UNIVERSITY OF MINNESOTA | EXTENSION

# Gifting Assets

Estate Planning Series #6 8/2017

## Agricultural Business Management

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**Introduction:**

Gifting assets to others can be a valuable tool in estate planning. Gifts can help you reduce your taxable estate. In some states, gifts might help you make a small estate smaller and thus avoid the probate process. Gifts can also transfer tax obligations to your children who may be in a lesser tax bracket, provide for a favorite charity, or provide help to others. By giving assets away before you die, you get to see the recipient enjoy your generosity.

Use caution however. You want to be sure that gifts are made only from excess assets. You do not want to impoverish yourself or your spouse. In addition, gifts made while you are alive, beyond a certain size, are subject to gift taxes rules.

**Federal Gift Tax:**

Virtually anything you own can be gifted to others. The IRS allows you to give away a certain amount of property without any gift tax or gift tax reporting. Currently, each person can gift up to $14,000 per year (Annual Gift Exclusion) to as many people as they wish, free of any gift tax. In addition, the individual is not required to file the IRS 709 Gift Tax Form. A couple can gift up to $28,000 per donee per year, if they write two separate checks for $14,000 each or they file an IRS 709 form. This strategy can be used to reduce a person's estate to a level below the federal and perhaps the state exclusion amount, thus avoiding estate tax.

Federal estate & gift tax law initially established the lifetime exclusion amount at $5,000,000 and indexed it for inflation. For 2017, every person has a federal Lifetime Gift Exclusion that will offset gifts of up to $5,490,000.

**NOTE:** Each person has **one** federal lifetime exclusion amount in any given year. You decide how you want to spend the exclusion amount. That is, you can use it to offset estate tax or gift tax. You do not have two separate exclusion amounts.

Federally, gifts given in excess of the annual exclusion ($14,000 per individual, $28,000 per couple) reduce the individual's lifetime exempted amount. *See Estate Planning Series #1-Estate Planning Principles.* The following example illustrates this.

Example: Susan gave $54,000 to her son Caleb. After subtracting the $14,000 annual exclusion, a possible taxable gift of $40,000 remained. The $40,000 is subtracted from her $5,490,000 (2016) Lifetime Exclusion amount, leaving $5,450,000 of the credit to be used for future gifts or at the time of her death. No gift tax is payable until the total Lifetime Exclusion amount is used up. However, a gift tax return (IRS Form 709) must be filed on gifts to any individual, other than your spouse, when the gift exceeds the annual $14,000 exclusion. Be careful not to get caught on a technicality. If you give a $14,000 gift and later in the year give a $100 birthday gift to the same individual, technically you have exceeded the $14,000 allowable gift and may be required to file a gift tax return. No tax is due while you are alive but the IRS 709 form should be filed.

In summary:

- Annual gifts of $14,000 per person or $28,000 per couple or less: no tax and no IRS Form 709
- Annual gifts between $14,001 - maximum federal exclusion per person or $28,001 - maximum exclusion per couple: no tax while you are alive but must file IRS Form 709
- Annual/lifetime gifts in excess of the federal Lifetime Gift Exclusion amount (individual): tax due April 15 of year follow year of gift and file IRS Form 709

Gifts are always valued at fair market value (FMV) at the time of the gift. As long as the FMV of the property gifted is less than the $14,000 per year per person ($28,000 for couples) annual exclusion, no gift taxes will be imposed. In addition, you can give unlimited gifts to your spouse (called the Marital Deduction) or to a qualifying charity in any year with no gift tax consequences.

If there is any tax due resulting from a gift, the tax is generally paid by the donor, not the recipient of the gift.

Federal gift tax and federal estate tax are intertwined. Any gift in excess of the federal annual exclusion amount must be recorded on IRS Form 709. Once that individual dies, the amounts on their 709 forms are added up and this total amount of gifts in excess of the annual exclusion amount are added back into the decedent's estate, increasing the size of the estate, and to determine if any federal estate tax is due.

## Minnesota Gift Tax:

The Minnesota Gift Tax law that was to take effect July 1, 2013 was repealed to the effective date of July 1, 2013 through MN legislation that was signed into law on March 21, 2014.

For property located in MN, the value of gifts in excess of the annual exclusion amount (recorded on the IRS 709 form) made within 3 years of the decedent's death will be added back into the decedent's estate to determine if MN estate tax is due. The 3 year add back provision is retroactive applying to estates of decedents dying after Dec. 31, 2012.

The MN gift add back provision applies to the transfer of property located in MN only. The add back applies to MN residents. It also applies to gifts of real estate and tangible personal property located in MN but owned by any non-resident to determine if the non-resident must file a MN estate tax return.

