A FINANCIAL PROFESSIONAL'S thoughts on

FOUR PROPOSED TAX LAW CHANGES

by David Fisher

There are several proposed **tax law changes** that could **influence** the **ranch and farm marketplace**

and I feel privileged to be able to discuss my thoughts on these proposed changes and their possible effect on the rural marketplace. I am going to focus on 4 proposed changes. These proposed changes are (1) the elimination of 1031s or dramatically reducing the benefits to $500k, (2) elimination of the stepped-up basis, (3) the doubling of the capital gains tax to 39.6% and (4) the decrease of the federal estate tax exemption to $3.5 million and the increase in the federal estate tax rate to 45%. Although nothing has yet been finalized, I believe it is important to understand what these proposed changes are and what they may mean to landowners.

1 The first proposed change is the possible elimination of 1031 exchanges or dramatically reducing 1031 benefits to a maximum benefit of $500k. Although there are a couple of other options to defer taxes, 1031s are by far the most popular. When selling and transacting a 1031, if the seller follows the IRS requirements, he/she can defer the capital gains tax, state tax, depreciation recapture and the Medicare tax on the gains of the sales proceeds when buying another property. If 1031s are eliminated or the benefits dramatically reduced, that could have a chilling effect on potential selling. Many families have properties that they have owned for decades and it is not unusual to have 80%+ of the sales proceeds considered as capital gains of the sales proceeds. If the capital gains are increased as proposed, that would mean that sellers in at least 12 states would be paying 50% or more in taxes on the gains of their proceeds. If they are not increased, that could still be a tax of 30% or more. Why would anyone sell unless there was a distressed situation? This proposed change could have a severe impact on selling ranches and farms.

2 The second proposed tax law change is the elimination of the stepped-up basis. The stepped-up basis may not be quite as well known as 1031s, but it can play an integral part of selling property especially when heirs are involved. For example, parents buy a property for $100k and hope that the property will appreciate in value so when the parents pass on, they can pass the property on to their heirs and give them an asset to sell if they like in a tax advantaged opportunity. Say the parents are now gone and the property is now worth $1 million when received by the heirs, and the little brats decide to sell the property for $1.1 million. Their new basis because of the stepped-up basis is $1 million so the taxes that the brats will pay is based on the $100k gain. If the stepped-up basis is eliminated, then their basis when received would be the same 100k as the parents when they originally bought the property. If they sell for $1.1 million, their capital gain will be $1 million and they will pay much more in taxes than they would have otherwise. This proposed tax change may be somewhat under the radar of most property owners but can be quite a shock when the heirs get their tax bill.

3 The third proposed change is the possible doubling of the capital gains tax to 39.6%. No explanation necessary. If this happens, I believe that there are at least 12 states that will have a tax rate of at least 50% on the gains of their sales proceeds. That is simply wrong. Here is a major concern and that is the lack of information coming out about those changes. Let me explain. We are told that the capital gains tax rate will only apply to families with a $1 million income but here is the problem. I have not been able to find out exactly what income means? Is it earned income, or will it include capital gains income? For example, a farmer has worked hard for decades and now is ready to sell his farm and retire. He averages $50k annual revenue. He sells his farm and now has a $1.5 million capital gain. That capital gain may be included as income and now in the year that he sells, his income is $1.55 million, and he is over the income threshold. My instincts — based on being in practice for over 40 years — tell me this farmer would probably have to pay the additional taxes, which would mean that he could pay 50% or more in taxes on his gains when including state taxes if applicable, depreciation recapture taxed at up to 25%, and the Medicare tax. Hopefully, the term "income" will be clarified for everyone's benefit soon.

4 The fourth proposed tax law change may not affect all landowners but could cause major concerns for those that have to deal with this proposed change. This change is the reduction of the federal estate tax exemption to $3.5 million and the increase of the tax rate on the taxable estate to 45%. If the federal estate tax is not a concern, that is great — but if it is, a conversation with your appropriate advisor should be at the top of your list. Unfortunately, I have not seen any direction on whether farmers and ranchers will have any exemptions on the federal estate tax, so because of the appreciation of land over the last few years, it may be a good idea to get your land appraised. You may have a potential federal estate tax problem and not know it. If so, that could be devastating to your family. One quick note and I learned this from a great Colorado broker. If there are minerals on the property, find out if those minerals are going up in value or decreasing in value. That could help determine if you should value the property at date of death or 6 months later which may be possible. If minerals are going up, use the initial date but if minerals are decreasing in value, wait and hopefully you can get a lower valuation and that can lead to a lesser estate tax burden.

It is important to note that nothing is finalized yet and I am only writing what we know as of the end of May. Things may change, so please stay informed on what is happening with these proposed tax law changes. You may have options and I would be more than happy to discuss some of the tax deferral opportunities that are still available. Best wishes and good luck!

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