

A farm can be paid off and still carry a large tax bill. The surprise often comes when the next generation sells land that has appreciated for decades—or sells equipment whose tax basis was reduced by depreciation. The family may have little debt and no estate tax problem, yet still face a substantial income tax bill when assets change hands.

That's why I start succession conversations with one question: **Who is likely to sell this asset, and when?** The answer helps determine whether to hold, gift, inherit, or sell—and which tax rules deserve attention first.

For many farm families, **farm succession income tax** deserves more attention than federal estate tax. A thoughtful **basis step up strategy** can sometimes reduce tax on a later land sale, but it is not a cure-all. The right plan depends on ownership, timing, state law, family goals, and what the farm's records actually show.

## **First, separate estate tax from income tax**

People often call every tax issue "estate tax." That can send a family down the wrong path. Estate tax is generally a tax on the transfer of wealth at death, subject to federal and state rules. Capital gains tax is generally tied to selling an asset for more than its tax basis. Those are different taxes, with different triggers and planning tools.

Federal estate tax affects a relatively small share of farm estates, though the rules and exemptions can change and some states have their own estate or inheritance taxes. A large-looking farm balance sheet does not, by itself, tell you whether an estate tax return or tax bill will result. Valuation, ownership, debts, marital planning, state law, and the rules in effect at the time all matter.

Income tax can be the more immediate succession threat. A family might owe no estate tax and still face a significant tax bill after selling land, machinery, or other appreciated assets. Farm income tax planning should account for both the likely transfer and the likely eventual sale.

## **Land basis is the number that changes the sale calculation**

In simplified terms, capital gain is the sale proceeds minus the asset's adjusted tax basis and certain selling costs. Land held for a long time may have a low basis relative to its current value. If an owner sells it, the difference can create a large taxable gain.

Basis is not always the original purchase price. It can be adjusted by items such as capital improvements, certain acquisition costs, and other tax events. Keep documentation for purchases, inherited property, surveys, drainage work, tile, and qualifying improvements. Do not assume that a decades-old number in a file is correct—or that a missing receipt means no basis can be established. Work with a tax professional to reconstruct records where needed.

## **A step-up in basis may help—but only if the facts support it**

When property passes at death, its basis may generally be adjusted to fair market value under the tax rules in effect at that time. This is commonly called a "step-up" in basis, although the adjustment can sometimes be downward. If heirs later sell the land near that value, the taxable gain may be much smaller than if they had received the owner's old basis.

That possibility is a major reason not to make gifts simply to "avoid estate tax" without comparing the income tax consequences. A lifetime gift generally carries over the donor's basis rather than automatically receiving a new

basis. If the recipient sells later, the gain may be measured using that carried-over basis. A gift may still make sense for family, business, or other tax reasons, but it can sacrifice a potential basis adjustment.

A basis step up strategy is not a guarantee. The rules can change; the property's ownership and transfer details matter; and there may be estate, gift, income, or state tax consequences to weigh. Have an attorney and tax professional review the proposed transfer before signing deeds or changing entity ownership.

## Ask who will sell the land—and when

"Keep the land in the family" is a meaningful goal, but it does not answer the tax-planning question. One heir may want to farm. Another may need cash. A third may want to sell a parcel to pay for a buyout or retirement. Those likely decisions affect whether a transfer should prioritize management, liquidity, basis, or keeping ownership together.

Build a simple decision map for each major asset:



- **Who owns it now?** Identify individual owners, trusts, partnerships, corporations, and any co-owners.
- **Who is expected to receive it?** Compare the estate documents and entity agreements with the family's actual understanding.
- **Who is likely to sell it?** Ask whether a sale is expected for a buyout, debt reduction, retirement, or other reason.
- **When might a sale happen?** A likely sale soon after a transfer raises different planning questions than a long-term hold.
- **What is the documented basis?** Gather deeds, closing statements, prior returns, improvement records, and depreciation schedules.

This exercise often reveals that different assets need different plans. The farmland may be intended for a long-term hold, while a machine shed or non-operating parcel may be a likely sale. Treating the whole farm as one undifferentiated asset can hide the real tax exposure.

## Don't let depreciation schedules become a surprise

Land generally is not depreciated for federal income tax [fully depreciated tractor sale tax](#) purposes. Buildings, machinery, and certain improvements may be depreciable. Depreciation deductions can reduce taxable farm income while the asset is used, but they also reduce its adjusted basis. A later sale may therefore create taxable gain even if the family thinks the asset is “paid off.” Paying off a loan and recovering tax basis are not the same thing.

