

FINANCE & INSURANCE

Provision may save ag land estate taxes

By JOHN OTTE

If you're involved in settling a farm estate, make sure your advisers consider Internal Revenue Code Section 2032A. The provision allows farmland to be valued at its value in agricultural production, rather than at fair market value, in the estate settlement process and for calculating federal estate tax due.

Stringent rules apply:

- ✓ The decedent must have used the land for a qualified use; that is, farming.
- ✓ The decedent or a member of the decedent's family had to be materially participating in operating the farm when the decedent died.
- ✓ A qualified heir must continue to farm the land for at least 10 years after the decedent's death.
- ✓ After the special-use valuation reduction, the land and other closely held business assets must still make up at least 50% of the value of the estate.
- ✓ The amount that special-use valuation can trim estate value is limited. For deaths in 2008, that limit is \$970,000.

No free lunch

Suppose a farmer dies owning 500 acres with a fair market value of \$5,000. The land is worth \$2.5 million. Depending

Key Points

- Section 2032A special-use valuation may save estate taxes on farmland.
- Violating rules could save no estate tax and trigger more capital gains tax.
- Make sure rules fit with the family's long-term plan before you use it.

on other steps the farmer has taken, the estate may or may not face estate tax. Suppose it does. Further, suppose the land's use in farming is \$3,500 per acre. That would ratchet its value down to \$1.75 million, thereby sheltering \$750,000 from potential estate tax.

Suppose the heirs choose to use the \$1.75 million special-use value in the estate calculation. That \$1.75 million becomes the heirs' tax basis should they eventually sell the land. If the heirs don't use Section 2032A, their basis in the land would be \$2.5 million. So one trade-off is potential estate tax on the \$750,000 now vs. income tax on \$750,000 of capital gain at some later date.

Also remember that a qualified heir must farm the land for at least 10 years. Suppose no qualified heir is able to farm the land for those 10 years. The farm loses the special-use valuation, which



means the \$750,000 originally sheltered gets pulled back into the decedent's estate, potentially subject to federal estate tax. However, the heirs are still saddled with the \$1.75 million basis, not the \$2.5 million, when they eventually sell the land.

Failing to abide by the 10-year rule can result in:

- no federal estate tax savings
 - more income tax on capital gains
- That's why you and your family need to do the following:
- Have a long-term plan.
 - Understand the trade-offs and considerations of using Section 2032A.
 - Seek competent advice.

The goal is to avoid making a decision that appears advantageous in the short run but could turn into a decision you regret because it ends up costing the family more money later.

Know trade-offs of Section 2032A

SHARPLY higher land prices can boost farm estate values to the level where estate taxes become an issue with a lot fewer acres than just a year or three ago. Land values in agricultural production also are rising. But sharply rising input costs mean land's value in production may not be keeping pace with actual land price gains.

Whether Internal Revenue Code Section 2032A makes sense for you depends on your family's long-term plans for your farm. Pencil pushing and family discussion now may position your heirs to optimize estate and income tax management.



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