Farm Management

Consider the tax benefits of gifting

Country Counsel

By ROBERT MOORE

ONE of the most important and common concerns among farmers is transferring assets to the next generation. One means of transferring assets is gifting. While this may seem the easiest strategy for transferring assets, it is often not the best strategy when taking into consideration income taxes. Before implementing a gifting strategy, a thorough analysis of the advantages and disadvantages should be performed.

There are basically two types of gifts: the annual exclusion gift and the unified credit gift. For the annual exclusion gift, the IRS allows anyone to give up to $14,000 each year to an unlimited number of people. This type of gift does not trigger any taxes and requires minimal documentation, such as a canceled check or gift declaration. The annual exclusion gift is indexed to inflation and is increased in $1,000 increments every few years.

The unified credit gift is a gift that exceeds the $14,000 annual exclusion gift. There is no tax on the unified credit gift, but the individual's federal estate tax exemption is reduced by the amount of the gift. For example, a farmer gifts $100,000 of land to his daughter. Neither farmer nor daughter owes any tax on the gift, but the farmer's federal estate exemption is decreased from $5,350,000 to $5,250,000. The IRS requires the farmer to file a gift tax return reporting the $100,000 gift.

In essence, the IRS allows people to make large gifts while they are alive in exchange for having a reduced federal exemption amount when they pass away.

Estate benefit

Gifting is best used by individuals who are facing federal estate taxes. Federal estate taxes are paid on estates exceeding $5.35 million, and the tax rate is 40%. In these situations, every dollar gifted reduces estate taxes by 40 cents. For example, a farmer has a net worth of $7 million, which will trigger federal estate taxes. He gifts his daughter $14,000 to reduce his taxable estate. The $14,000 reduction in the farmer's estate will reduce his estate taxes by $5,600 ($14,000 times 40%).

For people with a net worth below the $5.35 million federal exemption, gifting may not be the best tax strategy. The recipient of a gift receives the tax basis that the grantor of the gift had in the asset. For example, a farmer owns a $100,000 tractor with $0 tax basis. He gifts the tractor to his daughter, who now owns the tractor with the same $0 tax basis. Daughter has no tax basis to depreciate and will pay tax on the sale of the tractor.

Conversely, if the farmer allows the same tractor to go through his estate, his daughter will inherit the tractor with a stepped-up tax basis. Daughter will have $100,000 of tax basis to depreciate, or she can sell the tractor and pay no tax on the sale proceeds. For an estate that will not have federal estate taxes, it is often better to allow assets to go through the estate, instead of gifting, so the heirs will receive the assets with a stepped-up tax basis.

Individuals with a net worth exceeding $5.35 million should consider a gifting strategy to avoid the 40% estate tax. Individuals with a net worth below the federal exemption amount should give considerable thought to gifting, as it prevents the beneficiaries of the gift from receiving a step up in basis.

This discussion has only considered the tax implications of gifting. Sometimes, a person simply wants to gift assets for benevolent reasons or business reasons other than tax management. In those situations, gifting may be an appropriate strategy. Just remember, gifting is not always the best tax management strategy.

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Beef up financial management

On the Money

By JOHN OTTE

Key Points

- The ag boom fueled by rising world crop demand boosting profits is easing.
- Budgeting and wise use of debt are two tools to stay on sound financial footing.
- Having "enough" to cover rainy day expenses, retirement are top concerns.

HUMANS have a strong desire for instant gratification. Fulfilling it, as an old saying goes, can result in the amount spent expanding to absorb all income, and then some.

Sometimes earnings subsequently slip. When that happens, controlling spending can become a challenge, both at home and on the farm.

Hopefully the recent ag boom will give way to a soft landing, rather than a 1980s-style bust. Still, farmers who let financial controls ease during the boom may need to sharpen their financial skills, both on the farm and in the household.

Deficiencies are common

A recent National Foundation for Credit Counseling survey found 41% of adults gave themselves a grade of C, D or F on their knowledge of personal finance.

"The survey also reveals Americans have significant knowledge gaps on budgeting, saving and understanding credit reports and credit scores," says Susan Keating, NFCC president. "Those are all key areas related to successful money management."

Budgeting and debt

Sixty-one percent of U.S. adults, the highest percentage in six years, admit to not having a budget. Financial experts generally agree that a budget is a basic financial management tool. Without a budget, a person can more easily lose track of spending.

