



## Donor-Centered Philanthropic Solutions for Retiring Farmers and Ranchers

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## Analysis of Proposed Gift

1. **Identity of the donor/who owns the asset?**
  - Retiring - sole proprietor farmer or rancher filing IRS Schedule F.
  - No on-farm heirs willing to take over the farm
2. **What is the asset is under consideration and the issues that asset entails?**
  - Farmland
  - Farm house
  - Grain
  - Machinery
  - Livestock
  - Oil & gas
3. **What gift technique is being considered and if there are any restrictions?**
  - Outright gift, charitable gift annuity, etc.
4. **What type of charity will be the recipient and what issues does that create?**
  - Public charity status

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## Farm or Ranch Land - Possible Options

- Assume a retiring farmer wanting to rid him/herself of the farm and its operations:
1. Neighboring farmer could purchase
  2. Gift or sale to "on-farm" heir
  3. Philanthropic options....

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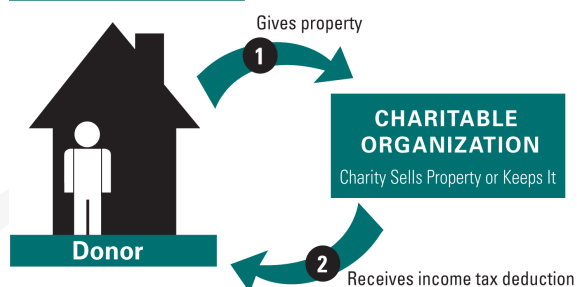
## Farm or Ranch Land - Possible Philanthropic Options

1. Outright gift
2. Bargain sale
3. Charitable remainder trust
4. Charitable gift annuity



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## Gift of Real Estate



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## Farmland - Outright Gift

1. Farmer gets out from under management headaches
2. Not becoming bogged down in complicated trusts or contract agreement as with other gifts
3. But loses control, ownership and income

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## Farmland - Outright Gift

- For long term capital gain property (held for more than 1 year), the donor's deduction = fair market value (not the cost basis)
- No loans/mortgage is preferable
- Avoids (maximum) 20% long-term capital gains tax on growth

## Gifts of Farmland - Example

- Fair market value of 400 acres at \$10,000 per acre = \$4,000,000
- Cost basis is \$4,000 per acre = \$1,600,000 in '95
- Gift to charity: deduct \$4,000,000 up to 30% of donor's AGI; plus 5 year carryforward
- Avoid 20% (max) long-term capital gains tax on the \$2,400,000 growth

## Farmland – Bargain Sale

- A sale to a charity below the land's fair market value
- Difference between sale price and fair market value = charitable deduction
- Good when farmer has immediate large cash needs and wants to hand over management of farm and has use for some level of income tax deduction

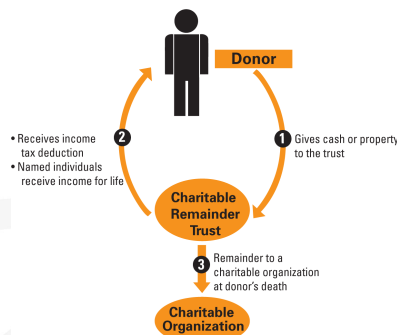
## Farmland – Bargain Sale Example

- Farmer Fred age 72; farmland FMV = \$4,000,000; CB = \$1,600,000
- Farmer sells land now to charity for an agreed upon price of \$2,500,000
- Charitable income tax deduction of **\$1,500,000** up to 30% of AGI with a 5 year carryforward
- **AND** farmer has long-term capital gains tax of **\$300,000** (assuming a 20% rate) for the amount of gain on the "sale" portion of the gift

## Farmland - CRT

- CRUT provides lifetime (variable) income to farmer and spouse
- Farmer gives land to Trustee of CRT
- Farmer eligible for partial income tax deduction = present value of remainder interest
- Trustee sells land and uses proceeds to invest and provide lifetime income to farmer and spouse
- After their lifetimes, remainder is paid to charities that donor selected

