



## GIFTS OF GRAIN and LAND RENT PAID TO YOUR SPOUSE

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Questions dealing with the compensation of a spouse for their landlord interest in farmland is an issue that frequently comes across my desk. The tax effect of this compensation is to reduce the amount of income subject to self-employment tax by shifting the income from the spouse actively involved in the business of farming to their spouse. In audits, the IRS is and will continue to closely scrutinize transactions among family members that result in a reduction of taxes within a family unit. Tax court cases and recent letter rulings on these strategies have been mixed - each case must be judged on it's own merits. Substance and form are critical, but substance seems to always out-weigh form. The IRS will attempt to analyze the substance of a transaction among family members to determine if the transaction is a mere mechanism for tax avoidance that lacks any economic substance or independent significance.

With regard to gifting of grain - there are three factors which will be scrutinized by the IRS. First, does the gift spring from "detached and disinterested generosity" and from which the donor expects no economic benefit. Second, does the donor completely divest themselves of all title, dominion, and control over the gifted property. And third, does the transaction have an economic substance or independent significance aside, from tax avoidance. The failure to transfer absolute control and/or depositing the sale proceeds in a joint account have resulted in adverse rulings for taxpayers.

Regarding rents, the mere fact of spousal ownership of realty does not guarantee a farm deduction for rental payments to the spouse. Relying of several court cases, the IRS indicates a deduction for rent paid by one spouse to the other spouse - is allowable only if the arrangement between the spouses is a bona fide landlord-tenant relationship and that the substance of the transaction instead of form governs. Factors which the IRS will evaluate are:

1. Do the taxpayers consistently treat the landlord/spouse's interest in the farm as separate rental property?
2. Are the expenditures for mortgage interest, property taxes, and insurance prorated between each spouse and reported separately on the Sch E and Sch F?
3. And are the rental funds managed and controlled by the landlord/spouse in a separate account?