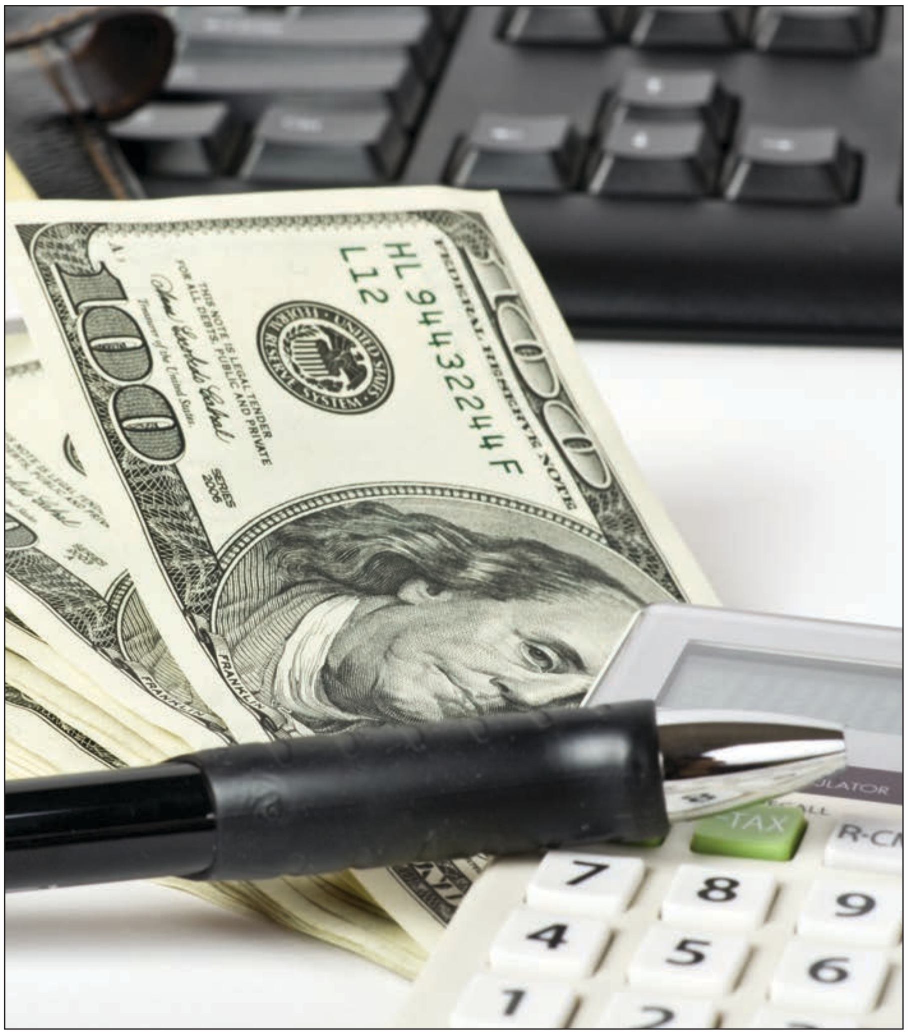
Nonetheless, Americans appear reluctant to use this tool, which could explain why about one in three adults (34%) indicate their household carries credit card debt from month to month. Fifteen percent, or more than 35 million people, admit to rolling over $2,500 or more monthly.

When asked which areas of personal finance are most worrisome, the top concerns are evenly divided between insufficient "rainy day" savings for an emergency (16%) and retiring without having enough money set aside (16%).

However, the proportion of adults who are spending less when compared to the previous year continues to decline. It peaked in 2009 at 57%, when the stock market bottomed. In the 2014 survey, that measure dropped to a low of 29%. The implication: While Americans are uncomfortable with their lack of savings, many are continually ratcheting up their year-over-year spending.

Farmers are no exception. From 2009 to 2013, farm household and personal spending advanced 23%. That's according to data compiled by the Center for Farm Financial Management at the University of Minnesota on the subset of farms that keep detailed family living records.

Otte is the farm management editor for Farm Futures *magazine. See* www.FarmFutures.com.



Get credit reports and scores

MOST adults (60%) have not reviewed their credit score within the past 12 months. Even more (65%) have not reviewed their credit report. "Close to one in four adults who did not order their credit report in the past 12 months (23%) indicated that they already knew their credit score(s), so they didn't think they needed their credit report(s)," observes Susan Keating with the National Foundation for Credit Counseling.

Although related, credit reports and credit scores are two different expressions of a person's credit. Since each plays a critical role in a person's financial future, both merit regular review. A further reflection of the confusion around credit reports and scores is that more than half of U.S. adults (54%) mistakenly believe that a standard credit report typically contains a person's credit score(s).