



# Gifts of Farm Assets

## Agricultural Business Management

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### Gifts of Assets:

Gifts of assets to the entering generation can be a valuable tool in the transfer process. Gifting can be used to:

- Help reduce a taxable estate,
- Transfer income tax obligations to the children who may be in a lower tax bracket, and
- Help get the next generation established.

Gifts are always valued at fair market value (FMV) at the time of the gift.

### Federal Gift Tax Provisions:

For federal gift tax, each individual currently has an Annual Gift Exclusion of \$14,000 allowing you to gift that amount per person per recipient per year to as many persons as you wish and pay no gift taxes. Married donors who own property together can treat a gift as though each spouse has given half of it, so that together they can give \$28,000 per recipient per year. They need to write two separate checks for \$14,000 each or file an IRS 709 gift tax form.

You can give unlimited gifts to your spouse (Marital Deduction). If your spouse is a non-US citizen, there are gifting limits - number changes each year. You can gift unlimited gifts to a qualifying charity in any year with no gift tax consequence. You can also gift unlimited amounts for tuition or medical care.

Federal law has permanently established the federal Lifetime Exclusion amount at \$5,000,000 and indexed it for inflation. For 2017 every person has a Lifetime Gift Exclusion of \$5,490,000. Gifts given in excess of the annual exclusion (\$14,000 per person, \$28,000 per couple) reduce this lifetime exempted amount. **NOTE:** Each individual, for the purpose of federal estate and gift tax purposes, has one exclusion amount equal to the applicable annual exclusion (2017 is \$5,490,000). One does not have a \$5,490,000 exclusion for estate tax and a second exclusion of \$5,490,000 for gift tax. Each person has one exclusion amount and you can decide how to spend that exclusion amount - on estate taxes or gift taxes or a combination of both.

No gift tax is payable until the total federal 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, which exceed the annual \$14,000 exclusion (\$28,000 for couple). If gift taxes are payable, they are generally paid by the donor (giver) not by the donee (recipient).

### Minnesota Gift Tax Provisions:

The MN 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.

However, 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.

### Summary:

- For annual gifts of \$14,000 individually (\$28,000 couple) - no tax, no IRS 709 or M709 form.
- For annual gifts \$14,001 up to federal & MN gift exclusion individually (\$28,001 - up to federal & MN gift exclusion per couple) - no tax due while the donor is alive, file IRS 709 and M709 forms.
- For annual or lifetime gifts greater than federal or MN gift exclusion - tax due by April 15 the year following the year of the gift and file IRS 709 and M709 forms.

### Gifts of Appreciated Property:

Gifts of appreciated property held long enough to qualify for long-term capital gains treatment (longer

than 12 months for land, breeding livestock, and machinery) could be gifted by high tax bracket parents to children in low tax brackets to save taxes.

Gifts of appreciated property to children under 18 or who are full-time students ages 19-23 can cause their income to be taxed at the parents' top marginal tax rate or greater ("Kiddie" tax provision). If recipient exceeds unearned income limits (amount changes each year - see your accountant), sale income will be taxed at the parent's marginal tax rate if greater than the child's rate.

### **Gifts of Grain or Market Livestock:**

Gifts of commodities are often used in parent-child transfers. Here are some consequences if gifting grain or livestock produced in the farming operation to the children:

- If FMV of the commodity is under \$14,000, no gift tax or Form 709 is required.
- The cash basis parent does not include the commodity on their tax return, thus reducing both income and self-employment (SE) taxes.
- The child must show the income on their tax return and pay income tax, not self-employment tax, on the income (remember "Kiddie tax provision").
- If the parent gifted the grain or livestock in the year of production, they must reduce deductible Schedule F expenses by the cost of producing the grain, but the child gets to use that carry over of basis as an expense. If the gift is made with grain produced in a year prior to the gift, the basis is in the hands of the parent donor and the child donee's basis is zero. When giving commodities, the best advice is to give crops or livestock produced in the previous tax year.

### **Gifts of Machinery:**

Gifts of machinery and equipment to the entering generation provides several advantages. It is often necessary for the entering generation to receive financial help in getting started in farming. Gifts of machinery can provide equity on their balance sheet. Gifts of machinery can reduce the tax burden of the parents. If the parents are in a weak financial position and cannot afford to give away some property, perhaps the entire transfer process should be reevaluated as to its viability.

The donor's remaining basis for depreciation on the gifted machine passes to the recipient of the gift.

If indebtedness on the gifted asset exceeds the donor's basis, the excess is considered a taxable gain to the donor at the time of the gift.

When you gift machinery, document the gift by stating it in writing. List the date of the gift, the donor and donee, the adjusted basis, the fair market value

of the gift, the make, model, and serial number. Sign and notarize the document effective the date of the gift. This eliminates any confusion over ownership and you have protected the asset for your farming heir(s) if that is one of your goals.

### **Gifts of Land:**

You can gift land by deeding actual acres. This requires legal work when each gift is given.

You can also gift land by deeding an undivided interest in property to someone. This method may require less legal work.

Forming a business entity for the purpose of gifting land can be used and the parent stays in control but transfers entity ownership units or shares to the entering generation or other children over time.

### **Gifts of Contract for Deed payments:**

After executing a contract-for-deed with their farming heir, some parents decide they would like to occasionally forgive the annual payment.

The best procedure is to collect a check for the principal and interest payment and then issue a check to the farming heir 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. Drafting a payment schedule listing all principal and interest payments and payment dates is a good idea. When a payment is made, the parents should initial and date the payment schedule eliminating any doubt the farming heir has made payments and has control of the property in the event of the parent's death.

### **Can you afford it? Does it violate your goals?**

Gifts can be a very useful transfer and estate planning tool. However, don't do it unless you can afford to give up the assets. Once an asset is gifted away you have no control of it and can expect no income stream from it. If gifting jeopardizes your financial security or violates your farm transfer and estate planning goals, you might want to reconsider the strategy.

### **CAUTION - Medicaid law change regarding gifting:**

Gifts of assets can cause eligibility issues if you are considering application for Medicaid for long-term health care costs. See an elder law attorney for help. For information on this issue, see *Estate Planning Series #9-Long-Term Health Care Planning*.

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