AMERICAN FARM BUREAU FEDERATION®
600 Maryland Ave. SW | Suite 1000W | Washington, DC 20024

ph. 202.406.3600
f. 202.406.3602
www.fb.org

CAPITAL GAINS TAXES AND STEPPED-UP BASIS

Issue:

Long-term capital gains are taxed a lower rate to encourage investment in farms and businesses that grow our economy, create jobs and in recognition that these investments involve risk.

The impact of capital gains taxes on farming and ranching is significant because production agriculture requires large investments in land and buildings that are held for long periods of time during which land values can more than triple.

Background:

Capital gains taxes are due when farm or ranch land, buildings, breeding livestock and timber are sold. The tax is owed on the amount that the property increased in value since it was purchased. The current top capital gains tax is 20 percent plus the 3.8 percent Medicare surtax. Farmers and ranchers often pay the top rate (which is assessed on high income taxpayers) because their capital gains can be realized in a single year, for example when a farm is sold.

Step-up sets the starting basis (value) of land and buildings at what the property is worth when it is inherited. If this were not allowed, capital gains taxes would be collected on both the increase in value while a person owned the property plus the increase in value during the decedent's ownership.

Starting or expanding a farm or ranch requires a large investment because of the capital-intensive nature of agri-business, with land and buildings typically accounting for 82 percent of farm or ranch assets. The higher the capital gains tax rate, the greater the disincentive to sell property or alternatively to raise the asking price. This makes it harder for new farmers to acquire land and hurts agriculture producers who want to buy land to expand their business to include a son or daughter.

To remain efficient and profitable, farmers and ranchers must have the flexibility to change their businesses to be responsive to market signals from American and overseas consumers. Because capital gains taxes are imposed when buildings, breeding livestock and farmland are sold, the higher the tax the more difficult it is for producers to shed unneeded assets to generate revenue to adapt and upgrade their operations.

Under current law, capital gains taxes are owed only when inherited assets are sold and only on the stepped-up value. If stepped-up basis were repealed, a new capital gains tax would be created and the tax code would become even more confusing and complex.

Legislative Status:

The President's FY 16 budget proposed to increase the maximum capital gains tax rate to 28 percent. The proposal would also repeal the stepped-up basis and tax capital gains at death. While the new death tax is delayed for inherited small family-owned and operated businesses until the business is sold, the proposal does not provide details or define eligibility. Farm Bureau opposes.

AFBF Policy:

Farm Bureau supports eliminating the capital gains tax. Until this is possible, the tax rate should be reduced and assets should be indexed for inflation. In addition, there should be an exclusion for agricultural land that remains in production, for transfers of farm business assets between family member, for farmland preservation easements and development rights, and for land taken by eminent domain.

Contact: Pat Wolff, 202-406-3670, patw@fb.org

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