Family Farm Succession & Estate Planning – The Basics

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Well, I guess it's time to start thinking about my farm succession and estate plan?

Agenda – Basic Estate Planning Tools for the Family Farm

- Legal Overview – Planning During Lifetime & How Assets Pass at Death
- Trusts – Types and When to Use Them
- Current Estate and Gift Tax Laws
- Specific Strategies
- Common Mistakes

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How Do I Begin?

- Let's get started before you board the plane!
- No "one size fits all" solution:
  - Fair does not necessarily mean equal.
  - What level of control following death? Pros/Cons.
- Start with a checklist – Inventory Outline.
- Accurate Personal Financial Statement is home base:
  - Fair market value, not cost basis or book value after depreciation
  - How are things titled – individual, joint, POD/TOD
  - Face value of life insurance, not cash value
  - Current beneficiaries of retirement accounts, annuities, life insurance
- Re-evaluate as needed.

What If the Plane Goes Down Tomorrow?

- …and you didn't die?
  - Court Appointed Guardian
  - Premortem Documents

- …and you did die?
  - Intestacy
  - Post-Mortem Documents
    - Funeral Planning Declarations
    - Last Will and Testament
    - Memorandums of Tangible Personal Property
    - Trusts

Court Appointed Guardian

- Expensive to establish and maintain!
- If you become incapacitated and no documents are in place…
  - Someone may have to go to court to become appointed as Guardian of your Estate in order to handle your finances.
    - Inventory within 90 days
    - Court's "okay"
    - Family may disagree on Guardian
  - Disagreements in medical care = court appointed Guardian of your Person.

Premortem Documents

- General Durable Power of Attorney
  - Can have one for farm & one for personal matters
  - Effective Immediately or Upon Incapacity
- Advance Directive
- Living Will (or Life Prolonging Procedures Declaration)

Funeral Planning Declaration

Indiana law allows you to document your preferences about the dispositions of your body, funeral arrangements, and who is going to carryout these decisions.

- Buried? Cremated? Entombed?
- Who is going to meet with the funeral home?
- Favorite flowers or want to work corn leaves into arrangements? Favorite antique tractor nearby?

Ways to Pass Assets at Death

- Intestacy- the do nothing plan/state's estate plan
- By operation of law – JTWROS
- By contract – beneficiary designations, POD, TOD
- Last Will and Testament – Probate
- Outright to beneficiary
- In trust for benefit of a beneficiary for period of years
- In trust for the beneficiary's lifetime

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- ✓ Your Will does <u>not</u> govern these assets:
  - Assets Titled as Joint Tenants with Rights of Survivorship
  - Life Insurance or annuity proceeds – paid to named beneficiary
  - IRAs or Retirement Accounts – paid to named beneficiary
  - Transfer on Death (“TOD”) Payable on Death (“POD”)
- ✓ Important to fit all the puzzle pieces together!

Digital Assets

- Apple – Legacy Contact
  - Designate
  - Keep the Access Key with estate planning documents.
- Google—Inactive Account Manager: named individual receives an email upon inactivity date (3-18mo) with instructions.
- Instagram
- Facebook
- Keep updated passwords and access keys with estate planning documents.

What If I Die Without a Will?

- Your wishes may not be carried out!
- Property that would pass by a Will ("probate property"), will instead pass by state statutes – the "State's Estate Plan:"
  - Half to surviving spouse and half to children (I.C. § 29-1-2-1(b)(1)).
  - If no children, but married, ¾ to spouse and ¼ to decedent's parents (I.C. § 29-1-2-1(b)(2)).
  - Even more complicated if surviving spouse is not first spouse and no children together (I.C. § 29-1-2-1(c)).
- Minor children inherit at age 18.
- No preference expressed as to Personal Representative.
- Most cases the "State's Estate Plan" is not the right fit for the family farm.

What Does My Will Say?

- Who's in charge? – Personal Representative (Executor)
- How are taxes allocated? Pro-Rata? Residuary?
- Nominate Guardian for minor children.
- Specifics about Tangible Personal Property ("the stuff").
- How to divide assets – perhaps including funding of trusts.

