CENTER FOR AGRICULTURAL PROFITABILITY
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Ideas For Estate and Transition Planning: Gifting

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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 article is part of a series that will 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 article for background and additional guidance.

The second tactic to transfer wealth between generations is gifting. The U.S. tax code has two main laws that apply to gifting: the annual gift tax exclusion and the gift and estate tax basic exclusion amount." In this article, the person gifting assets is going to be called the donor, and the person receiving the gift is going to be called the donee.

Each year the IRS releases the annual gift tax exclusion amount. The annual gift tax exclusion is the amount of assets that can be gifted from the donor to a donee, without reporting the gift to the IRS. The annual gift tax exclusion applies to anyone, the parties <u>do not</u> have to be related. In 2024, a donor can gift $18,000 to a donee. The limit is per donee. In other words, the donor can gift up to $18,000 per year to as many donees as they want.

The second law is the lifetime gift and estate tax basic exemption amount. Any gift over the annual gift tax exemption — $18,000 — must be reported to the IRS and is then accumulated toward the donor's lifetime gift and estate tax basic exemption amount. In 2024, this limit is $13.61 million. This means that a donor could gift more than the annual exemption to a donee in a single year, without paying gift tax. Estate or gift tax applies when the cumulative lifetime gifts to all donees and taxable assets passed through the estate are above estate tax basic exclusion amount.

There are some exceptions to these gifting rules. First, spouses can gift each other an unlimited amount, as long as they are U.S. citizens. The second exception is that a donor can pay <u>qualified</u> medical or education expenses to an institution on a donee's behalf, without it counting toward these amounts.

If you are thinking of gifting as a strategy to provide a viable standard of living for a family member, consider the following points.

1. **What is a gift:** These gifts must be true gifts. According to the IRS, "You make a gift if you give property (including money), or the use of or income from property, without expecting to receive something of at least equal value in return. If you sell something at less than its full value or if you make an interest-free or reduced-interest loan, you may be making a gift."

2. **No Step up in Basis:** Many families debate gifting assets during life versus waiting to pass an asset until after death. A key consideration is the basis the donee will have in the asset. If the asset is passed as a gift while the donor is alive, the donee retains the donor's basis. This loss of the step

up in basis means that if the donee eventually sells that asset, they may pay more in capital gains tax.

3. **Gifting Assets Rather Than Cash:** Often we think of gifting cash. However, the gift tax applies to other assets including, but not limited to, equipment, livestock, land, or shares of an entity. Gifting assets rather than cash can be tricky. Work with your financial team to determine the asset basis and value.

4. **Losing Control:** When assets are gifted during life, there is the risk that they could be "lost" by the operation. For example, if a donee receives a piece of equipment using the annual gift tax exclusion, the donee could sell that asset without the consent of the donor. Additional agreements, such as a buy-sell agreements or lease agreements may be needed to mitigate some of this risk.

5. **Look Back Period:** Gifting is often discussed when the donor needs to reduce their estate tax liability or protect assets from long-term care. When using gifting for these purposes it must be done well in advance. Both of these situations have "look-back periods." For long-term care, the look back is five years. For estate taxes, it's 3 years.

Gifting assets during life is not the only way to compensate family members. When developing a strategy to bring the next generation back into the operation, consider the viable standard of living for both the owners and the heirs. Gifting too much while owners are alive can be problematic. Look for future articles outlining other strategies on the Center for Ag Profitability website at cap.unl.edu.

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