Farm
Estate
Planning Strategies

The Need for Estate Planning

One of the challenges of Planning is to make people aware that they need to take action. Nowhere is that more of an issue than with the family farm.

*** Iowa Farm Bureau**

- Why is First Resources Involved?

1. One of the most common methods of paying Estate Taxes is Insurance – We sell insurance.
2. One of the risk factors for farms is Long Term Care – We sell LTC.
3. Investments are a key element in planning – We advise investors.

- Three Levels of Planning

1. Family Plan
2. Elimination of Tax
3. Management of Asset Cost and Continuity of Business

- Level 1

- 360 Acres @ $3,000 per acre.

1. Who receives the farm?
2. How do I treat other children?
3. Who will handle the estate?
4. How do I protect the farm from unexpected expenses?

- Level 2

800 Acres @ $3,000 per acre.

- Design wills/trusts that eliminate tax
- How do I treat other children?
- Who will handle the estate?
- Unexpected expenses?

- Level 3

- 1500 Acres @ $3,000 per acre

1. Minimize Estate Tax
2. How do I treat other children?
3. Who will handle the estate?
4. Unexpected expenses?
5. Management of Tax Payments?

The Need for Estate Planning

The tendency to listen to politicians in Washington discourages effective action. For 40 years, they have talked about solutions and we still have a tax of 45% for all values over $2,000,000.

Minnesota tax is imposed for values over $1,000,000.

What is Estate Planning?

① Determining goals with respect to your property both during life and at death.

② Arranging your property to accomplish these goals.

③ Protecting your assets from depletion risks.

Who Needs Estate Planning?

Everyone Needs to Plan Their Estate

- Property ownership that fits a plan.
- Wills that distribute according to your wishes.
- Appointment of responsible people to handle the estate.
- Reduce or eliminate taxation.
- Power of Attorney.

Property Ownership

Joint Tenancy

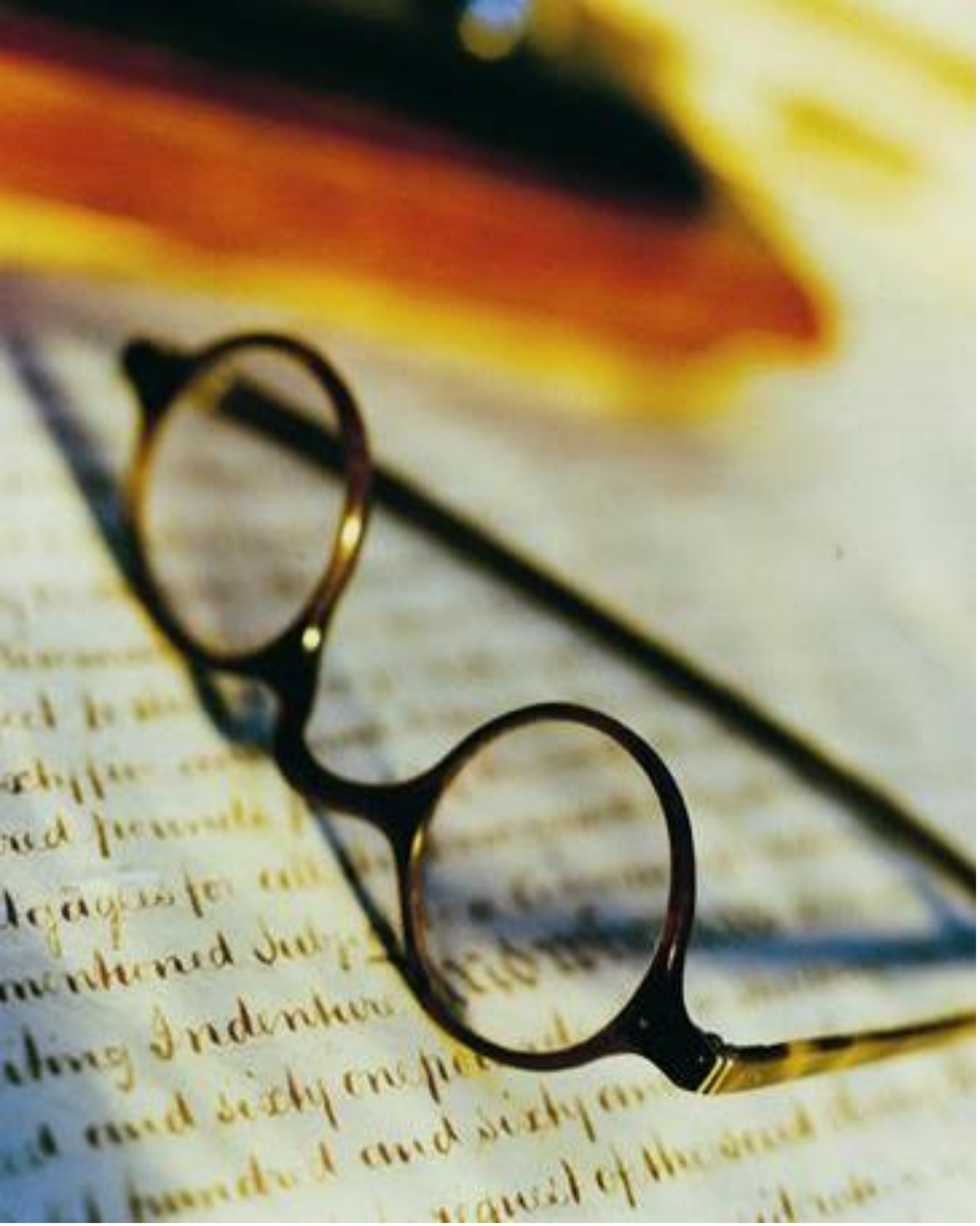
- Bypass the will
- Non-probate
- Reduces stepped up basis
- Can be fully subject to Medicaid claims

Tenancy in Common

- Proportionate Ownership
- Does not transfer to other owner at death
- Can raise questions of % ownership
- Subject to transfer by will or intestacy rules
- Probate

The Need for Estate Planning

- Everyone has an estate plan!
- If you don’t develop one, the state has one for you.



State Provided Plan

State Provided Plan

Article I

If no children,

All to Spouse

State Provided Plan

Article II

If children only from marriage of husband and wife:

- $70,000 to spouse
- ½ of excess to spouse

State Provided Plan

Article III

If all children are not from this spouse:

- **½ to spouse**

State Provided Plan

Article IV

Children receive equal shares by right of representation.

