

SHOULD YOU GIVE THE FARM OR RANCH AWAY?

Tom E. Prater and Eugene M. McElyea*

Have you thought about giving the farm or ranch away?

You may have considered leaving it to a child or children in a will. Maybe you have considered an outright gift now to those you want to succeed you ultimately in your agricultural operation.

While gifts are an excellent method of reducing estate values and often result in reduced federal estate taxes when you die, you should first give careful attention to current gift tax regulations and possible future income tax implications that may be involved for those who receive them.

If you have resources above those necessary for your survivors, you might consider a gift to a qualified charitable enterprise such as a church, educational institution, or social or welfare organizations such as 4-H or other groups.

Tax-Free Gifts

For estate tax purposes, gifts to charity are tax-free whether made during life or in a will. Depending on your financial situation, a dollar given to charity may have a net cost of far less than 100 cents. Charitable giving may provide tax savings. It can also reduce the gross estate at death, often removing a donor from higher death tax brackets.

The biggest consideration is to carefully understand the gift tax. While laws allow certain tax-free transfers, the gift tax itself is only about three fourths of a corresponding amount when taxed at death. Your attorney or tax advisor is the proper person to advise you on the size and timing of gifts.

*Extension economist-management specialist and County Officials Program specialist-attorney, Texas A&M University.

Each person has a \$30,000 lifetime giving exemption. This amount can be given in one or several years. It is reduced to the extent that gifts given to one or more persons within one calendar year exceed \$3,000.

For instance, a gift of \$6,000 to one child in one year would reduce the \$30,000 lifetime gift giving exemption to \$27,000. Automatically excluded was the \$3,000 annual exclusion. You can give as many \$3,000 gifts tax-free in one year to as many different persons as you choose. On these gifts, you need not file a gift tax return, although the return provides accurate records for tax purposes.

Gifts over \$3,000 to one person serve to cut into the \$30,000 exemption and require the filing of a gift tax return. When the \$30,000 exemption has been depleted, then all gifts over \$3,000 are taxable to the extent they exceed that amount.

Husbands and wives together possess a \$60,000 lifetime exemption capacity. That means a married couple, during one year, could give away to two children property or cash equaling \$72,000, tax-free. A gift tax return would be required, but no tax would be due, assuming no prior large gifts. Each spouse would give \$36,000 and reduce their community holdings in so doing. All future gifts over \$3,000 in succeeding years would be subject to tax.

Consideration of Tax Benefits And Pitfalls to Avoid

In gift giving, as in any business management undertaking, your personal and family objectives should be given foremost attention. Entering into various arrangements simply to avoid taxes without

proper assessment for the long-range consequences may be disappointing and may also create substantial personal hardships for those who survive.

Giving that achieves tax benefits must be complete and irrevocable. Gifts with strings attached are not gifts. For example, deeding a farm to a child with a parent or parents retaining a life estate interest does not serve to remove the value of the farm from estate tax evaluation at death, although legal title has immediately passed to the child at the moment of the death, ending the life estate.

Some farm families have wondered about the parent selling the farm to a child for a nominal sum or for an amount somewhat less than a fair market value of the land.

The Internal Revenue Service regards such transactions as gifts, subject to gift taxes if applicable, on the difference between what the parent receives and the land's actual worth. It can be readily seen that if the parent is holding a note from a child among his assets at death, the value of that note will be included in the value of the estate in the determination of death taxes.

The net result of such a transaction is to swap the value of the land for the value of a negotiable instrument with no resultant tax savings because the estate is not diminished in value.

In some instances, parents have conveyed by deed certain partitioned portions of real estate to a child and continued to use the land as though the land had never been conveyed. Giving deeds to land tracts and retaining such use may create problems with the estate tax collector, who would undoubtedly seek to have such instruments disregarded and declared to have no legal effect as far as taxes are concerned.

Favorable Transactions

For instance, however, where the parent might lease back the conveyed land, paying a fair market rental value for it, such a transaction may be effective for the desired purposes. As in all transactions where tax benefits are desired, it pays for intra-family dealings to be made with the same arms-length bargaining that characterizes non-family business dealings. In some respects it is more important for dealings among family members to be in writing than might be the case in transactions between non-kinfolks.

Giving farmland, or any property for that matter, can have income tax consequences for the recipient of the property when it is disposed of after a gift. For example, a donee takes the same cost-basis in the gift land that applied to the donor. When the donee later disposes of the property, he will owe a capital gains tax on the difference between the cost and return from the present transaction.