What is Probate?

- Formal process in court where an individual is given authority to transfer a decedent's assets, either pursuant to terms of a Will, or intestacy.
- Records are public.
- May wish to avoid probate to save time, expenses, and keep assets and distribution private.

What Else About Probate?

- Many techniques can be used to avoid probate.
  - Revocable Trust
  - JTWROS
  - TOD/POD – “Mini Wills” Use with Caution.

- If probate becomes necessary, shop around for a lawyer who doesn’t charge a fixed fee.

- Small Estate Affidavits (I.C. 29-1-8-1)
  - Under $100,000.
  - Wait 45 Days.

Wills Versus Revocable Living Trusts

- **Revocable Living Trust are used to:**
  - reduce costs and time delays by avoiding probate.
  - ensure property continues to be properly managed with successor trustee provisions.
  - To lessen potential challenges to or elections against the will.
  - To maintain privacy.
  - To avoid ancillary administration of out-of-state assets.
- **Disadvantages of Revocable Living Trusts:**
  - Does not remove assets from your gross estate (only gifting does).
  - Does not shelter assets from your creditors.
  - Costs to setup.

Trusts

- ✓ If you don't want a beneficiary to inherit his/her share of your assets immediately, then such share can be held "in trust."

- ✓ Trust terms can be in a Will ("Testamentary Trust") or a separate document ("Revocable Trust").
  - Does not eliminate the need for a Will.
  - Can be used to transfer property at death.
  - May avoid probate administration in one or more states.

Trusts for Spouse After the First Death?

- ✓ Those in a second (or third…) marriage with children from a first marriage can use a marital trust to preserve assets for children while providing lifetime support to surviving spouse.
- ✓ Provides protection ~~if~~ when spouse remarries.
- ✓ Unlimited marital deduction for gift and estate tax is powerful.
- ✓ Strike the proper balance between spouse & children.

Trusts—When Else?

- ✓ If you have young children you need a trust.
- ✓ Trusts help grown children with dependency problems, trouble handing money, bad marriages, or if you just don't want children to receive inheritance in a large lump sum.
- ✓ Can help children from becoming "too rich."
- ✓ Trusts are helpful for blended families.
- ✓ Beneficiaries receive distributions of the trust's income and perhaps principal on terms you set.
- ✓ Provides control of ultimate ownership where one child doesn't have children.

Trust Benefits

- ✓ Doesn't have to be all or nothing.
- ✓ You control how and when beneficiary's inherit trust property.
- ✓ Provide asset protection – beneficiary's creditors cannot reach assets you leave in certain trusts.
- ✓ You control who ultimately inherits the property, and can exclude spouses and step-children if you wish.

Divorce Protection for Next Generation

- ✓ Trusts and Entity documents can only provide so much divorce protection, depending on a lot of factors, including how much control the beneficiary has.
- ✓ Buy-Sell provisions are nice, but other owners may have to buy back interests to keep an ex out
- ✓ Ultimate discretion is given to the judge in the divorce proceeding.
- ✓ Spouses have right to elect assets at death, which can be waived in a Prenup.
- ✓ Best protection is a Premarital Agreement.

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Current Estate/Gift Tax Law

- “Permanent” for now...

- Upon death, up to $15M(as of 1/1/2026) will pass exempt from Federal Estate Tax. A married couple can pass $30M.

- During lifetime, you may give away up to $15M of your assets ($30M for married couples) exempt from Federal Gift Tax, which would reduce the amount of your exemption remaining at death.

- For estates or gifts in excess of this exemption, the maximum tax rate is 40%.

Current Estate/Gift Tax Law, Continued

- Portability Election of unused exemption to surviving spouse is <u>not</u> automatic. Can be a $15M mistake if not timely elected!
- Precautionary Portability- weigh the costs and benefits carefully!
- Annual gift tax exclusion is $19,000 - to as many individuals as donor wishes, without reducing door's $15M estate tax exemption or triggering Gift Tax.
- State inheritance or estate taxes deserve special attention: Connecticut, District of Columbia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oregon, Rhode Island, Vermont, Washington, Iowa, Kentucky, Nebraska, and Pennsylvania.