State Provided Plan

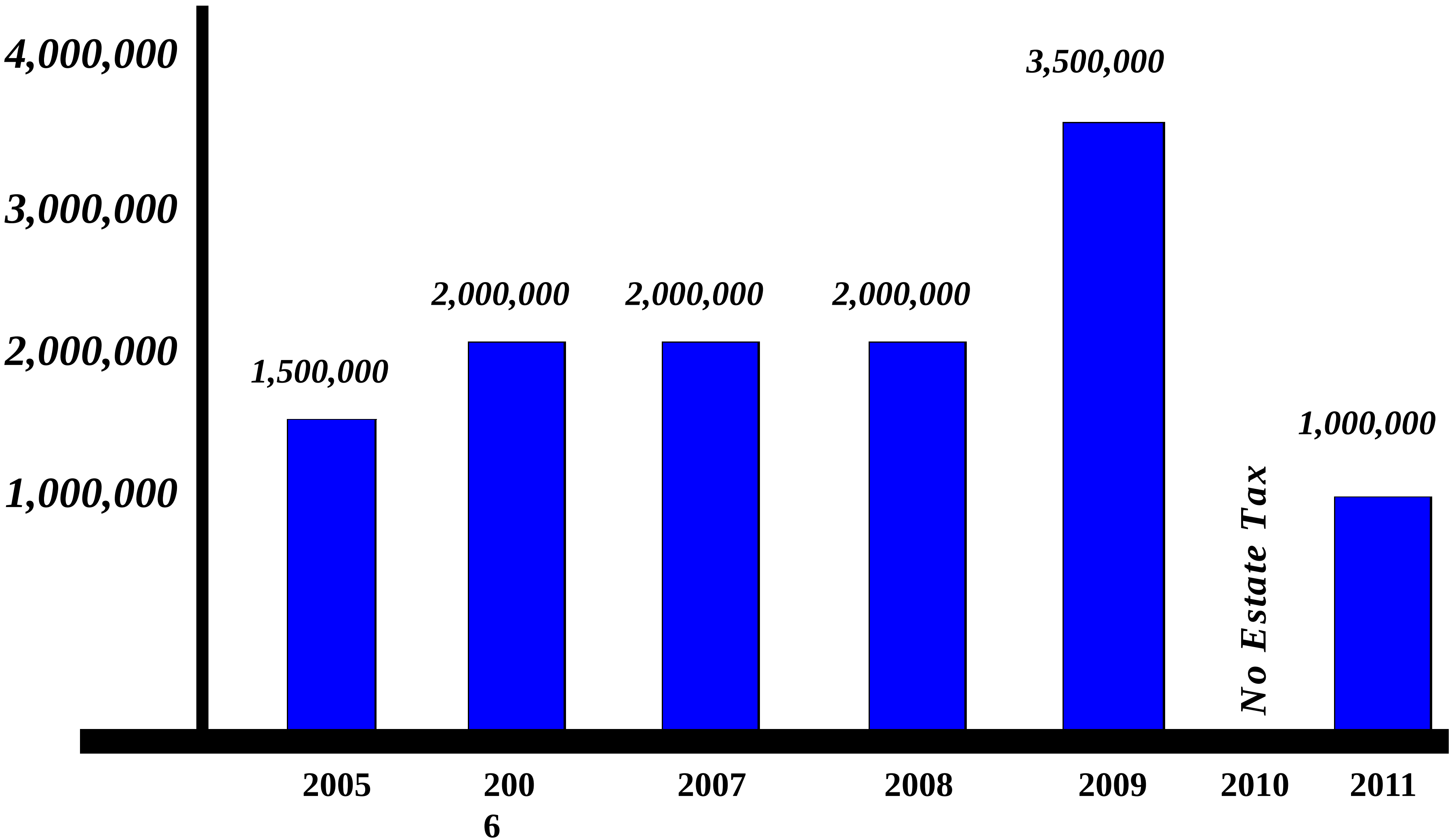
Article V

If a child has pre-deceased the parent without grandchildren, then to parent(s) of child; if not alive, then escheat!

Election Against The Will

Years of Marriage		% Share
1 year	=	Supplemental Amount ($50,000)
1-2	=	3
2-3	=	6
3-4	=	9
4-5	=	12
5-6	=	15
6-7	=	18
7-8	=	21
8-9	=	24
9-10	=	27
10-11	=	30
11-12	=	34
12-13	=	38
13-14	=	42
14-15	=	46
15+	=	50

Who Needs Estate Tax Planning?



Stepped-up Basis

Congress giveth and taketh away!

While there is estate tax, the basis of property is "stepped-up" to the value at date of death or 9 months after death (Alternative valuation).

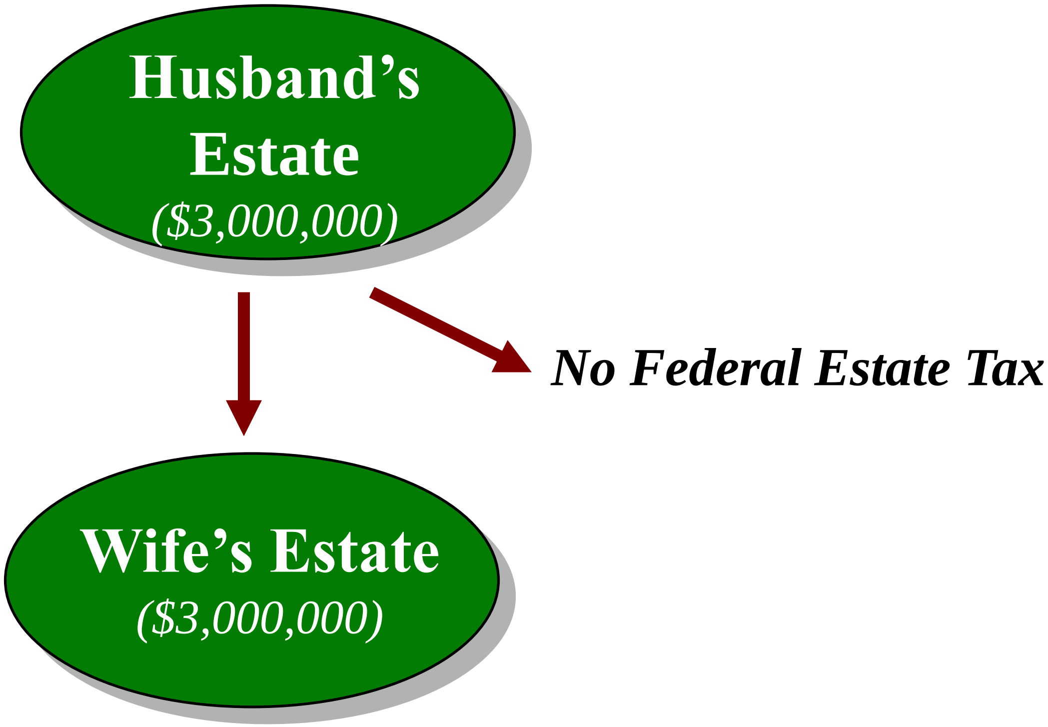
If death occurs when there is no estate tax, stepped up basis is limited or eliminated.