MN residents transferring real and tangible personal property located outside MN are not subject to the MN gift add back provision.

## Income Tax Implications:

Gifts of cash do not subject the recipient to income tax. Gifts of stock, real estate or equipment are also exempt from income taxation upon receipt of the gift. However, when you receive a gift, the adjusted basis (original cost) of the gift remains that of the donor. If the recipient sells the property and it has appreciated in value, they will generally pay capital gain tax on the difference between the sale price and the donor's adjusted basis.

## Gifting Grain:

If a cash basis farmer gifts grain to his/her children, the farmer does not include the grain as income on his/her tax return. If gifted in the same year produced, the farmer must reduce Schedule F expenses equal to the cost of growing the amount of grain gifted. The child must include the sale of grain on his/her tax return, less any basis which might have been passed on by the donor. Generally, raised grain has no basis. Gifting grain can reduce a farmer's income and self-employment (SE) tax. The sale of the gifted grain increases the child's income, but the child pays no SE tax on the gift of grain. Two possible savings can result: 1) the grain is taxed at the child's tax rate which is possibly lower and 2) no one pays the 15.3% SE tax on the grain sale. Be careful when gifting grain to children. There are limitations on the amount of unearned income that can be taxed at the child's tax rate. Amounts above this threshold will be taxed at the parent's rate which may be higher ("Kiddie" tax provision). See your accountant or tax preparer.

## Documenting Gifts:

When gifting, it is important to document the gift. To document a gift, state in writing that a gift was made including a description of the item, the date given, the value of the gift, a serial and model number, adjusted basis, FMV, etc. Both parties should sign and date the document and the document should be notarized. If the gifted property is a titled asset such as a vehicle or real estate, transferring the title serves as documentation that a gift has been made. Without proper documentation, tax authorities may dispute that a gift ever really took place and may include the gifted property in your estate or assign the income tax liability to the donor if the property is later sold by the donee. Documentation can also serve to notify the recipient's lender that the recipient is now the owner of the property. It will allow the donor to increase the assets on their financial statement. Such documentation can also avoid any misunderstanding or potential arguments between family members. Even though an IRS Form 709 may not be required, it is good practice to list the recipient's basis in the gift.

## Completing Gifts:

If you truly gift property, you cannot retain any control of the property. If you do, your gift will be considered incomplete and therefore not a gift for income or gift tax purposes. Retaining interest, control, or income will result in the gift being considered incomplete.

## Gifting Land:

You can gift land by deeding over actual acres. You might give the west 20 acres to John and the east 20 acres to Mary. Giving actual acres requires legal work and legal descriptions of the property when each gift is given. You can also gift land by deeding an undivided interest in property to children. You can give a 10% interest in the 160 acres to John & Mary (together or separately) and this may require less legal work.

A business entity, such as one of the many partnership entities or corporations, can also be used to gift land. The business entity holds the land and the shareholders (usually parents) simply gift shares to Mary and John over time.

## Gifting Contract for Deed Payments:

If you wish to forgive debt payments from your farming heir, the best procedure is to receive a check for the principal and interest payment and then issue a check back to the child for any gift you wish to make. Ignoring the check exchange can result in the farming heir not having complete evidence of having paid for the property. You must declare payments received on a contract on your tax return.

## Charitable Giving:

Some people prefer to give to their favorite charity or religious organization. Doing so can provide you with an income tax deduction. If you have appreciated property, a charitable remainder trust allows you receive an income stream, much like an annuity, from the donated asset with the remainder going to charity.

## Can You Afford It? What About My Goals?

Gifting is a very useful estate planning tool. However, don't do it unless you can afford to give up the assets. If gifting jeopardizes your financial security, proceed carefully. Do not impoverish yourself in order to get a farming heir started in farming. If gifting violates your business transition and estate planning goals, do not do it.

## Medicaid law change regarding gifting:

With the signing into law of the Deficit Reduction Act of 2005 on Feb. 8, 2006, there is now a 60 month disclosure period on all non-compensated transfers including gifts. Technically this includes such things as birthday and Christmas gifts as well as donations to your church. Gifting can create a period of ineligibility for an individual regarding Medicaid coverage for a period beginning the date of Medicaid application. For more information on this issue see the following information sheet in this series: *Estate Planning Series #9-Long-Term Health Care Planning*

Consult an elder law attorney for more information regarding Medicaid and issues specific to your situation.

**Caution:** This publication is offered as educational information. It does not offer legal advice. If you have questions on this information, contact an attorney.