Factors in Giving

Before making a particular gift to a donee it is important that several factors be carefully considered:

1. What does the donee plan to do with the land given to him?
2. Does the property in the possession of the donor have a low or high cost-basis?
3. Is the donor, if he dies without making the gift, in a high or low estate tax bracket? (At death, land will take on a new cost-basis, which is its value on the date of the owner's death. It may be more economical to consider holding low cost-basis property until death even though an estate tax may be applicable.)
4. Is the donee in a high or low income tax bracket?
5. Is the donor in reasonably good health or is he in poor health or in advanced years? (Gifts made within three years prior to death are presumed to have been made in contemplation of death and their value does not escape estate taxation unless a clearly contrary intention can be shown.)

It is obvious that in weighing all factors, a person must consider the cost of giving against the cost of retaining. These costs vary according to the personal financial situation. This requires the assistance of a professional equipped to give knowledgeable counsel and guidance.

Before giving an outright gift to a minor, be aware that such gifts can often force the creation of a guardianship proceeding in a probate court. This is often cumbersome, expensive and undesirable.

Trusts are frequently used as a means of avoiding guardianships. Your lawyer can create a trust

that meets your specific needs, either in your will or in a separate instrument designed to have present effect.

In giving a gift of a specific tract of land, a survey may be needed, particularly when land is being partitioned from a larger tract. It is always advisable to have an independent appraisal to use when the gift tax return is audited at a later time.

An attorney is the proper person to prepare the legal instruments involved. Your concern to have the matters properly handled at the beginning can avoid complications that might arise later.

One method of giving the farm or ranch away, which allows the control of the business operation to remain in the hands of the donor, is through incorporation. Depending upon size, business volume, and personal goals, this arrangement can have advantages. It should be noted that the disadvantages of initial cost of creating a corporation, tax considerations (franchise and income) and annual maintenance attorney costs must be carefully weighed before you choose this form of business organization.

When incorporated, you will find it somewhat easier to transfer stock shares than to give the enterprise away by the deed, survey and appraisal process described above.

In every transaction involving the earnings and accumulation of a lifetime, proper advice and

counsel is essential. But your personal and family objectives must ultimately dictate the specific action taken in transferring the estate to those of your choice.

GIFT-TAX SCHEDULE

The rates above exemptions and exclusions are:

First \$5,000 or any part thereof	2.25 percent
Next \$5,000 or any part thereof	5.25 percent
Next \$10,000 or any part thereof	8.25 percent
Next \$10,000 or any part thereof	10.50 percent
Next \$10,000 or any part thereof	13.50 percent
Next \$10,000 or any part thereof	16.50 percent
Next \$10,000 or any part thereof	18.75 percent
Next \$40,000 or any part thereof	21.00 percent
Next \$150,000 or any part thereof	22.50 percent

The gift tax on amounts above exemptions and exclusions are:

<u>Amount</u>	<u>Tax</u>
\$ 5,000	\$ 112.50
\$ 10,000	\$ 375.00
\$ 20,000	\$ 1,200.00
\$ 30,000	\$ 2,250.00
\$ 40,000	\$ 3,600.00
\$ 50,000	\$ 5,250.00
\$ 60,000	\$ 7,125.00
\$100,000	\$15,525.00
\$200,000	\$38,025.00

COMPUTATION OF FEDERAL GIFT TAX

A man wants to give his son 640 acres of farm which is community property. The farm is worth \$400 per acre . . . \$256,000. The property is given to the son more than 3 years before the death of the man or his wife.

Total gift.....	\$256,000
Total gift of each donor (husband or wife).....	\$128,000
Total gifts for year.....	\$128,000
Less exclusions not exceeding \$3,000 for each donor (husband or wife).....	\$ 3,000
Total amount of gifts for year.....	\$125,000
Deductions:	
Charitable gifts.....	\$ -0-
Marital deduction.....	\$ -0-
Specific exemption claimed.....	\$ 30,000
Total deductions.....	\$ 30,000
Amount of taxable gifts for preceding years.....	\$ -0-
Total taxable gifts (each donor).....	\$ 95,000
Tax computed (each donor).....	\$ 14,475
Value of gift to son by each donor after consideration given to exclusions and exemptions.....	\$113,525
(Net value to son.....)	\$227,050)

Other fact sheets on estate planning: **L-774, L-950 through L-956, L-1164.**

This publication is designed to provide accurate and authoritative educational information in regard to the subject matter covered.

It is distributed with the understanding that the publisher is not engaged in rendering legal services. An attorney should be contacted for legal advice.

(Adapted from an article originally written by authors for The Farmer-Stockman Magazine and reprinted here with its permission.)

Educational programs conducted by the Texas Agricultural Extension Service serve people of all ages regardless of socio-economic levels, race, color, sex, religion or national origin.

Cooperative Extension Work in Agriculture and Home Economics, Texas A&M University and the United States Department of Agriculture cooperating. Distributed in furtherance of the Acts of Congress of May 8, 1914, as amended, and June 30, 1914.
10M-5-73 AECO-6