Simple Will

Husband's Estate

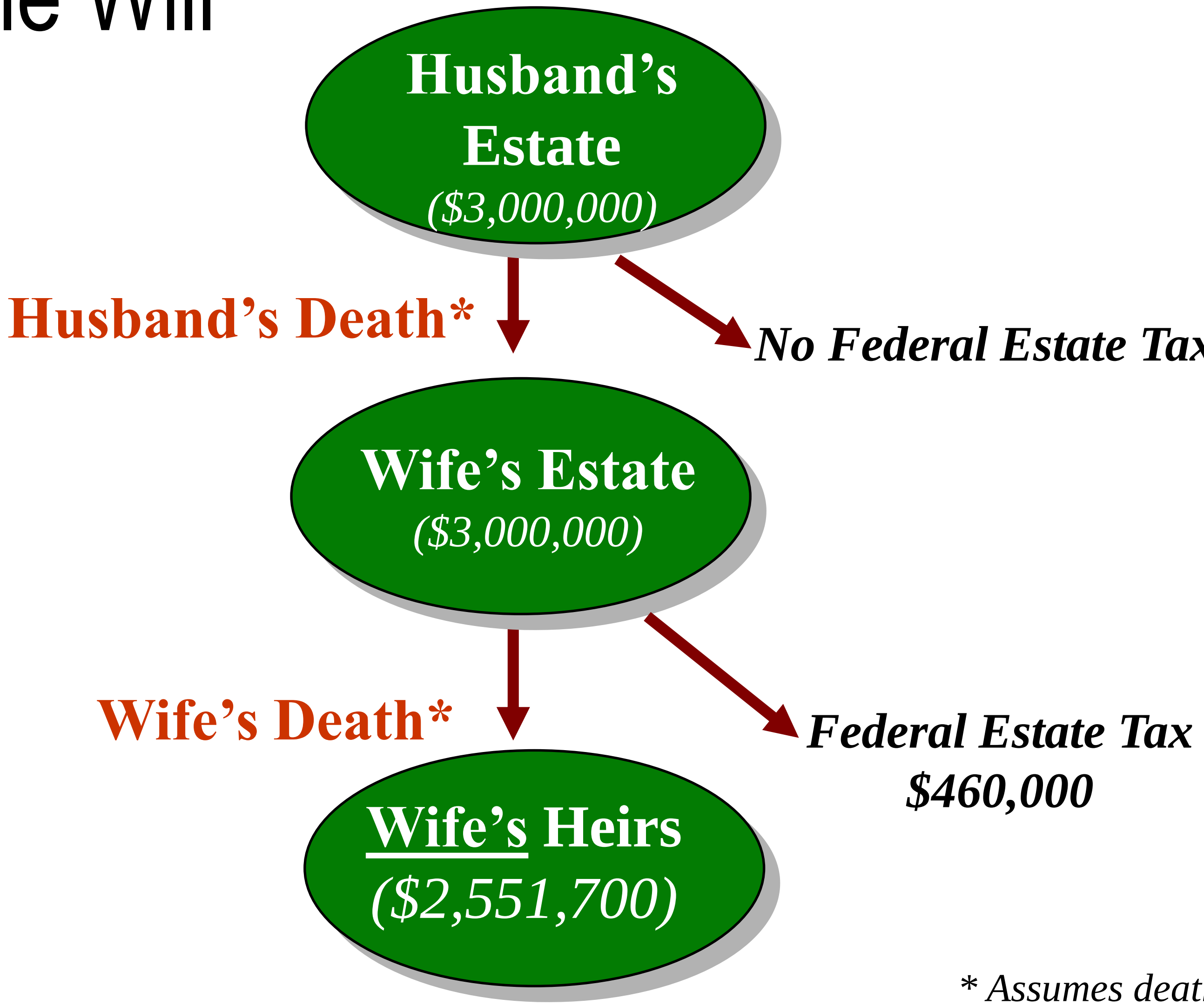
($3,000,000)

Simple Will



Husband's Estate
($3,000,000)
No Federal Estate Tax
Wife's Estate
($3,000,000)