### Charitable Remainder Trust



## Farmland - CRT

- Donor can retain the right to change charities during his/her lifetime
- Income must be at least 5% annually
- FLIPCRUT is preferred type of CRT for hard to sell assets
- Avoid using a CRAT for hard to sell assets

## Farmland - CRT Example

- Farmer Fred age 72
- Farmland FMV \$4,00,000; CB \$1,600,000
- 5% FLIP CRT pays January 1 following year farmland sells inside the CRT
- Charitable income tax deduction of \$2,215,920 up to 30% of AGI with a 5 year carryforward – assuming a 2.2% IRC Section 7520 rate

## Avoid

Property with an existing agreement to sell already in place

See line of cases: *Palmer and Blake* cases or article on Planned Giving Design Center ([www.pgdc.com](http://www.pgdc.com)), "How Far is Too Far?" By [Emanuel J. Kallina, II, Esq.](#) and [Philip Temple, Esq.](#)

## Farmland - Charitable Gift Annuity

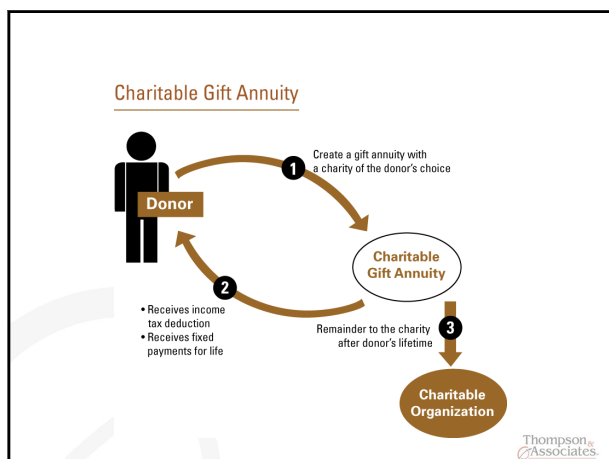
- Charitable gift annuity is a direct gift to one particular charity in exchange for FIXED lifetime payments typically to the donor (and 1 other person if desired)
- Farmer gives land to charity
- Farmer eligible for partial income tax deduction = present value of the remainder interest

## Farmland - Charitable Gift Annuity

- Charity provides lifetime payments to farmer (and possibly spouse) based on their ages at time of initial gift
- After their lifetimes, remaining amount is useable by that particular charity for their mission

## Farmland - Charitable Gift Annuity

- Risks increase to the charity by accepting hard to sell assets in exchange for a CGA
- Price
- Timing
- Ways to minimize the risk to the nonprofit



**ACGA Maximum Suggested Charitable Gift Annuity Rates**  
Effective January 1, 2012

AGE*	RATE
60	4.4%
65	4.7%
70	5.1%
75	5.8%
80	6.8%
85	7.8%
90 or older	9.0%

\*Age nearest birthday

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## Farmland - CGA Example

- Farmer Fred age 72; farmland FMV \$4,000,000; farmland CB \$1,600,000
- Fred gives ½ of the farmland (\$2 M) in exchange for a CGA and he sells the other ½ (\$2M) to a neighboring farmer

## Farmland - CGA Example

- CGA rate is 5.4
- Charitable income tax deduction of **\$830,187** up to 30% of AGI with a 5 year carryforward
- Helps when he had \$1,200,000 of long term capital gain on the ½ he sold to the neighbor

## Farmland - CGA Example

- Charitable gift annuity pays \$108,000 every year for as long as he is alive
- |                              |                  |
|------------------------------|------------------|
| •Tax free portion of payment | \$ 32,270        |
| •Long-term capital gain      | \$ 48,406        |
| •Ordinary income portion     | <u>\$ 27,324</u> |
| •Total payment               | \$108,000        |

## Farmland - CGA Example

- Now for the rest of the story.....one year later

## The Charity's Perspective

1. Importance of nonprofit's gift-acceptance policy
2. Real estate is full of due diligence by the nonprofit
3. Board approval is important
4. Nonprofit will analyze the costs of selling
5. Is the property marketable? What could it sell for?
6. Is there a mortgage?
7. Is it land the charity wants to keep and use? Does the donor want to restrict the charity's use?
8. Is there an up-to-date appraisal?
9. Carrying costs to the nonprofit (short and long-term)
  - Insurance, maintenance and property management

## Farm House

If Farmer Fred does NOT want to live in the farm house any more.....

