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ESTATE TAX AND DISCOUNTED VALUES

Issue:

Valuation discounting is a proven practice of adjusting asset values for estate tax purposes when a business is passed at death to multiple heirs. A reduction to the value of each person's portion of the business is allowed to account for the lack of marketability and diminished control due to the fractional ownership structure. Valuation discounting helps farm and ranch families transfer their agricultural operations from one generation to another.

Background:

Estate taxes are assessed on the fair market value of an individual's assets when the asset total exceeds the estate tax exemption amount. Fair market value is defined as the price at which property would change hands between a willing buyer and a seller.

For estate tax purposes, the law allows the value of business assets to be reduced when divided and owned by multiple heirs. This reduction reflects the non-marketability of a portion of a closely held business and the reduced control over decisions that comes from fractional ownership.

For example, at death, a farmer gives his farm, valued at $1.5 million as a whole, equally to his three children. Two of the children want to continue farming and the third wants to sell his share and exit the business. If divided equally, the market value of the one-third portion would be $500,000. However, potential buyers are not likely to pay $500,000 to become a minority owner of another family's business. As a result, the fair market value of each third of the business that is less than $500,000 (one third of the original value). Assuming that a reasonable amount that a willing buyer would offer for ownership of a third of the farm is $350,000, the value of each child's share of the business, for estate tax purposes, would be the discounted value of $350,000, not $500,000 (one third of the original value of $1.5 million).

If structured properly, courts have routinely validated discounts ranging from 10 to 40 percent making valuation discounting a proven and effective strategy for transferring farm and ranch businesses from one generation to the next. Without this estate planning tool, higher estate taxes could lead to the liquidation of productive business assets needed to successfully operate a farm or ranch or force the family farm or ranch to take on an unstainable level of financial debt.

AFBF Policy:

Farm Bureau supports allowing valuations for estate and gift tax purposes to reflect discounts for minority ownership and lack of marketability.

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