Simple Will

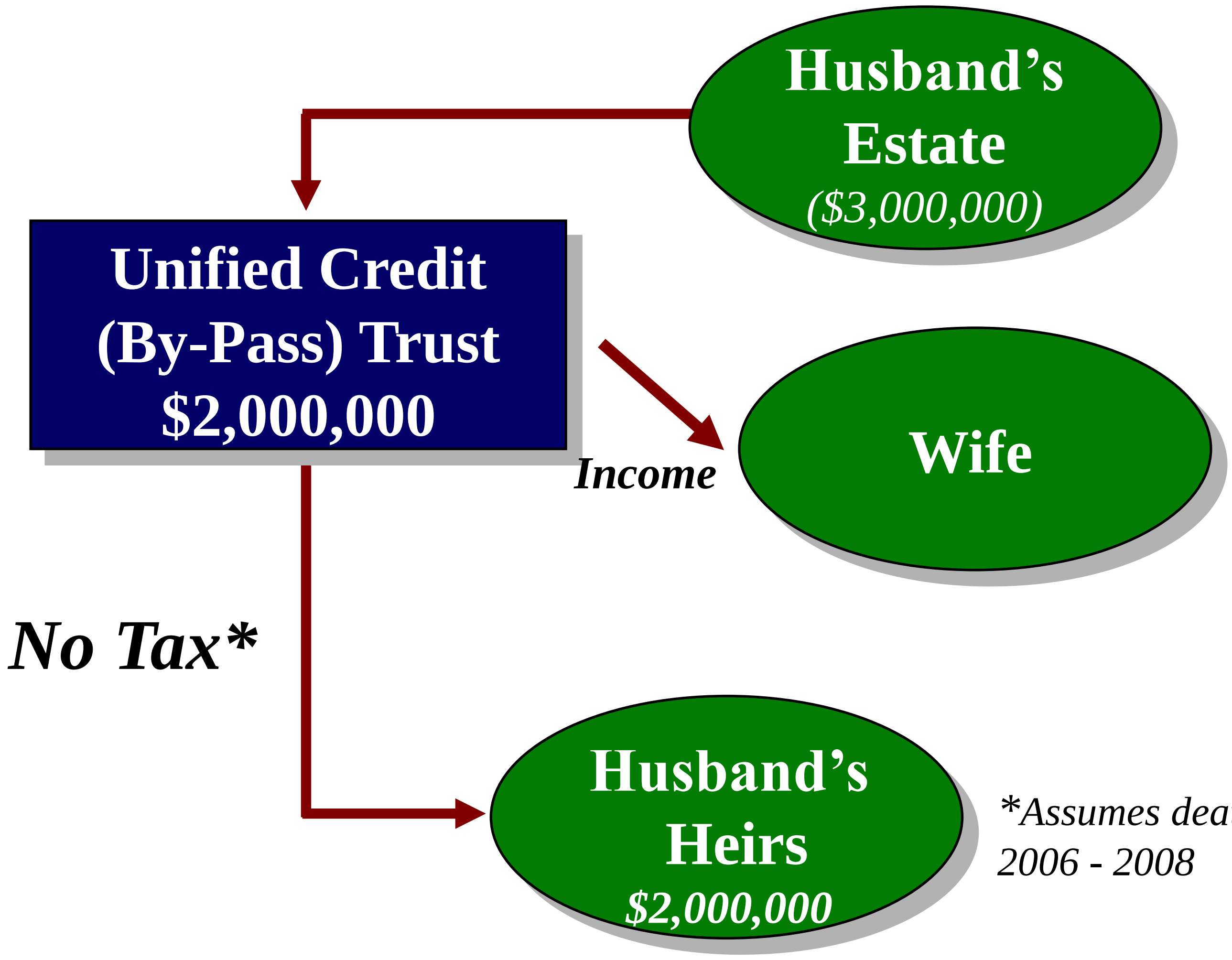


** Assumes death in 2006.*

Simple Will

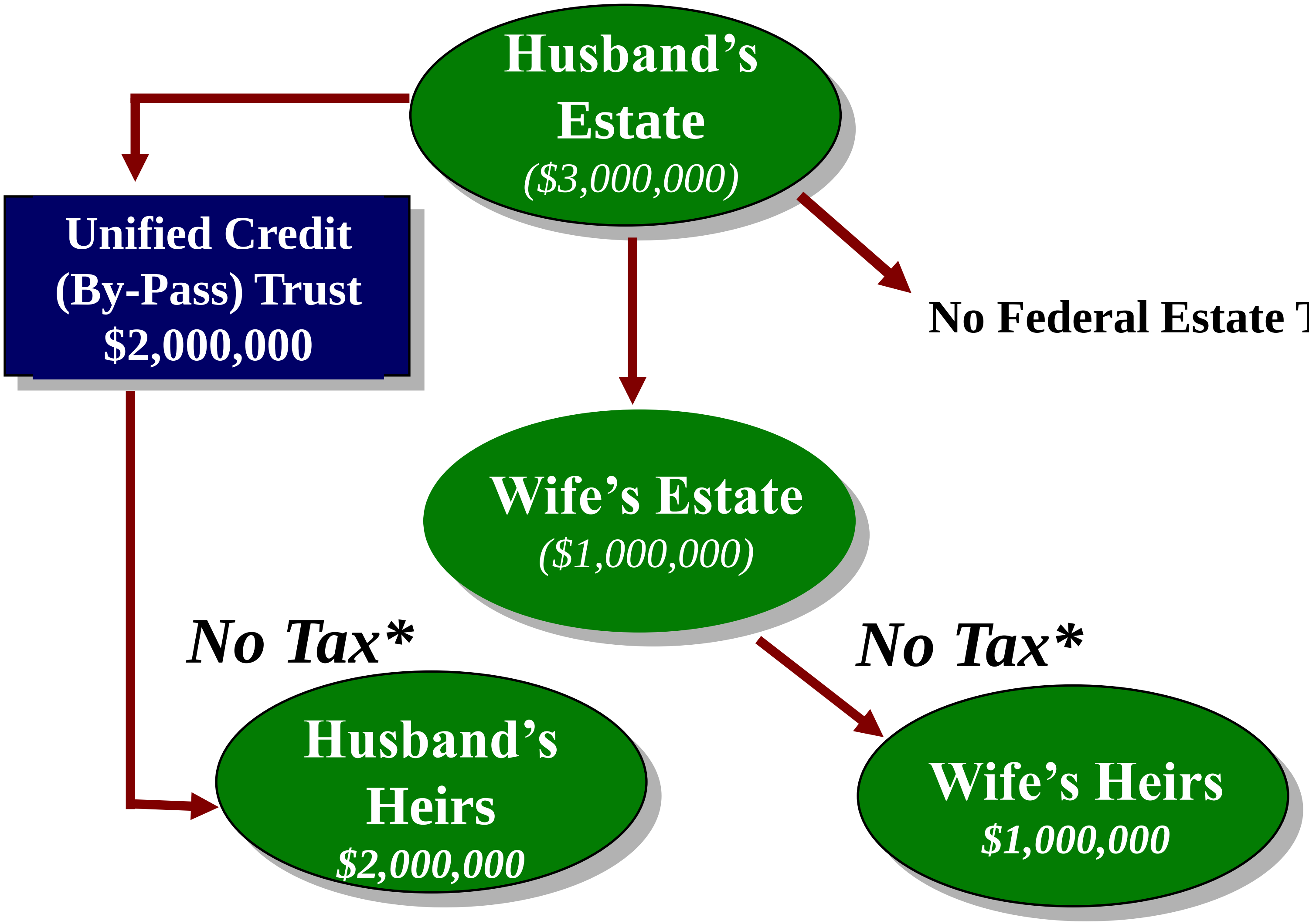
- **Result**
  - No taxes at first death.
  - Entire estate is taxed at second death.
- **Advantages**
  - Transfer of maximum amount of property to spouse outright.
  - No federal estate tax at first death.
- **There may be substantial federal estate tax on death of surviving spouse.**

Unified Credit Trust Will



*Assumes death in 2006 - 2008

Unified Credit Trust Will



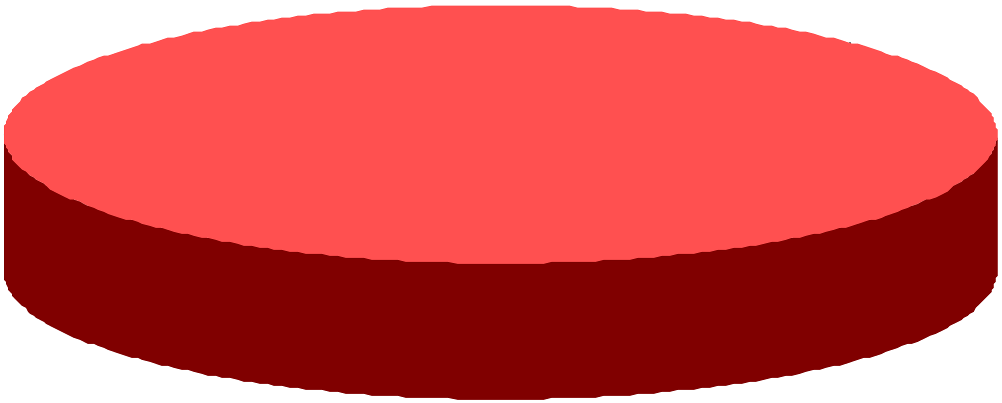
*Assumes death in year 2006.

