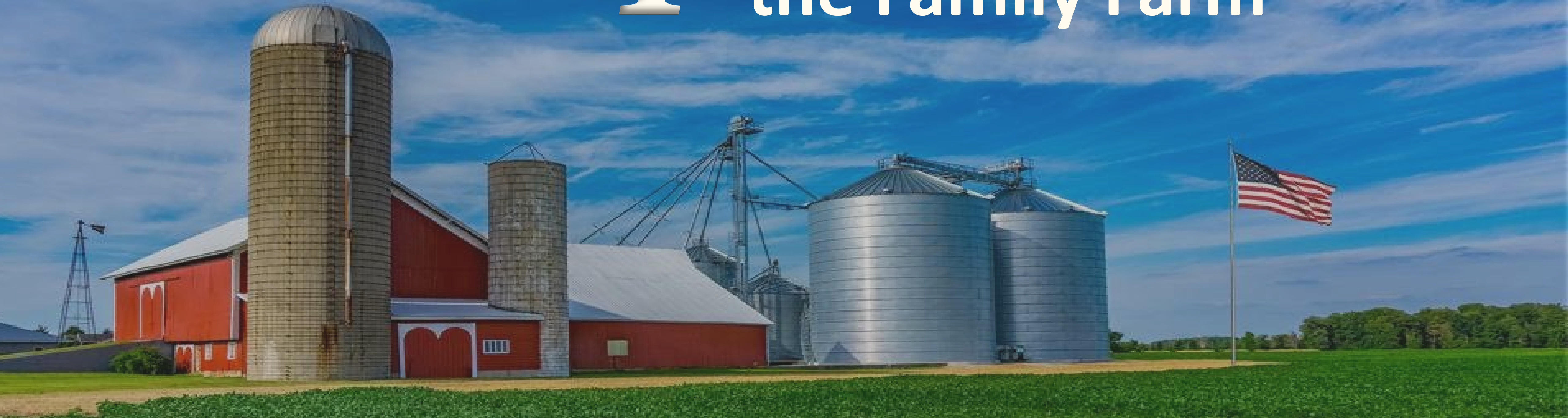
4 Ways to Lose the Family Farm



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July 20, 2023

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4 Ways to Lose the Family Farm:

1. Underestimate your federal estate tax liability
2. Ignore signs of family disharmony
3. Assume that you will never go to the nursing home
4. Ignore the possibility of liability creditors

4 Ways to Lose the Family Farm:

#1

- Underestimate your federal estate tax liability by not updating your estate tax planning balance sheet to reflect increased land prices

Death Tax Impact of 30% Increase in Land Value

- *The Value of your estate may be closer to this year's exemption of $12,920,000 than you thought ($25,840,000 for a couple)*

- *800A x $15,000/A or 1,000A x $12,000/A = $12,000,000 + machinery + growing crop + face value of life insurance + other assets*

- *Remember that a couple loses one of their exemptions at the death of the first spouse unless there is a federal estate tax return filed*

- *The exemption will drop to about half of whatever it has risen to on* ***1/1/26***
- (possibly $6,800,000 for an individual or $13,600,000 for a couple)

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Gift Tax Impact of 30% Increase in Land Value

- *The annual gift tax exclusion of $17,000 per person year won't go as far*
- *The percentage that you've used for your annual gifts of an LLC interest or the number shares of corporate stock may need to be adjusted*
- *The annual stock gift or LLC interest gift that was the equivalent of 2-3 acres after a 30% discount for minority interest and marketability now may only be the equivalent of 1-2 acres*
  - *$10,000/A x 70% = $7,000/A x 2.4 acres = $16,800 (below the limit)*
  - *$13,000/A x 70% = $9,100/A x 2.4 acres = $21,840 (above the limit)*

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Spousal Lifetime Access Trusts Can Use Higher Exemption While it Lasts

- One way to obtain the benefit of the higher estate/gift tax exemption available today is to make a completed gift now of an amount approaching today's available exemption
- But a completed gift to use the exemption will transfer income and control
- One method for a married couple to retain some income and control is through a spousal lifetime access trust

Spousal Lifetime Access Trusts Can Use Higher Exemption While it Lasts

- With Spousal Lifetime Access Trusts, each spouse creates an irrevocable trust that provides benefits to the other spouse

