



UNIVERSITY OF MINNESOTA  
EXTENSION

# Ag Business Management

*Informing farm families and ag businesses about management issues.*

Transferring the Farm Series #6 9/2009

## Gifting Farm Assets

Prepared By:

Gary A. Hachfeld, David B. Bau, C. Robert Holcomb, & James N. Kurtz, Extension Educators

### Gifting Assets:

Gifting 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,
- Help get the next generation established.

Gifts are always valued at fair market value (FMV) at the time of the gift. Each individual has an Annual Gift Exclusion of \$13,000 allowing you to gift that amount per recipient per year 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 \$26,000 per recipient per year.

Example: A husband and wife could join together and give jointly owned land worth \$208,000 to their eight children in a single year. Each child would receive a gift valued at \$26,000 with no gift tax incurred by the parents. You can give unlimited gifts to your spouse (Marital Deduction) or to a qualifying charity in any year with no gift tax consequence. You can also gift unlimited amounts for tuition or medical care.

Currently every person has a Lifetime Gift Exclusion with the IRS, which will offset gifts of up to \$1,000,000. Gifts given in excess of the annual exclusion (\$13,000 per person, \$26,000 per couple) reduce the lifetime \$1,000,000 exempted amount.

Example: Sally Smith gave \$53,000 to her son Paul. Minus the \$13,000 annual exclusion there is a taxable gift of \$40,000. This amount is subtracted from her \$1,000,000 lifetime gift credit amount. This leaves \$960,000 of the credit to be used by Sally for future gifting. No tax is due while Sally is alive.

No gift tax is payable until the total \$1,000,000 credit 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 \$13,000 exclusion (\$26,000 for couple).

If gift taxes are payable, they are generally paid by the donor (giver) not by the donee (recipient).

### Summary:

- For annual gifts of \$13,000 individually (\$26,000 couple) – no tax, no Form 709
- For annual gifts \$13,001 to \$1 million individually (\$26,001 - \$2 million couple) – no tax due while the donor is alive, file Form 709
- For annual or lifetime gifts greater than \$1 million (individual) – tax due immediately and file Form 709

### Gifts of Appreciated Property:

Gifts of appreciated property held long enough to qualify for long-term capital gain 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.

Example: Parents in the 25% income tax bracket gift cull dairy cattle to their son who is in the 10% bracket. The parents would have paid 15% capital gain tax on the cattle sale. Instead, the son pays 5% capital gain tax (0% for years 2008, 2009, & 2010). Since the dairy cattle were raised and over 24 months old, they have no basis, so are taxed as 100% long-term capital gain.

Be cautious when gifting appreciated property to children under 18 years old or who are full-time students ages 19-23. Their income could be taxed at the parents' top marginal tax rate or greater ("Kiddie" tax provision). The recipient must not exceed earned income in excess of a given amount (amount changes each year – see your accountant). Unearned income above that amount 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. If a parent gives grain or livestock produced

in the farming operation to the children, here are the consequences:

- If FMV of the commodity is under \$13,000, 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 a year prior to the time of the gift.

#### **Gift of machinery:**

Gift of machinery and equipment to the next generation provides several advantages to both parents and children. Since it is a necessity that the entering generation receive substantial financial aid to get started farming, gifting of machinery can provide equity on their balance sheet. Gifting machinery can reduce the tax burden of the parents. Gifted assets are never “sold” on the parent’s tax return, thus reducing taxes. 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 receiver 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 a machine, 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 and model, and you may consider listing the serial number. Sign and notarize the document effective the date of the gift.

#### **Gift of Land:**

You can gift land by deeding over actual acres. For example, you may 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 percent interest in the 160 acres to John and Mary together or separately. This method may require less legal work.

Some families form a business entity for the purpose of gifting land to the next generation. The parent stays in control but transfers entity ownership units or shares to the entering generation or other children over time.

#### **Gift 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.

If you wish to do so, 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. You must declare payments received on a contract on your tax return. These payments must be declared even if you forgive the payment.

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

Gift of machinery 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, perhaps you should not make that gift.

#### **CAUTION - 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 on all non-compensated transfers including gifts. This includes such things as gifting farm assets but also birthday and Christmas gifts as well as donations to your church. Gifting will make an individual ineligible for Medicaid coverage for a period, beginning the date of Medicaid application. See an attorney who specializes in elder law for more details.

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