Farm Management

# Gifting strategy saves tax

## Farm & Family

By ROBERT ANDERSON

TOM Johnson just left my office; he was in to do some income tax planning. Tom has the same situation that many of my clients have. He will owe a large amount of income tax on his 2010 crop.

I suggested that Tom has too much grain and needs to give some of it away. While Tom disagreed, saying one can never have too much grain, he was willing to consider a gifting program.

Gifts are generally taxable. However, there are two ways to avoid the tax.

The first is to limit annual gifts to one person to $13,000 or less. This $13,000 amount is called the annual exclusion and is available to everyone. The annual exclusion applies to a gift to a single person — thus, the $13,000 annual gift can be made to multiple people. For example, during 2010, Tom can give his daughter $13,000, his son $13,000, his daughter-in-law $13,000 and his grandson $13,000.

Furthermore, he can split the gift with

his wife, even though it is Tom's property.

For example, Tom can give grain to each member of the family. Since it is Tom's grain and not his wife's, he can use split-gift rules to give each family member $26,000 worth of grain. This will use up his wife's annual exclusion, as well. In this example, Tom has four family members, and he and his wife can annually give a total of $104,000 free from gift tax.

In addition to the annual exclusion, gift tax law also allows a lifetime exclusion. At this writing, the lifetime exclusion is $1 million per person. The lifetime exclusion is over and above the annual exclusion. Thus, in 2010 Tom can give his son $1,013,000 without having to pay gift tax.

However, the $1 million lifetime exclusion is not per recipient. Thus, if Tom gives each of his four family members $250,000 in excess of the annual exclusion, he will have used his $1million lifetime amount.

Keep in mind that Tom's wife also has a $1 million exclusion, so the couple can give $2 million to their family, plus $104,000 per year without triggering gift tax.

### Grain gifts

This brings us back to tax planning and the large 2010 crop.

Tom could use his annual $13,000 gift amount to give family members grain rather than cash. This means he will not have to pay tax on the grain prior to the gift. The downside is that the recipient of the gift will have to pay the tax because Tom deducted his expenses for growing the crop on his Schedule F.

However, if the grain given as a gift is over a year old when sold, the gifted grain will qualify for long-term capital gain rates in the hands of the recipient.

In 2010, those rates are 0% federal for low-income recipients and 15% federal for high-income recipients. Minnesota also taxes this income at regular Minnesota income tax rates.

The giver will avoid both regular income tax and self-employment tax on the gifts.

For example, Tom and his wife are in the 25% federal income tax bracket and will be paying self-employment tax on the grain when they sell it. Instead of selling the corn, they give their son John 5,200 bushels in December 2010. This corn has a fair market value of $5 per bushel, thus the total value of the gift is $26,000. The grain was harvested in 2009, so it is a year old. When John sells the grain he will report it as a long-term capital gain. John's long-term capital gain rate is 0% federal so he will owe no federal tax, and since he lives in South Dakota, he pays no state income tax. Tom and his wife save about $3,674 in self-employment tax and $7,743 in federal and Minnesota income taxes by not selling the grain.

As always, consult with an experienced tax adviser before proceeding.

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