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Gifting Assets

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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 who are deserving. By giving property away before you die, you get to see the recipient enjoy your generosity.

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

Virtually anything you own can be gifted to others. Stocks, bonds, cash, antiques, farmland or a house can be gifted to others if you wish. The IRS allows you to give away a certain amount of property without any gift tax or gift tax reporting. Federal law allows each person to give away up to \$13,000 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 U.S. Gift Tax Return Form 709. A couple can give up to \$26,000 per donee per year, if the assets are owned jointly. Again, there is no need to file Form 709. This strategy can be used to reduce a person's estate to a level below the federal exclusion amount, thus avoiding federal estate tax. If possible, using the same strategy can also enable a person to reduce their estate to a level below the state exclusion and thus avoiding state estate tax as well.

Currently, every person has a Lifetime Gift Exclusion with the IRS that will offset gifts of up to \$1,000,000.

Gifts given in excess of the annual exclusion (\$13,000 per individual, \$26,000 per couple) reduce the individual's lifetime \$1,000,000 exempted amount. See *Estate Planning Series #1-Estate Planning Principles*. The following example illustrates this.

Example: Susan gave \$53,000 to her son Caleb. After subtracting the \$13,000 annual exclusion, a possibly taxable gift of \$40,000 remained. The \$40,000 is subtracted from her \$1,000,000 Lifetime Exclusion amount, leaving \$960,000 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 (Form 709) must be filed on gifts to any individual, other than your spouse, when the gift exceeds the annual \$13,000 exclusion. Be careful not to get caught on a technicality. If you give a \$13,000 gift and later in the year give a \$100 birthday gift to the same individual, technically you have exceeded the \$13,000 allowable gift and may be required to file a gift tax return. No tax is due while you are alive but the 709 form should be filed.

In summary:

- Annual gifts of \$13,000 per person or \$26,000 per couple or less: no tax and no Form 709
- Annual gifts between \$13,001 - \$1 million per person or \$26,001 - \$2 million per couple: no tax while you are alive but must file IRS Form 709
- Annual/lifetime gifts in excess of the \$1 million Lifetime Gift Exclusion amount (individual): tax due and file 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 under \$13,000 per year per person (\$26,000 per couple), 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 paid by the donor, not the recipient of the gift.

Gift tax and federal estate tax are intertwined. Any gift in excess of the federal annual exclusion amount is recorded on Form 709. Once the individual dies, their 709 forms are added up and the amount of gifts in excess of the annual exclusion amount are added back into the decedent's estate, increasing the size of the estate.

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 commensurate with that amount of grain. 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 items like stock, machinery, livestock, land or vehicles, 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 number, adjusted basis, etc. Both parties should sign and date the document and the document should be notarized. If the gifted property is a titled asset like 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 no Form 709 is 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. 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% interest in the 160 acres to John & Mary (together or separately) and may require less legal work.

A business entity, such as one of the many partnership entities, 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 child, 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 children 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.

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. If gifting violates your business transfer 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 on all non-compensated transfers including gifts. 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. Consult an elder law attorney for more information specific to your situation.

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