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Evaluating Impact of House Ways & Means Proposal for Tax Changes

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New details for a potential $3.5 trillion spending and tax package were released by the House Ways & Means Committee on Monday September 13, 2021, including a proposal for funding new policies advanced by Democrats. This package includes proposals for several changes to the tax code intended to generate additional tax revenues. Several of these provisions could impact farmers; however, two tax changes proposed earlier in the year were not included: a new tax on property transfer to attain a step-up in basis and limitations on like-kind exchanges. It is important to note that this proposal is not the final version that will pass in the House and the Senate. Regardless, these details represent an important step in what will likely be a long, involved process.

Background

Since the beginning of the year, several proposals for both government spending and increasing tax revenue have been generated by Congress and the White House, including draft legislation and the American Families Plan. Of these tax proposals, farmers and farm groups were most concerned about new tax on property transfers and limitations on like-kind exchanges. In particular, the new tax on property transfers would require the recipient of property with a gain in value to pay a tax on the difference in the original basis in the property and the value at time of transfer. This would impact transfer of farm estates from one generation to the next, potentially making it more difficult to transfer the farm to the next generation (see *farmdoc daily*, May 28, 2021).

In effort to advance at least some portion of these proposals, Congress has been working on a $3.5 trillion spending and tax package (2,3). This spending portion of the package includes the framework to enact many of the Democrats social, economic, and environmental policies included in the Build Back

Better agenda (4), such as incentivizing green energy, assisting families with child costs, and lowering education and prescription drug costs. The intent is to fully offset this spending with a combination of new tax revenue targeted at wealth, health care savings, and long-term economic growth.

On Monday September 13, 2021 the House Ways & Means Committee released new details for funding the $3.5 trillion spending and tax package. This package includes proposals for several changes to the tax code intended to bring in additional tax revenues that could impact farmers. However, the House plan does not include limitations on like-kind exchanges or creation of a new transfer tax that would have impacted farm families (see *farmdoc daily*, May 28, 2021). Without these items included, the tax changes proposed in the House plan have less of an impact on farmers' tax liabilities in general.

Notably, Congress continues to debate overall amount of this package and what should be included on both the spending and tax sides of the package. This proposal for funding the package will be subject to mark-up and must be approved by a majority vote of the committee to advance to the House floor for a vote. The Senate has not released an official proposal for funding and may or may not follow the same approach as the House. As a result, passed legislation could differ significantly from this House Ways and Means Committee proposal.

Potential Tax Impacts on Farmers

Following are five of the proposed tax changes and explanation of impacts on farmers.

1. Estate Taxes – While this proposal did not include the transfer tax, it does propose lowering the unified credit, or exemption level, referring to a set amount that an individual can gift before becoming subject to any gift or estate taxes. The House proposal would lower the existing estate tax exemption level from an inflation adjusted $10 million per individual ($11.7 million for 2021) to an inflation adjusted $5 million per individual. This proposed exemption level is the same that existed prior to the 2017 Tax Cuts and Jobs Act that doubled the estate tax exemption. Only 0.16% of U.S. farm operator estates owed estate taxes in 2020 under the existing exemption. More would owe estate taxes if this limit passes.

2. Section 2032A Special Use Valuation – Though lowering the exemption level would increase the number of farm estates owing estate tax, a separate move related the estate taxes could alleviate that for some farms, particularly those located in areas where farmland is highly valued for other purposes. The House proposal updates the Special Use Valuation for Certain Real Property Used in Farming or Other Trades or Businesses that is contained in Section 2023A of the tax code (5). This provision allows descendants who own real property used in a farm or business to value the property based on actual use instead of fair market value in determining the value for estate tax purposes. For example, farmland located on the outskirts of an urban area of Illinois may be valued at $10,000 per acre for its use value as farmland but have a fair market value of $30,000 per acre due to demand for use as a developmental property. When qualified, the farm use value may be used instead of the fair market value in determining taxable estate value. However, this special use valuation is currently limited to $750,000, indexed for inflation was $1.18 million in 2020 (6), meaning it would only take 59 acres in the example to max out the use ($1.18 million divided by the difference in use value and FMV). The House proposal would increase the allowable reduction from the base of $750,000 to $11,700,000. In specific instances where the FMV of land is higher than the farm use value, this provision would reduce estate valuation for estate tax purposes for families continuing to farm the land.

3. Capital Gains Tax Rate – The House proposal would increase the highest tax rate for long-term capital gains from 20% to 25%. Notably, this is higher than prior to the 2017 Tax Cuts and jobs Act which did not make a change to the rates on long-term capital gains. An earlier proposal this year made in the American Families Plan would have taxed capital gains at the same rate as ordinary income, meaning capital gains would have added to ordinary income level and all would have been taxed at the corresponding bracket rate. While the proposed change is an increase in the capital gains rate, the resulting 25% rate likely is lower than the ordinary income tax rate. Notably, the proposed effective date for this is 9/13/21 as opposed to the year-end effective date of much of the rest of the proposal. The retroactive date prevents making sales prior to year-end in hopes of avoiding a higher tax in the next year.

4. Ordinary Income Top Tax Bracket – The House proposal would increase the tax rate for the top tax bracket for ordinary income from 37% to 39.6%, the same as prior to the passage of the 2017 Tax Cuts and Jobs Act. The proposal would also lower the starting point for the top tax bracket to begin at $400,000 for individual filers or $450,000 for those married filing jointly. Currently those levels are within the second-highest, 35% tax rate.

5. Corporate Tax Rates – Under the House proposal, corporate tax rates would move from the current 21% flat rate to a progressive tax rate structure. The 21% flat rate was a result of the 2017 Tax Cuts and Jobs Act which transitioned corporate tax rates from tiered scale ranging from 15% up to 39% depending on income with rates of 25% or greater applying to income above $50,000. While the House proposes moving back to a tiered scale, it is generally more favorable than prior to the 2017 changes for smaller farms. The first $400,000 of income would be taxed at 18%, a rate of 21% applied to income up to $5 million, and a rate of 26.5% above that level. Because of the graduated scale, corporations with incomes up to just over $5.2 million would owe a lower tax than with the current 21% flat rate. This would benefit farm corporations with incomes under that level.

Conclusion

Information released by the House Ways & Means Committee provides a foundation for understanding possible changes to the tax code. The House proposal does not include a new transfer tax or limitations on like-kind exchanges, proposals that would have large impacts on farmers during estate transfer. There are several proposals that would increase taxes including changes that would lower the estate tax exemption level, increase the top capital gains tax rate, and increase the top tax rate for ordinary income. Notably, some proposed changes, such as the change to the special use valuation for farm estates and corporate income tax changes could lower taxes for some farm families. This proposal will be subject to mark-up before reaching a vote on the House floor and the Senate has not yet released their tax proposal, which may or may not follow the same pattern. This is an important step in what will likely be long, involved process to reach the final set of tax related provisions.

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