

HOT TOPICS IN FARM ESTATE PLANNING

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Death taxes are a hot topic now

- Death taxes become a hot topic every 4 years (coinciding with election campaigns)
- Some politicians suggest eliminating the death tax while others suggest that the exemption be lowered so the “rich” pay more
- The current situation is unique in that the exemption will be lowered on 1/1/2026 if the law is not changed

Current and Proposed Exemptions

- The current exemption from the federal estate tax (the “death tax”) is \$13,610,000 for a single person or \$27,220,000 for a married couple
- That exemption will increase for inflation on 1-1-2025, but then drop on 1-1-2026 to about \$6,800,000 for a single person and about \$13,600,000 for a married couple
- President Biden recently suggested that the exemption drop to \$5,000,000 for a single person or \$10,000,000 for a married couple although in the past he suggested an exemption of \$3,500,000 for an individual and \$7,000,000 for a couple

Exemption for specific situations

- A married couple with less than \$7.0 million in assets who doesn't envision their estate ever exceeding that amount may not need to worry about death taxes
- A single person or a surviving spouse with less than \$3.5 million in assets who doesn't envision their estate ever exceeding that amount may not need to worry about death taxes
- A married couple who have assets between \$7.0 million and \$27.22 million should watch the November election results to see whether death tax reduction planning would be desirable
- Similarly for a single person or surviving spouse whose assets range in value from \$3.5 million to \$13.61 million
- Couples with assets in excess of \$27.22 million and single persons or surviving spouses with assets in excess of \$13.61 million should be doing death tax reduction planning NOW

Possible Election Scenarios

- If one side controls Washington, the exemption may be lowered
- If the other side controls Washington, the exemption may continue to increase
- If neither side controls Washington, the exemption may be reduced on 1/1/2026 to about half of its current level

Accurately Estimate Your Federal Estate Tax Liability

To-Do:

- Make sure your balance sheet reflects current (increased) land prices
- Include the death benefit amount of your life insurance

Current and Anticipated Estate Tax Exemption

Example:

800A x \$15,000/A or 1,000A x \$12,000/A = \$12,000,000

- + machinery
- + growing crop
- + face value of life insurance
- + stored grain (last year's crop)
- + other assets (livestock etc.)

= Taxable Estate

Death Tax Calculation

- Once an estate exceeds the exemption amount, the excess is taxed at 40%
- President Biden has proposed that the excess be taxed at 45%
- At the death of the first spouse, the unused portion of their exemption may be carried over to the estate of the surviving spouse
- But for the family to gain the benefit of the carried over exemption there must be a federal estate tax return filed following the death of the first spouse

Options to Reduce or Eliminate Federal Estate Taxes

- Annual gifts of \$18,000 per person
- Gifts for education or medical care paid directly to institutions
- Creation of LLC's to use valuation discounts
- Outright gifts of amounts large enough to use exemptions (use the exemption while it exists or watch it be severely reduced)
- Major gifts to charitable/religious/educational institutions during life or at death
- Spousal lifetime access trusts by both spouses or one spouse
- Single irrevocable trust

Spousal Lifetime Access Trusts (SLATs)

- If your estate value will be above the amount of two exemptions (about \$13.6 million after 1/1/2026), consider SLATs
- Concept: Obtain the benefit of the higher estate/gift tax exemption available today by each spouse making a gift of an amount approaching today's available exemption to his/her own SLAT

Pros:

- Allows a married couple to retain some income and control
- Each spouse's trust provides benefits to the other spouse which may approximate the benefits that the spouses had prior to the creation and funding of the trusts

Spousal Lifetime Access Trusts

Issues:

- Generally irrevocable
- IRS' reciprocal trust doctrine - cannot be identical (or even close)
 - Spouses' income interests should be different
 - Trustees should be different
 - Beneficiaries and what they receive when the spouses are gone should be different
 - Possibly be signed at different times
 - Possibly signed in different states under different trust rules
- Ensure value of trust assets are not included in either spouse's estate
- Spouses should not be trustees of either trust

Single Irrevocable Trust

- If your estate value will be between the amount of one exemption and two exemptions (between \$7,000,000 and \$14,000,000), an irrevocable trust for one spouse may be a better solution

Concept: One spouse uses most of their exemption while the other spouse keeps assets to generate income for the couple or to retain control of certain assets

Example:

- One spouse puts \$10,000,000 into an irrevocable trust (using most of their exemption today)
- The other spouse keeps \$4,000,000 (but an amount less than the expected exemption in 2026)

Minority Interest Discounts

Other Info:

- Current law allows discounts for minority interests in entities
- Possible to use an LLC to make the discount available when valuing farmland
- Spouses can place their land in an LLC with each then owning 50% of the LLC
- Each spouse then can gift a small percentage to their children
- Each spouse is left with a minority interest (less than 50%)
 - Minority discount of 30%-35% may be allowed

Timing of these Plans

- All plans involve a degree of irrevocability
- May wish to wait to implement your plan until after the 2024 general election in November
 - Will have a better idea of what the exemption will be in 2025 and thereafter
- BUT, if the value of your assets already exceeds two exemptions at today's exemption level:
 - Consider implementing your plan NOW
- If the value of your assets already exceeds what two exemptions might be worth in 2026:
 - Consider what your plan will be and be prepared to act quickly after the election

Another Hot Topic - Family Disharmony

- Don't assume that all the kids will want land, and none will want cash
- Don't assume that the kids will be married happily ever after
- Don't leave all your land to all your kids as equal tenants in common, which could result in the filing of a partition lawsuit

Disharmony Doesn't Mean Anger and Hate

- Times change - Circumstances change
- What seemed like a good idea when you did your plan 20 years ago may look different to you today
- Your plan from 20 or even 10 years ago may not make sense to your kids
- Marriages change with time
- Grandkids grow up and may not still be enamored of farm life
- Kids may not want to retire in Indiana
- Kids may want to do their own planning with their inheritance

Dealing with Disharmony

- Maintain flexibility if possible
- But flexibility may not be easily achieved with tax planning or even farm succession planning
- It's not unusual for families to ask to change what was irrevocable and unamendable

Changing the Unchangeable

- What cannot be changed might be changeable if everyone involved agrees
- If possible, don't make the plan so favorable to one person that the others decide to talk to a lawyer or sue before talking to each other
- The heirs need to know that non-pro rata distributions from estates and trusts are possible, even if the language says divide equally
- Settlement agreements (where all agree) can resolve and document changes to the plan
- Decanting can even change trusts in some circumstances

Settlement Agreements

- A settlement agreement is a written document signed by all involved that states the “new” plan (IC 30-4-5 et seq)
- A settlement agreement should not violate the material purpose of the trust
- A settlement agreement can deal with the following matters, among others:
 - Trust interpretation
 - Resolution of a dispute arising out of the trust’s administration or distribution
 - Appointment of a new trustee
 - Criteria for distribution where trustee has discretion

Decanting a Trust

- Decanting means moving the assets of the first trust into a second trust with different provisions (IC 30-4-10 et seq)
- In order to decant, the trustee of the first trust must have some power to distribute trust principal
- The trustee's power to distribute is used by the trustee to move trust assets to the second trust
- The second trust must grant to the beneficiaries of the first trust rights substantially similar to what they have in the first trust
- The second trust may not include beneficiaries who were not included in the first trust

Indiana Partition Law

- A joint tenant or tenant-in-common of farmland may force the land to be partitioned (I.C. 32-17-4-1)
- Prior to 6/1/12, 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
 - Land will be sold at auction unless the parties agree on another method of sale
 - Auction will be conducted by the sheriff unless the parties agree on an auctioneer

Practical Effects of Partition in Indiana

- 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
- Revise your will or trust to:
 - Give specific tracts of land to specific family members (not to all family members as equal tenants-in-common)
 - Give those who want to keep land an option to buy it on terms that will make it possible
 - Give those who want to continue to farm the land the right to rent the land
 - Hold land 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

Solutions to Solve the Problem

- Enter into a long-term lease with those who want to continue to farm the land while you are still alive
- Establish an LLC to hold the land with:
 - Those who want to keep the land having control of the LLC
 - Those who want to farm having a lease with the LLC
- Provide for interest only installment payments for a period of time

Solutions to Solve the Problem

- Calculate the value of the farm assets when the child “returned to the farm” and base their buyout payment to others on the excess value
- Hold land in trust until all children agree to a sale
- Allow 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

Review of Current Succession Planning Documents

- Due to increased land values, succession planning documents (wills, trusts, buy-sell agreements, operating agreements for LLC's)...
 - With fixed prices in options to purchase
 - With required purchase provisions, or
 - With provisions 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, because those who wish to continue farming or owning the land:
 - May not be able to borrow sufficient funds to exercise options or to complete required purchases
 - May not be able to cash flow required installment payments

Marriage Issues

- Don't make outright gifts of assets to children or others that you wouldn't want to see involved in a divorce
- Retain control or the right to reassert control
- Use trusts to hold assets and merely give the income
- Use LLCs to impose transfer restrictions and buy-back terms



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