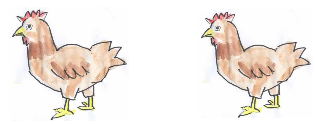
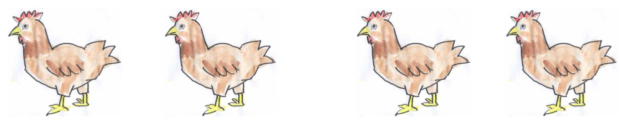
Chicken Tax Law - Will I Pay Tax on my Chickens?

It's a good and serious question. Here goes.

Say you purchased two chickens for $100 each.



So your chicken portfolio is worth $200. Now let's say these chickens hooked up with a rooster and a short time later you got two more chickens at no cost to you. So now you have four chickens,



... each worth $100 each, so your total chicken portfolio is now worth $400.

You decide to sell all your chickens – you just got so damned fed up with them pooping on the deck. So you got $400 from the buyer for your four chickens.

How much of this $400 is taxable? Well, your cost basis in the chickens is $200 ($100 x 2 chickens = $200). But you sold your chickens (four of them) for $400, so that means you had realized a $200 gain on the chickens. So you have to pay a tax on the gain. Let's say the chicken tax is 25% so 25% of the $200 gain is $50. So then you have $350 after taxes.

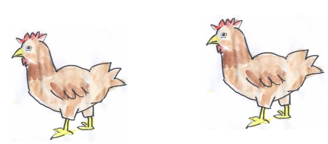
Let's say, however, that you didn't sell the chickens, continued to clean up their poop on your deck, but because of the stress you died and your son-in-law inherited the chickens (you wouldn't want to put this pain-in-the ass chicken clean-up thing on your lovely wife).

So your son-in-law inherits the chickens, all four of them worth $400. Does he pay any tax?

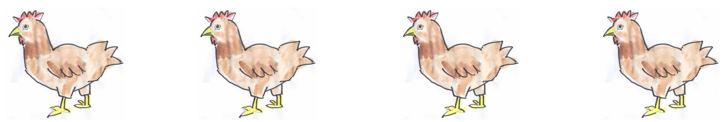
No. Because the chicken tax law states that no matter what someone else paid for chickens, if you inherit them your cost basis is what they were worth when you inherited them. This is called stepped-up-cost-basis: your cost basis is stepped up to their value when you inherited them.

So while the original cost basis was $200 for four chickens worth $400, your son-in-law's cost basis is $400. So if he sold them immediately (knowing full well what a pain in the ass poop on the deck can be) he would not have any taxable gain and get the whole $400 tax free.

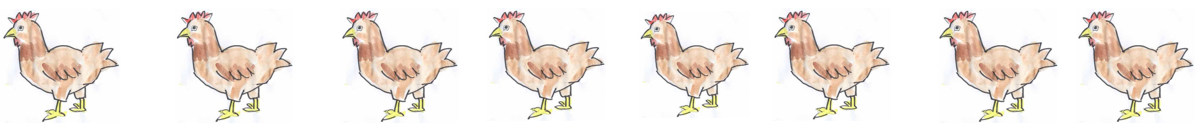
But what if your estate planner suggested you buy the chickens in an irrevocable trust (so that these chickens would not be included in your taxable estate). So let's say you did purchase the chickens in the irrevocable trust, let's say it's a B-Trust. This is a trust that once created cannot be changed (that's why they call it "irrevocable," duh). Let's say you purchased the original two chickens for $100 each in the trust, so the trust owns $200 worth of chickens.



But, as stated above, these chickens had two more chickens so now the trust owns four chickens at $100 each for a total trust value of $400.



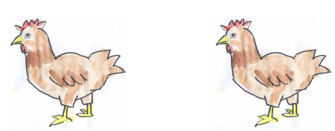
Let's say you live long enough that these four chickens have four more chickens. Now you have eight chickens worth $100 each for a grand total of $800 worth of chickens in the trust.



You die and your son-in-law, again, is the beneficiary of this trust so he inherits the eight chickens worth $800 total. What is his cost basis?

Well, the chicken tax law of irrevocable trusts says that if chickens are owned by an irrevocable trust the cost basis of the chickens remains what the trust paid for them, in this case, $200. So if your son-in-law decides to sell the eight chickens for $800 he'll have $600 of gain. Again, if the capital gains tax on chickens is 25% then his tax would be $150, (25% of $600 gain = $150). So your son-in-law gets to keep $650 from the sale of his chickens.

But what if your son-in-law is introduced to a stellar financial advisor who asks him if he ever made charitable contributions to any organization he supported? And suppose he said, "Yes, to a couple environmental groups." So this stellar financial advisor suggests that instead of sending a check for, say $200 to the environmental groups, he simply donate two chickens worth $200. He would still get the same $200 tax deduction for his donation and the environmental groups still get their $200 and could sell the chickens tax free because of their charitable status. So nobody pays tax.



The stellar financial advisor then suggests he could take the $200 he would have given to the charities and go purchase two new chickens which would have a new cost basis for him of $200, the price he paid for them.

This all sounded very interesting to the son-in-law except for one thing: he preferred ducks.

Now the price of ducks ….