Increased Unified Credit

If death occurs in year. . .	*Amount passing estate tax free*
2003	$1,000,000
2004	1,500,000
2005	1,500,000
2006	2,000,000
2007	2,000,000
2008	2,000,000
2009	3,500,000
2010	Repealed
2011	1,000,000

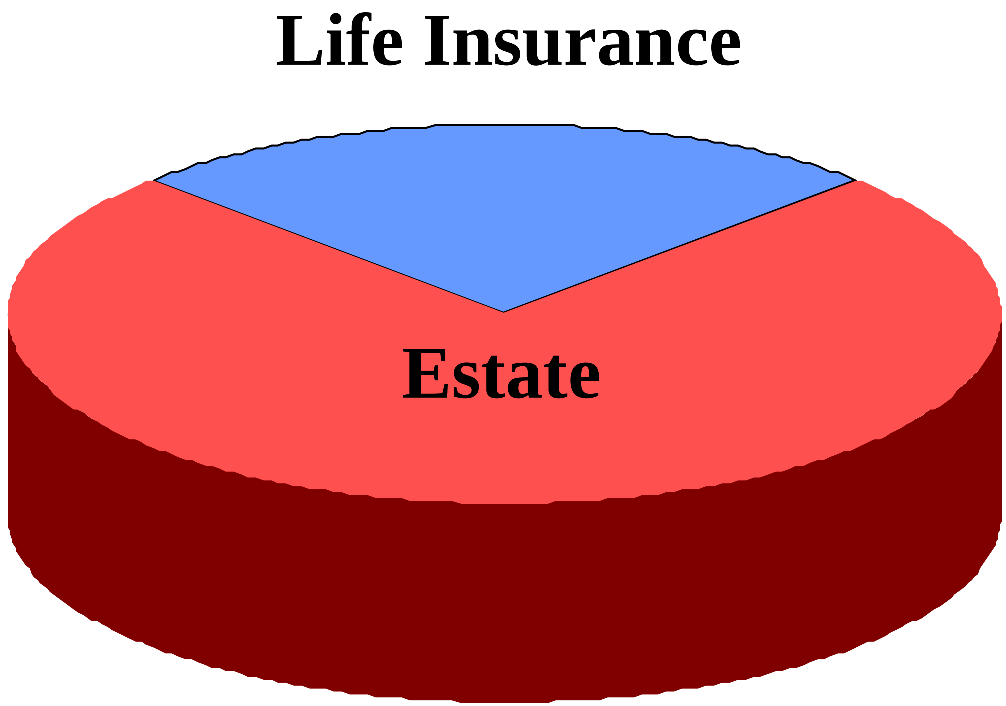
Life Insurance Improperly Owned

$4 Million Estate



Life Insurance Improperly Owned

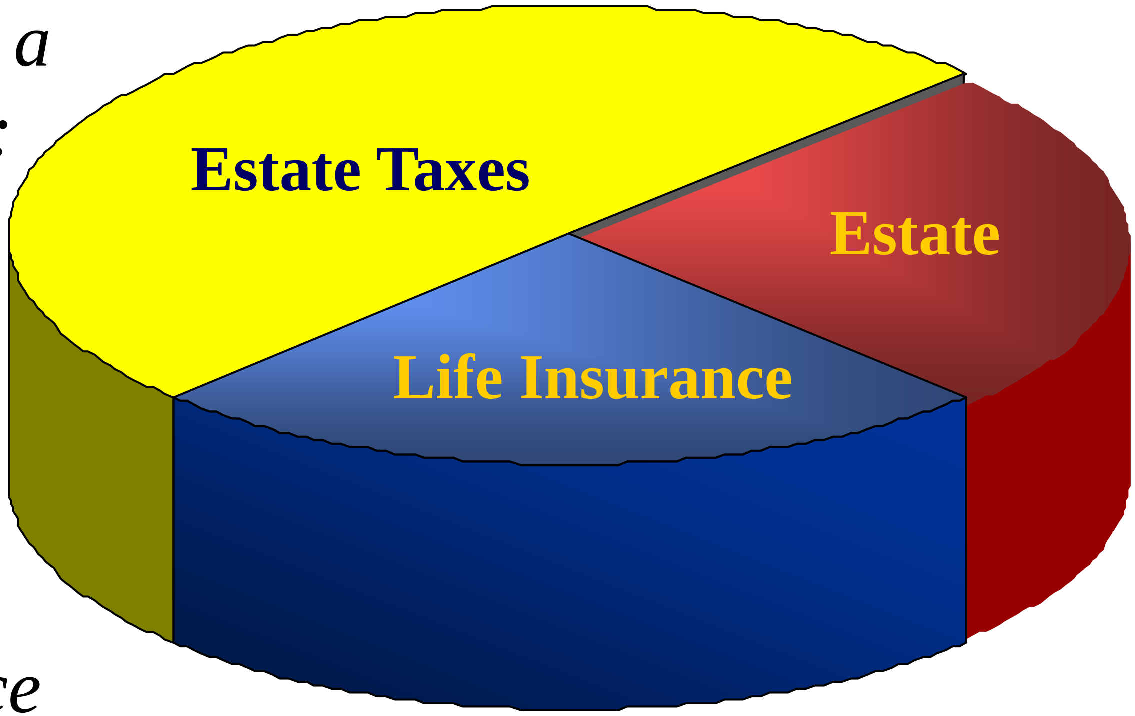
$1,000,000 of the Estate is Life Insurance



Life Insurance Improperly Owned

Estate without Life Insurance but with a unified credit trust:

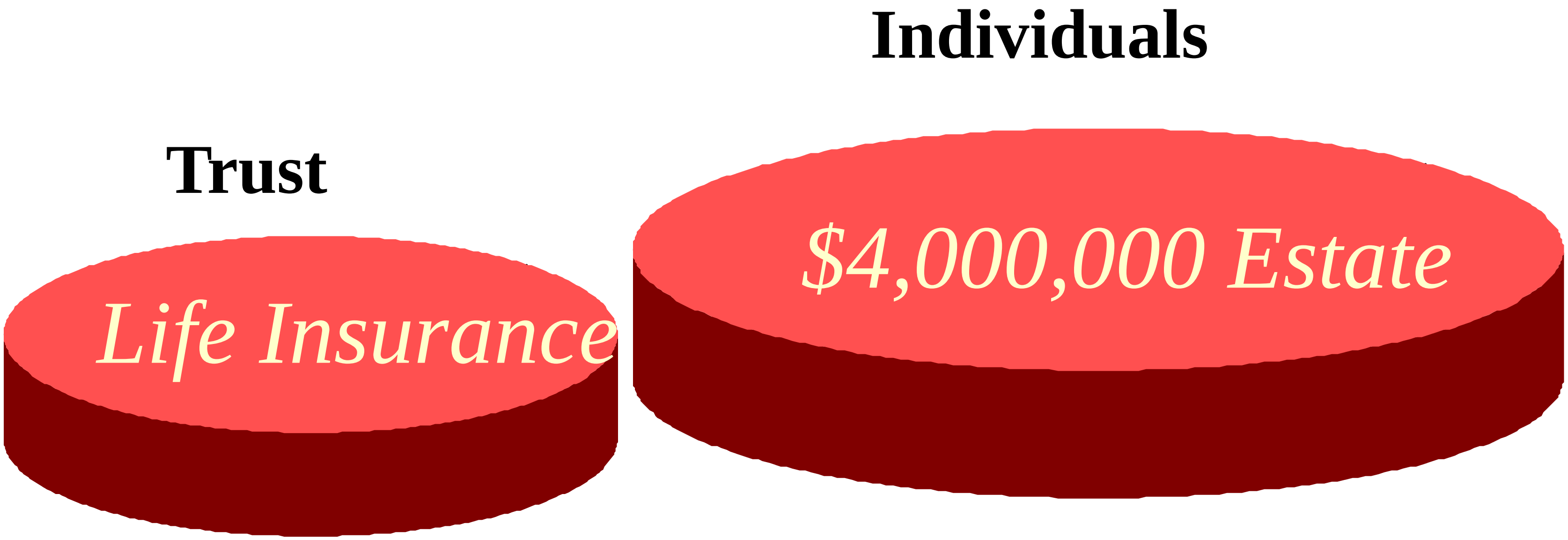
$0 Taxes



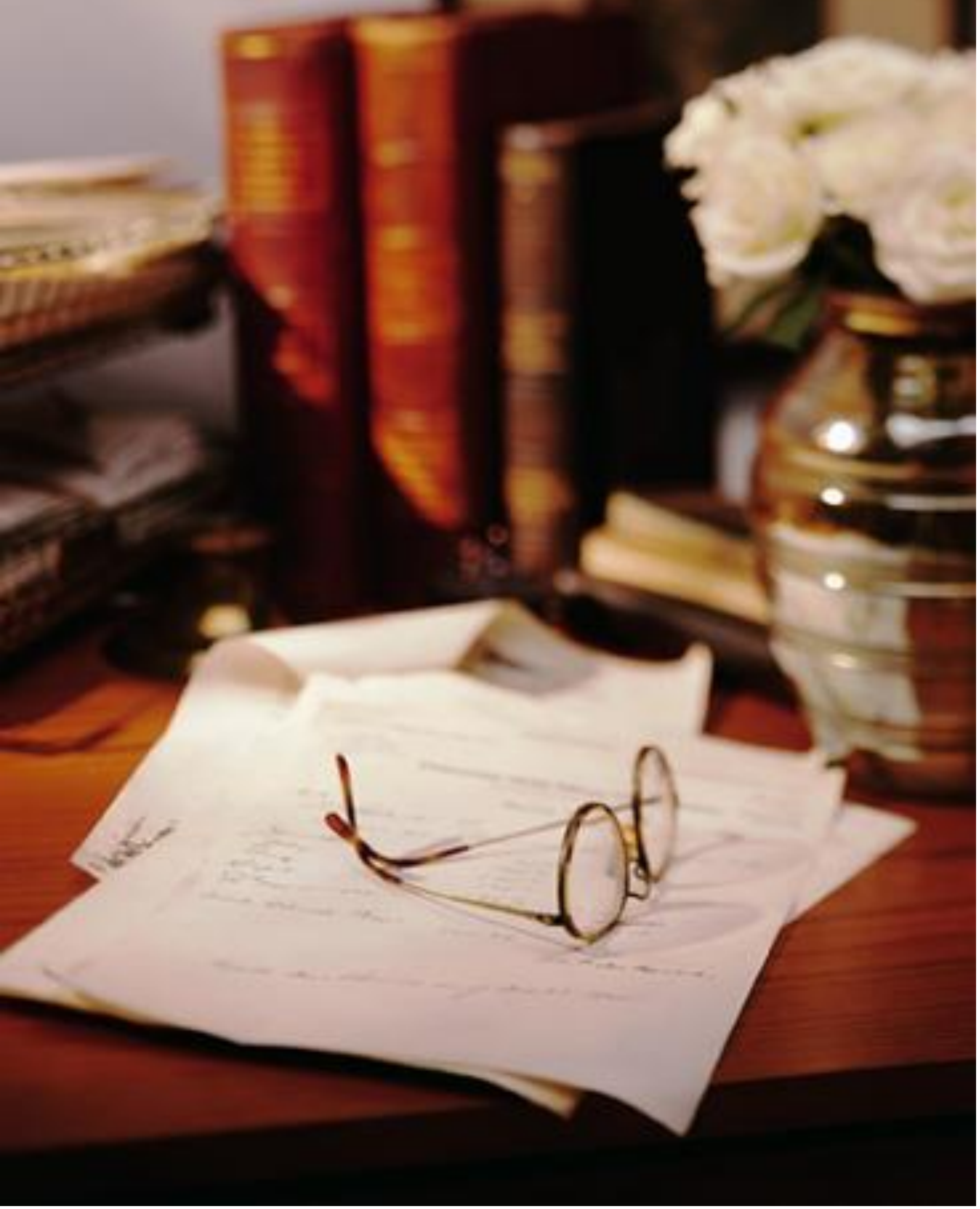
With Life Insurance in the Estate:

$460,000 Taxes

Life Insurance Properly Owned



$0 Taxes



The Need for Estate Planning?