- If successful, the benefits of the separate trusts for each spouse may approximate the benefits that the spouses had from the trust assets before the creation and funding of the trusts

Spousal Lifetime Access Trust Issues

- They’re generally irrevocable
- They cannot be identical (or even close) because of the IRS’ reciprocal trust doctrine
- To avoid the reciprocal trust doctrine, the spouses’ income interests should be different, the trustees should be different, the beneficiaries and what they receive when the spouses are gone should be different, and they could be signed at different times
- Some say it would be best if they were signed in different states under different trust rules
- Great care must be taken to make sure the value of the trust assets is not included in either spouse’s estate at death
- It’s best if the spouses are not trustees of the trusts

4 Ways to Lose the Family Farm:

#2

- Ignore signs of family disharmony
- Assume that all the kids will want land, and none will want cash
- Leave all of your land to all of your kids as equal tenants in common, which could result in the filing of a partition lawsuit

Partition Lawsuits

- A joint tenant or tenant-in-common of farmland may force the land to be partitioned (I.C. 32-17-4-1)
- Today partitioning the land does not mean dividing the land
- Prior to July 1, 2012, the partition statute contained a procedure for dividing the land
- Today a lawsuit demanding partition will result in the judge ordering mediation, but if that is not successful, the judge will order the land to be sold

Partition Lawsuits

- The land will be sold at auction unless the parties agree on another method of sale

- The auction will be conducted by the sheriff unless the parties agree on an auctioneer

Practical Effects of Partition

- The partition statute favors those who want to sell the land and get money
- Those who want to keep all, or part of the land, must somehow reach an agreement with those who want to sell, or the land will be sold
- Once a lawsuit demanding partition has been filed, those who want to keep the land must be prepared to finance its purchase and outbid all others at auction

Solutions to Solve the Problem

- Work to get the law changed to favor those who want to keep the land rather than those who want to sell

- Revise your will or trust to:
  - Give specific land to specific family members rather than all land to all family members as equal tenants-in-common who can demand partition
  - Give those who want to keep the land an option to buy the land on terms that will make it possible
  - Include a provision giving those who want to continue to farm the land the right to rent the land

Solutions to Solve the Problem

- Revise your trust so that the land will continue to be held in trust after your death with those who want to sell not actually owning the land but still getting income from their share of the land

- While you are still alive enter into a long-term lease with those who want to continue to farm the land

- Establish an LLC to hold the land with those who want to keep the land having control of the LLC and those who want to farm having a lease with the LLC

Solutions to Solve the Problem

- Provide for interest only installment payments for a period of time
- Calculate the value of the farm assets when the child “returned to the farm” and base their payment on that amount
- Hold land in trust until all children agree to a sale
- Consider allowing the exercise of purchase options on a portion of the land, rather than requiring purchase of all or none
- Remember that those who receive cash can do with it what they want, but that those who receive land must work to get its value

Impact of Increase in Land Values and Interest Rates on Provisions for Farming to Continue

- Succession planning documents (wills, trusts, buy-sell agreements, operating agreements for LLC's)…
  - With fixed prices in options to purchase or required purchase provisions
    - OR -
  - That refer to fair market value by appraisal or less than 100% of fair market value by appraisal

… Must be reviewed and possibly revised to be certain that the purchase provisions still work for those who will want to purchase

- Those who wish to continue farming or owning the land:
- 1. may not be able to borrow sufficient funds to exercise options or to complete required purchases
- 2. may not be able to cash flow required installment payments

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4 Ways to Lose the Family Farm:

#3

- Assume that you will never go to the nursing home or that a nursing home will cost $4,000/month like it did when your parent was there

Excuses for not planning for long-term care costs:

- My kids will take care of me in my home
    - Your medical needs may be greater than can be provided at home or you might be a wanderer
    - Your kids' own lives may prevent them from helping

- I will pay for 24-hour in-home care
    - In-home care can be just as (or more) expensive than a nursing home

- I will pay for nursing home care out of my cash rent income
    - Get realistic cost numbers

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Options to pay for long-term care costs
Option 1: Self-Pay out of Cash Flow

- Do you have enough income to cash flow a nursing home stay for one or two persons?
  - Currently, the State of Indiana says that the annual cost is about $90,000 but it's probably $100,000 to $120,000