  Indiana repealed 1/1/2013

Planning for the Family Farm:

- "Fair" does **<u>not</u>** necessarily mean "equal" ownership among kids.

- Equal tenants in common ownership may set the stage for a family feud .

  – Partition actions can allow <u>one</u> tenant in common to trigger a court ordered auction, no matter how <u>small</u> an interest he owns.

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The Do Nothing Plan

- No, if you ignore this, it won't go away.
- "I love you" Will: All to spouse… then he remarries, then what!?
- The kids will just work it out….um, no.

The Say Nothing Plan

- Planning in secrecy is a bad idea. Entitlement may be brewing at the next generation.
- Take a poll – not a vote -It's not a democracy.
- Once you decide what's fair – tell everyone – no surprises!
- "No Contest" clauses are not binding in half our states. Other techniques can build a wall to easily defend any lawsuit:
  - Plan early, while you're healthy.
  - NEW as of 7/1/2023! Indiana Premortem Validation Process – Trusts (IC § 30-4-6-14) and Wills (IC § 29-1-7-16.5). BUT not for everyone!
  - Waive attorney/client confidentiality regarding intent to leave one child less or no inheritance.
  - Include fee shifting provision that all fees to defend an heir's lawsuit are charged against that child's share (back door no contest clause).

Threshold Issue

Is Co-Ownership at Next Generation Best?

- Should your children be in business together?
- Do you have a child in mind as a management successor?
- Can they get along well enough to split the cash rent?
- Could they get along if a professional farm manager was involved?

If not – pursue a different plan

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Ideas & Strategies – Divide it up

- ✓ Through Estate Plan – direct ownership of different tracts of land to different children. 100% NOT TIC.
- ✓ If land is owned by an Limited Liability Entity ("LLE") - dissolve entity at death with instructions to distribute different farms to different children.
- ✓ Give successor right to purchase land from LLE and define terms (appraisal to set price, % down with delivery of low-interest Note).
- ✓ All land (or ownership in land-holding LLE) to farming child and identify different assets for other beneficiaries.

Ideas & Strategies – Divide it up

- ✓ Are there sufficient assets to pull this off?
  - Summer lake house
  - Winter beach condo
  - Residence (if not located on the farm headquarters)
  - Securities accounts
  - Life insurance
- ✓ Separate tillable farmland from operations (grain bins, shops, sheds).
  - Easier to pass at death
  - Survey and split off operations from bare land – now or at death
  - Who gets it?
- ✓ What happens to your home?

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Ideas & Strategies – Continued Trusts

- ✓ Keep the farm in trust for your children's lifetimes – They never truly own it but receive its income. Provides asset protection.
- ✓ You pick the trustee who'll have control, and you dictate continued management or sale of the farm in the trust agreement.
- ✓ Address cash rent if Trustee or a Beneficiary will be farming!
- ✓ Structured, but flexible.
- ✓ Prevent land from being included in children's gross estate for tax purposes (allocation of GST tax exemption is tricky).
- ✓ How many generations?

You control ultimate disposition

Strategies – First Right of Refusal

- ✓ During lifetime: Landowner can "sell" first right of refusal to a family member. It is important that consideration is given (ex: $100) to make the contract valid.
- ✓ Then the first right should be recorded in the chain of title.
- ✓ The farm cannot be sold without first being offered to the holder of the first right.

Strategies – Right to Purchase

- ✓ At death: You can leave the farm (or interests in LLE that owns the farm) equally to all children.
- ✓ Require the off-farm children to offer their interests for sale to the on-farm child, and giving the on-farm the option to purchase same.
- ✓ Certain kids don't ever have a right to own land, but get cash on defined terms. Are you OK with this?
- ✓ Simple strategy - avoids problems in future generations when ownership is fractionalized among cousins.