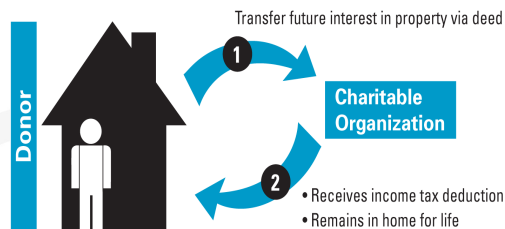
He could sell it on the real estate market, or give it outright, or do a bargain sale with the nonprofit.....or.....



## Farm House - Possible Philanthropic Options

If he wants to remain living in the farm house.....consider a retained life estate

### Retained Life Estate



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## Retained Life Estate

- Allows farmer to make a gift today; yet retain possession and use of house for life
- After farmer's lifetime, the charity has possession
- Farmer receives a partial income tax deduction in year of original gift = present value of remainder interest

## Retained Life Estate

Farmer can keep any income the farmhouse might generate – although unlikely

Farmer gives home to charity via a deed but retains life estate; farmer continues to pay:

- maintenance,
  - insurance and
  - taxes
- throughout his/her lifetime (need separate written agreement)

## Retained Life Estate Example

- Farmer Fred age 72; house FMV \$150,000
- Fred gives deed to home now and retains a life estate
- Charitable income tax deduction of more than \$98,000 up to 30% of AGI with a 5 year carryforward

## Charitable Gifts of Grain



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## Grain - Possible Philanthropic Options

Harvested crops

1. Outright gift
2. Charitable remainder trust
3. Charitable gift annuity

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## The Tax Rules

Crops produced for sale in a farming operation are considered "ordinary income property." The charitable deduction for a gift of ordinary income property to charity is limited to the lesser of:

- 1) fair market value, or
- 2) cost basis.

See 1.170A-1(c)(4) Example 5

## The Tax Rules

In addition, the deduction is subject to the 50% deduction limitation regardless of whether or not the crops are for a related or an unrelated use by the charity.

## Outright Gifts of Grain

By giving grain to a charity, the farmer avoids including the sale of the grain in income.

Note, the charitable deduction is nearly \$0 for the grain – the benefit is the avoidance of declaring it as income.

And, the farmer deducts the cost of growing the crops which results in saving self-employment tax, federal income tax and state income tax.

## Example of Gift of Grain

Tax Year **without** charitable gift of grain:

\$350,000	Other income from farming
<u>+\$100,000</u>	<u>Income from grain sale</u>
= \$450,000	Total income

*Farmer pays employment, federal income and state income taxes based on AGI of \$450,000 (less exemptions, deductions, etc.)*

## Example of Gift of Grain

Tax Year **with** charitable gift of grain:

\$350,000	Other income from farming
<u>+ 0</u>	<u>No additional income from grain gift</u>
= \$350,000	Total income

*Farmer pays employment, federal income and state income taxes based on AGI of \$350,000 (less exemptions, deductions, etc.)*

## The Process to Complete the Gift

1. Let the charity know of the gift.
2. The charity will set up an account at the elevator.
3. Donor will deliver the grain to the elevator or co-op.
4. The donor will have the elevator transfer the grain to the charity via step #5.



## The Process to Complete the Gift

5. Have the elevator send a warehouse storage receipt to the charity – the receipt must show the charity as the owner of the grain.
6. The charity will give the donor a donation receipt for the gift – but it is basically nondeductible.
7. The charity will sell the grain and receive the sale proceeds.

## Tips to Consider

- After the gift, the charity is responsible for storing and or transporting the grain, and for the risk of loss.
- The farmer cannot control where/when the charity sells the grain.