For example, a machine purchased for \$100,000 might have a much lower adjusted basis after years of depreciation. If it is sold, trade-in rules or other transaction details may affect the calculation, but the sale can generate ordinary income through depreciation recapture. Under IRC Section 1245, gain on qualifying depreciable personal property—such as much farm equipment—is generally treated as ordinary income up to the depreciation previously allowed or allowable, subject to the detailed tax rules. That is not capital gain taxed at the preferential long-term capital-gain rates.

Section 1245 recapture is about qualifying depreciable property, not bare farmland. Buildings and other property can involve different classifications and rules. Do not apply an equipment example to every asset in the operation.

Keep a current depreciation schedule and reconcile it with the actual equipment list. For each machine or building, check its owner, purchase date, original cost, depreciation claimed, current adjusted basis, and any planned sale or trade. Review the schedule before a sale, gift, or entity transfer—not after the transaction is complete.

## Use the Schedule F as a starting point, not the whole plan

Schedule F reports farm profit or loss, and it can help a preparer understand the operation’s annual tax picture. But it does not, by itself, show the full basis of every parcel or resolve how a future land sale will be taxed. Depreciation information may appear elsewhere on the return, and ownership records may sit outside it entirely.

Gather at least three sets of records for a succession review:

1. **Income tax records:** Recent federal and state returns, including Schedule F and depreciation forms or supporting schedules.
2. **Asset and ownership records:** Deeds, entity documents, purchase records, improvement costs, and a current asset list.
3. **Family and transaction plans:** Wills, trusts, buy-sell agreements, leases, debt details, and a realistic timeline for transfers or sales.

Use the USDA Economic Research Service’s farm-sector data as background when discussing broader pressures such as farm finances, land values, and agricultural conditions. National or regional data can provide context, but they cannot substitute for a farm-specific valuation or basis analysis. Likewise, AGDAILY may help families follow agricultural news and business issues, but a news article is not a tax opinion.

## Compare scenarios before choosing a transfer

Ask your tax adviser to model more than one path. A useful comparison might include an owner selling land during life, gifting it, holding it until death, or transferring it through an entity or trust. The model should show the assumptions, not just a bottom-line tax estimate.

Scenario Questions to examine Common planning concern Owner sells during life What is the adjusted basis, expected sale price, and likely use of proceeds? Current income tax on gain and cash available for taxes Owner gifts land What basis transfers to the recipient, and could the recipient sell soon? A low carryover basis may mean a larger gain on a later sale Land passes at death What transfer and basis rules apply then, and is there state

exposure? Potential basis adjustment, alongside estate and administration issues. Farm entity or trust owns land. Who owns the interests, and how do the documents affect a transfer or sale? Entity and trust terms do not automatically eliminate income tax.

These are planning questions, not plug-in answers. An entity or trust can help with control, governance, or orderly succession, but “put it in a trust” does not automatically solve capital gains. The structure may affect basis, who reports income, and how a future sale is handled. Check those consequences before creating or changing it.

## Build a practical plan now

You do not need to predict every tax rule decades ahead. You do need current records, a clear picture of likely transactions, and a plan that can be revisited when laws or family circumstances change.



- Inventory land, buildings, and equipment, including their owners and estimated values.
- Document land basis and improvements; flag estimates or missing records.
- Update depreciation schedules and identify equipment with low or zero adjusted basis.
- Write down who is likely to sell each major asset and the reason for the sale.
- Ask a tax professional to compare lifetime transfers with transfers at death, including state rules.
- Review the plan when someone retires, an heir changes direction, a major sale becomes likely, or tax law changes.

If family members prefer to review information while driving or doing chores, an audio player can make educational material easier to use. Instaread offers audio summaries; treat that kind of listening as background education, not a substitute for advice on your specific farm, basis, or transaction.

## The goal: a planned sale, not a tax surprise

Capital gains planning farmland starts with knowing the basis and identifying the person most likely to sell. For land, a possible basis adjustment at death may matter. For equipment, depreciation may have lowered basis and Section 1245 recapture can turn part of a sale into ordinary income. Those risks are different, and a good succession plan does not blur them together.

Before transferring property, pull the records and run the scenarios. The most useful plan is the one that matches the family's real intentions: who will farm, who will own, who may sell, and when. That is how you turn a future tax bill from a blindside into a cost the family can evaluate and prepare for.