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Crafting First Rights

The document granting the first right can be any of the following:

- ✓ Last Will and Testament
- ✓ Trust Agreement
- ✓ Freestanding Contract (recorded if addressing real property)
- ✓ Articles of Organization or Operating Agreement if LLC
- ✓ Articles of Incorporation or By-laws if Corporation
- ✓ Partnership Agreement
- ✓ Separate “Buy-Sell” for any entity- careful of inconsistencies

First Rights – Details Details Details

The document granting the first right must clearly identify:

- ✓ The purchase price (cash, promissory note, payment terms)
- ✓ Match bona fide offer that's on the table?
- ✓ Appraisal – who selects? average?
- ✓ "Sweetheart deal" – ok but TELL ALL
- ✓ What liabilities will be considered?
  - ✓ *If C Corp. will Built In Gains Tax Liability be reflected?
- ✓ Will valuation discounts be applied?
- ✓ CPA should walk all owners through the formula showing the current value per share, and have everyone sign off agreeing
  - ✓ in annual minutes
  - ✓ Attach a sample as an exhibit to the Buy-Sell

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First Right- Non Related Successor

- ✓ Could give option to buy machinery, or "operating" assets to non related successor, for ex: long time employee, young farmer who won't be inheriting an operation.
- ✓ Kids become landlords, and hand picked successor gets a chance to buy operating assets, perhaps at a discounted price, on installment over time.
- ✓ Take steps to ensure successor to operations has access to farm land, and outline formula to set price.

Will the Kids Sell? What's your basis?

- ✓ Lifetime gifts remove appreciating assets from donor's estate resulting in estate tax savings.
- ✓ Lifetime gifts = "Carryover Basis" → Recipient receives your low basis in your land.
- ✓ Inherited assets = "Step up in Basis" → Recipient's basis is equal to fair market value on date of death.

Will the Kids Sell? What's your basis?

- ✓ Lifetime gifting may <u>not</u> be advisable if there may be a future sale.
- ✓ Careful analysis of Estate Tax vs. Capital Gains Tax is necessary before gifting.
- ✓ In light of new tax laws, higher exemptions, returning gifts previously received to original donor may be best (wait… what!?).

Common Mistake #1

"I'm doing nothing because I'm worth less than $15M," or the similar reasoning: "Because my wife and I are worth less than $30 M."

1. You may have a false sense of security that your total assets are worth less than $15M. What's your farm ground really worth today? What are your neighbors selling for? Death benefit of life insurance? Have you consolidated your balance sheet? Maybe you have a lurking tax problem.

2. Taxes may not be your biggest problem! Family farms are destroyed more often by feuding families than by taxes.

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Common Mistake #2

"I want to treat all my kids exactly the same."

NO

#1 lesson Fair does not mean equal!

Change your mindset!

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Common Mistake #3

- "I plan to title my property jointly with my children and their spouses so that it automatically passes to them at death."
  - Avoids probate administration.
  - Is it best to leave property outright to child? That puts your farm squarely in their estate in the event of divorce or other creditor problems.
  - Hey wait – you just made a taxable gift and need to report it on a gift tax return and the kids' basis in 50% of the whole is carryover basis = FMV on date of gift without the benefit of step up.

Common Mistake #4

- "I'm just going to copy what my neighbor did."
  - No cookie-cutter approach.
  - Lifetime gifting may be great for some, and rotten for others.
  - This is very fact-sensitive.
  - Every family has different goals – for some, transferring farm ground to business entity first may be best way to achieve those goals.

Dust it off every 5 years

- Plan for now, based on today's circumstances.
- Original plan should allow as much flexibility as possible.
- Review when there's a change in the laws.
- Big life event or change in circumstances—time to review!
- Keep your advisors up to date—no farmer stands still!
- Adjust if necessary.

INVOLVE YOUR CPA!

- Team approach is best!
- Entity selection includes consideration of:
  - Payroll taxes (15.3% FICA & Medicare)
  - Income taxes
  - Tax-Free Fringe Benefits
  - FSA Limits
- Funding Entity:
  - Provide Deeds
  - Update depreciation schedules
  - Let them know who is contributing
  - Updates to ownership! CPA has to be involved!

Questions?

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