

Taxation Tidbit

Private Annuities – The End is in Sight

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Over the years, you have probably heard me refer to private annuities. An annuity is a promise to pay a specific amount of money over a specified period of time. For example, a private annuity could be used to transfer the farm to the succeeding heirs in exchange for their promise to pay a specified amount of money over a stated period of time (frequently for the life of the parents).

If the parents die earlier than expected, the obligor/heirs receive the farm for only a fraction of its value. If the parents live longer than expected, the cost of the farm to the heirs becomes greater, but the parents have a source of lifetime income.

A primary advantage of a private annuity agreement between the generations is that the transfer of the property may substantially reduce future estate taxes, and income taxes may also be reduced. A potential disadvantage of private or “family” annuities is that the lifetime income of the annuitants (i.e. the parents) is essentially unsecured.

Admittedly, private annuities will not fit well into the business succession plan for many people. However, where it does fit – it can be very beneficial.

The reason for discussing private annuities at this time is the IRS is about to shut the door on one of the primary benefits of private annuities – spreading the recognition of gain over the length of the annuity contract. The current tax treatment of spreading the recognition of gain over time will remain intact for annuities entered into prior to April 17, 2007.

So if you have been contemplating the use of a private annuity – get with your estate and business planning team ASAP. Unless there is a change in the proposed regulations (and I hold very little hope for that to happen) – very few private annuities will be utilized in farm business succession planning after April 17, 2007.