Farm Management

Uncertainty about estate law makes gifting an option

Country Counsel

By ROBERT MOORE

Key Points

- The federal estate-tax exclusion of \$5 million expires at the end of 2012.
- The option to gift up to \$5 million in assets is also scheduled to end.
- Without a known exclusion, estate planning is a guessing game.

THE federal estate-tax exemption has been a closely watched issue by the farming community. Currently, each person has a \$5 million exemption before any federal estate taxes are paid. The law providing for the \$5 million exemption will expire at the end of 2012 and revert to a \$1 million exemption unless Congress intervenes with a new law.

The Obama administration is suggesting the exemption be set at \$3.5 million, with an annual adjustment for inflation. Most experts believe the exemption will be about \$3.5 million, but it will require Congress to take action, which is never a certainty. The federal estate-tax rate is expected to be around 50%.

The current law also allows for a unique opportunity to make large, tax-free gifts. Any individual may gift up to \$5 million, less any previous large gifts that have been made. This opportunity will also expire at the end of 2012.

People who think they will be in a federal tax bracket should consider gifting assets out of their estate to avoid large estate taxes. This decision should be considered carefully and with the advice of legal and tax professionals.

Exemption level

The biggest challenge when considering gifting is often guessing at where the federal estate-tax exemption will be. A more aggressive gifting strategy will likely be taken if the exemption reverts to \$1 million versus a more conservative strategy if the exemption stays at \$5 million. This is an issue that should be thoroughly researched and discussed with advisers.

For example, a farmer has a net worth of \$5 million. If he thinks the federal exemption will stay at \$5 million, he may not need to do any gifting. If he believes the exemption will revert to \$1 million, he may consider gifting \$4 million to avoid potentially \$2 million in estate taxes. If the exemption goes to \$3.5 million, he may only need to gift \$1.5 million to avoid estate taxes.

Obviously, Washington has put farmers and anyone else with federal estate-tax concerns in a very difficult position by not having a known federal estate-tax exemption for 2013 and beyond.

What to gift

Another issue to address is what asset or assets to gift. Many people considering large gifts are older and are either in retirement or looking toward retirement. Enough assets must be kept to have a secure retirement. A gift cannot be given with strings attached, such as continuing to pay rent on land that has been gifted. This is a retained interest and will cause the gift to be void.

For example, a farmer owns \$2 million of land and considers gifting it all to his children. He cannot require his children to give him rent for the land, so he must be sure to have enough other sources of income to support himself.

An excellent vehicle for gifting is a limited liability company that holds land. A landowner can place land in an LLC, gift ownership of the LLC, and still maintain some control over the land.

For example, the farmer above decides to gift the \$2 million of land. First he places the land in an LLC. He then gifts 90% of the ownership of the LLC to his children. With his 10% ownership, he retains management rights and the rights to buy back any ownership if a child should wish to sell, get divorced, go bankrupt or some other event putting the ownership at risk. The farmer gifted almost all the intended \$2 million of land but held on to at least some control over the land.

The above is a very general and basic discussion of the potential for gifting to minimize federal estate taxes. If considering a large gift, consult your legal and tax adviser for an in-depth and thorough analysis before any gifting is completed.

Moore is an attorney with Wright Law Co. LPA
614-791-9112
rmoore@wright-law.net

If you have legal questions for this column, email them to twhite@farmprogress.com.