Jessica Groskopf
Agricultural Economist and Extension Educator
Department of Agricultural Economics, University of Nebraska-Lincoln

For many farm and ranch families, bringing children or grandchildren into the operation is the ultimate goal. Successfully bringing additional family members into the operation may require some creativity as all parties need to maintain a viable standard of living. This is part of a series of articles that highlight ideas and tactics for bringing another family member into the operation. If this is the first article you are seeing in this series, I would encourage you to go back to the previous articles for background and additional guidance.

In a previous article, we discussed gifting as a tactic to transfer wealth between generations. Simply gifting assets helps reduce estate value and potential taxes for the owners and increase the wealth of the heirs. However, some families are hesitant to engage in gifting strategies because the farm or the ranch needs access to those assets to remain viable. This article expands on gifting strategies by combining gifts with a lease agreement.

Remember, the person gifting assets is called the donor, usually a parent, and the person receiving the gift is the donee, usually a child.

In the scenario below, the donor will be gifting farmland to the donee. If it is a true gift, the donee could do anything with the farmland they want. If the donee wants to, they could lease the farmland back to the donor at fair market value.

This scenario greatly benefits the donor. First, the donor would continue to farm the land, allowing them to maintain their standard of living. Second, the asset would be removed from their estate, and if completed outside of the applicable lookback periods, could reduce the assets counted toward long-term care and/or estate tax. Depending on the nature of the asset, removal of the asset may also decrease the donor’s property taxes. Finally, like with other leases, the donor would be able to deduct the rent as a business expense, potentially lowering their income tax liability. However, the donor also has the risk of the lease being terminated.

The donee benefits by receiving the asset as a gift, and the income from the lease. Additionally, they may also be able to depreciate the asset if it is depreciable and there is value to depreciate. If the terms of the lease are not followed, the donee has the flexibility to terminate the lease.

Land is not the only asset that could be used in this scenario. Any physical asset used on your farm or ranch could be employed in a gift leaseback. However, land, machinery, and equipment are the most logical as they are often leased by farm and ranch operation.

The IRS is very critical of these types of transactions. Work with your financial team to make sure it is handled correctly. There needs to be a written lease agreement in a gift leaseback scenario, and the agreement needs to be followed.

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