- What if your income is less than the amount needed (maybe only $50,000/year)?
  - What liquid assets do you have?
    - $350,000 in CD's or investments could pay for 7 years if the annual shortfall is $50,000
    - But your plan might have been for those assets to go to the non-farm children so spending those assets on nursing care creates another problem

Options to pay for long-term care costs
Option 2: Long-Term Care Insurance

- If you have it already:
  - Great!
  - But get the policy reviewed to be certain that the daily benefit is adequate to cover current costs of long-term care
  - If adequate, continue to pay premiums even if they increase
  - But if premium increase is too much, lengthen the elimination period or reduce other benefits but keep the insurance

- If you don't have it yet:
  - Get a quote for a traditional or for a "hybrid" plan
  - But it's becoming more difficult to qualify and premiums may seem high, especially if you're over 65

Options to pay for long-term care costs
Option 3: Medicaid

- If a person qualifies for Medicaid:
  - Most of the person's income will go to the nursing home
    - Except $52/month for personal expenses such as clothing and hair care
    - Except those amounts needed to cover Medicare and Medicare supplement premiums each month
  - Medicaid will pay the difference between the person's income and the cost of the nursing home care
  - After the person's death, Medicaid can make a claim against the person's estate for amount of benefits paid
    - Farm may have to be sold to pay that claim

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Medicaid Basics

- Medicaid pays the nursing home bill after all of your assets are gone (not normally your plan) or after you've paid what you planned to pay.
  - It's never too late to plan, but usually earlier is better.
  - Medicaid is available for home care and assisted living in limited situations.
  - Eligibility for Medicaid requires satisfaction of both an income and a resource/asset test, but the resource test is more difficult to satisfy (an individual must have less than $2,000/$3,000 for a couple).
  - There is a 5-year lookback rule that applies to major gifts to anyone other than your spouse.

Medicaid Basics

- 5-yr Look-back Period
  - Gifts made in the last 5 years before applying for Medicaid create a period of ineligibility from Medicaid benefits.
  - The length of the ineligibility period relates to the amount of the gift and the cost of nursing home care. The State says that nursing care currently costs $7,496 per month - 405 IND. ADMIN. CODE 2-3-1.1(g). But this amount was $7,167 prior to July 1st.
  - A gift of 100 acres worth $8,500 per acre would be a gift of $850,000 and would create over 9 years of ineligibility. But that same gift of 100 acres if now worth 30% more at around $11,000 per acre would be a gift of $1,100,000 and would now create over 12 years of ineligibility. But there is no ineligibility if the gift was made more than 5 years before the application is filed.

Medicaid Basics

- The ineligibility period begins at the time of the Medicaid application, when the applicant is in the nursing home and otherwise eligible for Medicaid - 405 IND. ADMIN. CODE 2-3-1.1(c), not when the gift is made.

- "Otherwise eligible" means other assets reduced to $2,000 (individual) or $3,000 (couple).

More information can be found at Indiana's website: http://in.gov/fssa/index.htm

The Indiana Health Coverage Program Policy Manual can be found here: http://in.gov/fssa/files/Medicaid_Combined_PM.pdf

Medicaid Scenario #1

- One spouse is in nursing home, and one is at home
  - Step 1 – spend down countable resources as of snapshot date 1st day of at least a 30-day stay in a health care facility) to the lesser of $148,620 or ½ of total countable resources (but not less than $29,724) - 405 IND. ADMIN. CODE 2-3-14(c)(3) (2016).
    - Non-countable Resources:
      - Income-producing real estate, Home, Furnishings, Vehicle, Funeral, Business Assets, IRA of non applicant spouse (for a limited time)
    - Spend Down Options:
      - Funeral Home (*Ind. Family & Soc. Servs. Admin. v. Culley*, 769 N.E.2d 680 (Ind. Ct. App. 2002))
      - Home Repairs
      - Immediate Annuities
      - Nursing Home Costs
      - Farmland/Equipment/Debt Reduction (mortgage or operating line)
      - Can't make gifts to kids to spend-down

Medicaid Scenario #1

- One spouse is in the nursing home, and one is at home (continued)
  - Step 2 – transfer assets to spouse at home, but there will be income tax on IRA transfers and loss of basis step up at nursing home spouse’s death
  - Step 3 – revise estate plan of spouse at home to reduce any benefit to the nursing home spouse in case the spouse at home dies first and possibly to include an irrevocable trust to insulate their assets against their long-term care costs.