## Tips to Consider

- **THIS IS CRITICAL:** If the donor delivers the grain, then sells it and orders the **proceeds** from the sale of the grain be sent to the charity, the donor **won't** have the same tax benefits.
- Also, avoid making a gift of the “warehouse receipt” in the farmer’s name. It needs to be a gift of the grain, not the receipt.

### Questions and Answers

- Q: Can a crop sharing arrangement benefit from a gift of grain?
- A: No, shares of crop are rental income and must be reported as income.
- Q: Can a farmer store the grain on the farm and not deliver it to an elevator?
- A: Yes, prepare a notarized letter of transfer to the charity in place of the warehouse receipt.

### Questions and Answers

- Q: Can farm corporations benefit in the same way as the sole proprietor?
- A: The benefits described in the grain section of this presentation are for calendar year-cash basis sole proprietorships.

### Questions and Answers

- Q: Will the gifted grain count as income in government payments limitation caps?
- A: No, the gift of grain won't count as income in the farmer's government payments limitation caps calculation.

### The Tax Rules

Side note: If **harvested** crops are given to charity by a **non-farmer**, the grain is considered "tangible personal property" and subject to the related use rules.

### Grain - Example

- Martha was 81 years old; widow
- Owned a farm
- Her two adult children weren't interested in farming
- Planned to retire and close out the farm by leasing the farm land to another farmer

### Grain - Example

- Martha had 3 philanthropic options:
  - FLIP CRUT
  - CGA
  - Outright gift



## Grain - Example

•Martha chose a deferred payment CGA with payments beginning in one year:

- CGA rate 7.4% for her life
- More than \$200,000 in soybeans
- Little to no charitable income tax deduction however

•Donor story courtesy of Geo Sharkey, The Nature Conservancy. See PGToday Dec. 2014

## Charitable Gifts of Farm Machinery



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## Machinery – possible philanthropic options

1. Outright gift – Likely no income tax deduction
2. FLIP Charitable remainder trust – likely no current income tax deduction; yet can provide retirement income; avoid CRAT
3. Charitable gift annuity – likely no current income tax deduction; yet can provide retirement income

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## Machinery – possible philanthropic options

Machinery is often fully depreciated by the time of retirement

Benefit of a life income gift is truly the ability to obtain lifetime payments even though the deduction will be small or nothing at all

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## Machinery – Example

Farmer Fred has a \$400,000 combine – he has already fully depreciated it on his taxes

Neighboring farmer isn't interested in buying Fred's combine; he has his own

Fred uses a FLIP CRUT for the combine

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## Machinery – Example

5% payout beginning January 1 of the year following the year the trustee sells the combine

No charitable income tax deduction available to Fred

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## Machinery & Grain – Example

Farmer and wife (age 67 and 66) retiring from farming in the Midwest in 2010

No children who would take over farming operations

- 80,000 bushels of corn – FMV \$432,000
- 25,000 bushels of soy “beans” – FMV \$293,750
- Farm machinery – FMV \$467,700

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## Machinery and Grain – Example

•Previously depreciated the crops and the machinery

•He learned if he sells the crops and machinery he would have depreciation recapture

•They instead used two charitable remainder trusts

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## Machinery and Grain – Example

One trust for the grain in 2010 and a separate trust for the machinery in 2011 and transfer assets via an assignment gift document.

Farmer contributed extra cash to each trust to cover carrying costs including insurance, transport and related expenses.

Both trusts were 6% FLIP CRUTs with triggering dates of 12/31 each respective year.

•Donor story courtesy of Sheryl Morison, Gray Plant Mooty Law Firm

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## Charitable Gifts of Livestock



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## Livestock

- Livestock: cattle, hogs, horses, sheep, goats
- Does not include poultry, chickens, turkeys, fish
- IRC Section 1231 defines livestock

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## Livestock



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## Livestock

Considered inventory for a farmer/rancher and an ordinary income asset; deductible at cost basis up to 50% of AGI

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## Livestock - Possible Philanthropic Options

1. Outright gift
2. Charitable remainder trust – deduction may be delayed until livestock is sold inside the trust

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### Questions?

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