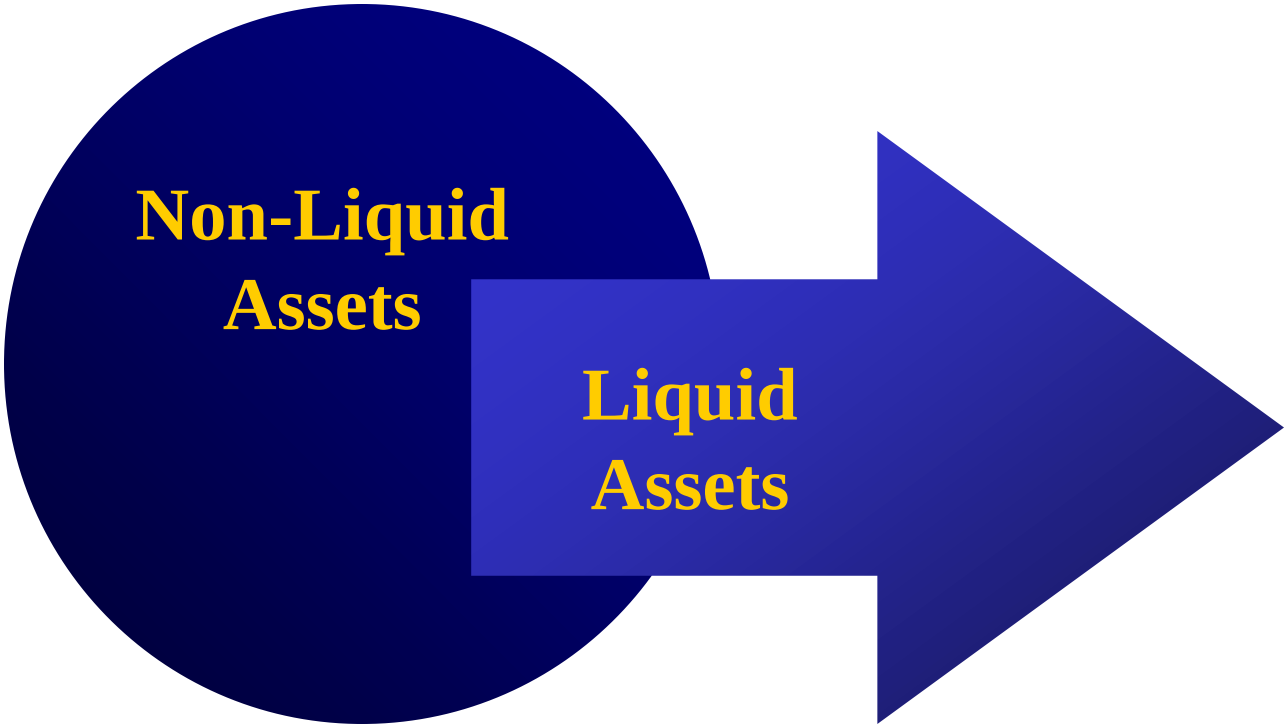
Financial Burdens

- Estate settlement costs are too high
  - Probate fees
  - Death taxes
  - Debts

Financial Burdens

- Estate Settlement costs are too high
  - Probate fees
  - Death taxes
  - Debts
- Estate assets are improperly arranged
  - Liquidity
  - Cash flow