Medicaid Scenario #2

- Surviving spouse is in the nursing home or both spouses are in the nursing home
  - Must spend down resources to $2,000 or less for surviving spouse or $3,000 or less for a couple.
  - Remember that monthly income still goes to the nursing home.
  - There is no spouse so no transfer possibility or spend-down.
  - But some assets do not count against Medicaid eligibility, such as income-producing real estate (farmland).

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Medicaid Scenario #2

- But the farmland is still at risk, even if it doesn't prevent Medicaid eligibility.
- Following the Medicaid recipient's death, Medicaid's resource recovery rights allow it to recoup all advances against the recipient's remaining assets.
- Might not be as bad as expected because monthly income goes to nursing home and Medicaid pays at a different (possibly lower) rate than private pay.

Shielding Farm Assets

- Four techniques used to shield farm-related assets from the future costs of long-term care, if there's no insurance or other assets that can be used
- Outright gifts
- Gifts of land with a retained life estate
- Transfers to irrevocable trusts
- Transfers to a limited liability company (LLC) and then gifts of the interest in the LLC

However, none of these can be easily reversed or changed

Outright Gifts

- **Good**:
  - Completed with only a deed
  - Less likely to be affected by future law changes
- **Bad**:
  - Takes the income with it
  - After an outright gift there is not an automatic right to live in the principal residence
  - Takes control of the asset away from the donor
  - Carries with it the donor’s basis and there is no basis step up at the donor’s death

Gifts of Land with Retained Life Estate

- **Good**
  - Completed with a deed
  - After the gift, the donor:
    - Retains the income from the land
    - Retains the right to live in the home
    - Retains control of the decisions about the land
  - Those who receive the gift get a basis step-up at the donor's death
  - There is no Medicaid estate recovery on the remainder interests
- **Bad**
  - If the land is sold, those who received the gift are entitled to a portion of the sale proceeds (and must sign the deed)
  - If the land is used as collateral, those who received the gift must sign the mortgage (but not the promissory note)
  - Restricting subsequent transfers by those who received is not easy (their divorce can cause major problem)
  - The exemption from Medicaid's resource recovery is not recognized in all states

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Transfers to Irrevocable Trusts

- **Good**:
  - The income from the land and the right to live in the home can be retained (unless VA benefits are being received).
  - If the income is retained, there can be a basis step-up
  - The trust can be used to control the succession of the farm after the donor's death.
  - If the land is sold, the sale proceeds stay in the trust.
  - While the land is in/owned by the trust, those who will eventually receive it cannot transfer/lose/mortgage it.
- **Bad**:
  - The settlor no longer controls the asset.
  - Costs more than simple gifting options.

Transfers to a Limited Liability Company (LLC)

- **Good**
  - Insulates farm assets against outside liabilities, such as accident liability or nursing home cost.
  - Also can be used as part of the overall farm succession plan or for death tax reduction planning
  - May preserve control and income for the one setting up the LLC
- **Bad**
  - LLC's can be more complicated and expensive than irrevocable trusts.
  - LLC interest of owners attachable by creditors/ex-spouse/Medicaid estate recovery, but outsiders do not get right to vote.
  - Future gifts of an LLC as part of a succession plan can create new gifts that count against Medicaid eligibility.

4 Ways to Lose the Family Farm:

#4

- Ignore the possibility of liability creditors

What liability?

- Farm equipment and machinery on the roads
- Employee misuse of farm machinery and equipment
- Overspray onto neighbors
- Groundwater contamination
- Injury/damage by livestock
- Slips and falls
- Hunter accidents

Insurance:

Your first line of protection

- Farm Liability Insurance, plus an Umbrella Policy
    - When you purchase insurance, you are purchasing a defense attorney

Limited Liability Business Entities:

Your second line of protection

- Minimize liability by separating the following from each other:
  - Your highest liability assets (farm machinery/equipment/livestock)
  - Your highest value assets (farm real estate)
  - Your personal assets (home and personal belongings)

- Very common to have 2 business entities:
  - 1 operating entity (either a corporation or an LLC)
  - 1 land-holding entity (usually an LLC)
  - With only personal assets remaining in your in personal name(s)


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