion to 2001 law would increase the share of farm estates that owe Federal estate tax and total Federal estate tax revenues. As many as 1 of every 10 farm estates would owe estate tax in 2011, with total Federal estate taxes rising to about \$2.55 billion, an increase of nearly three times the amount estimated to be owed in 2009.

How Was the Study Conducted?

This report uses both published and special tabulation data obtained from the Internal Revenue Service to provide an overview of the current tax situation for U.S. farm households and to evaluate the importance of various Federal income and estate tax policies. It also uses farm-level data from USDA's Agricultural Resource Management Survey (ARMS) to estimate the effects of various policies on Federal income and estate tax liabilities. ARMS was also used to estimate the number of farm estates, the number of estates that would owe taxes, and total Federal estate taxes for the estates of farm operator households.