Financial Burdens

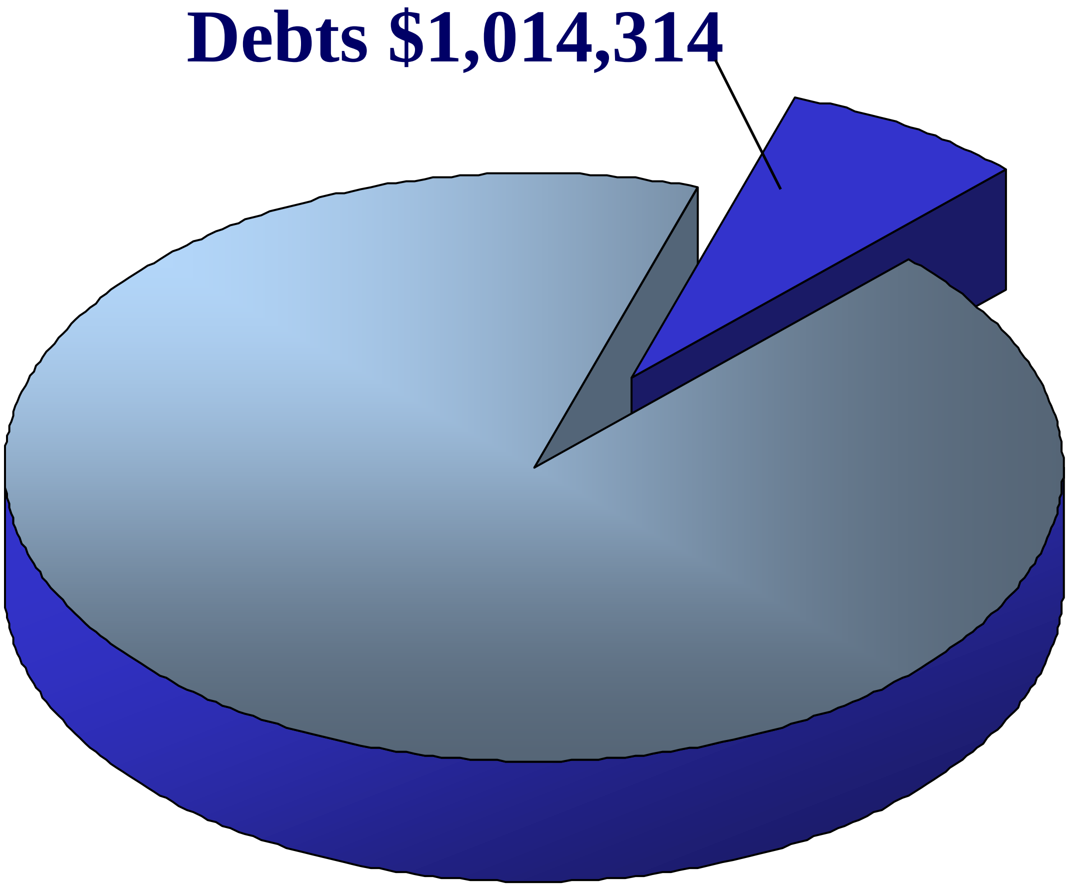


Common Mistakes

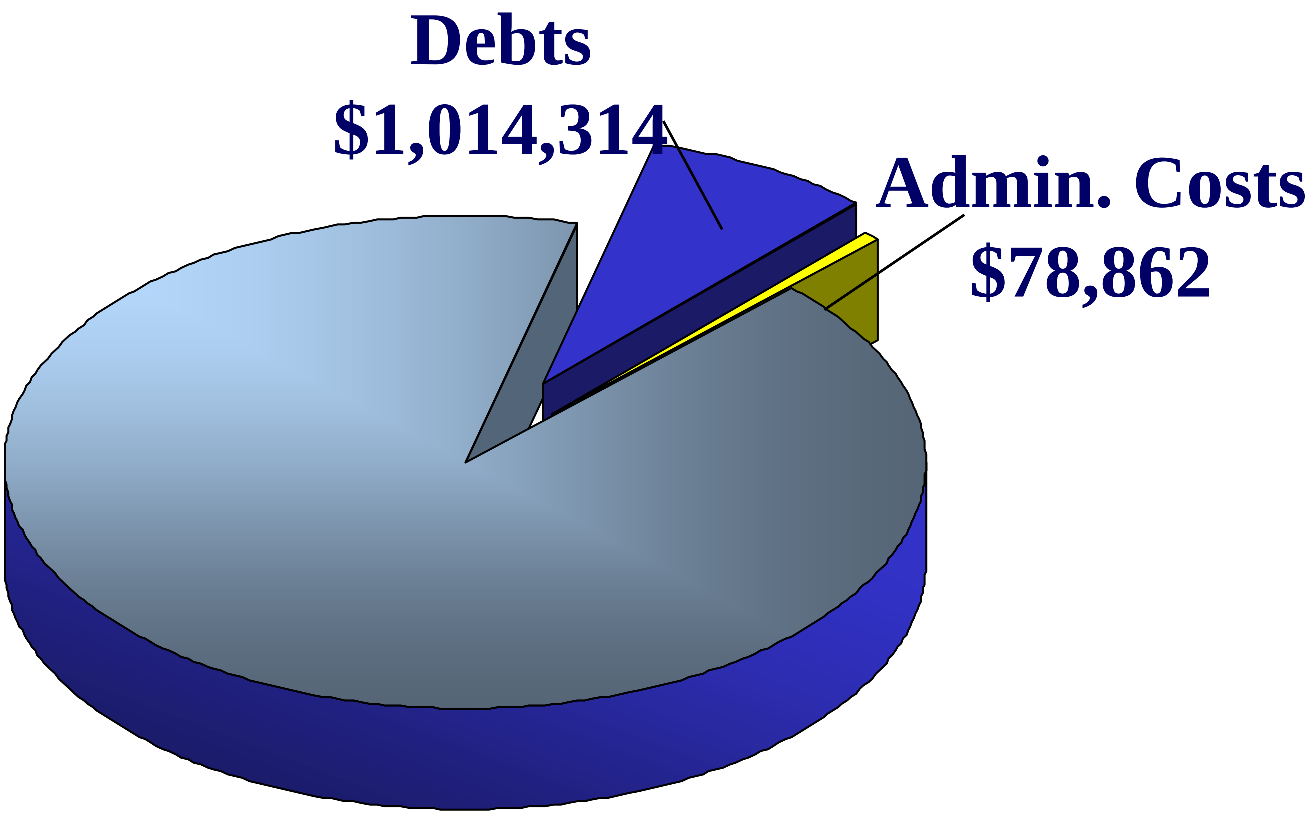
- No written plan.
- Improper ownership of assets.
- Life insurance is improperly owned.

Alwin C. Ernst Estate

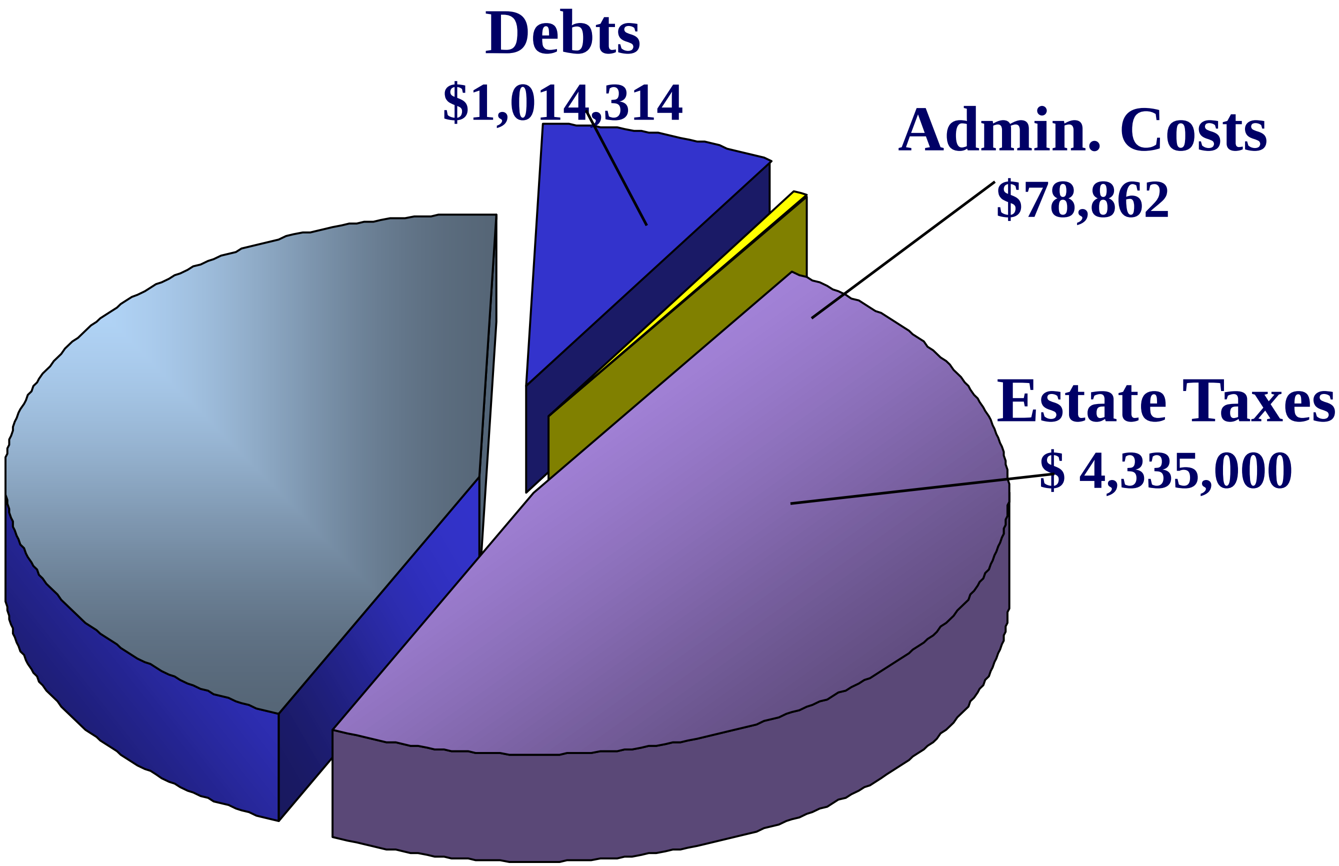
Alwin C. Ernst Estate



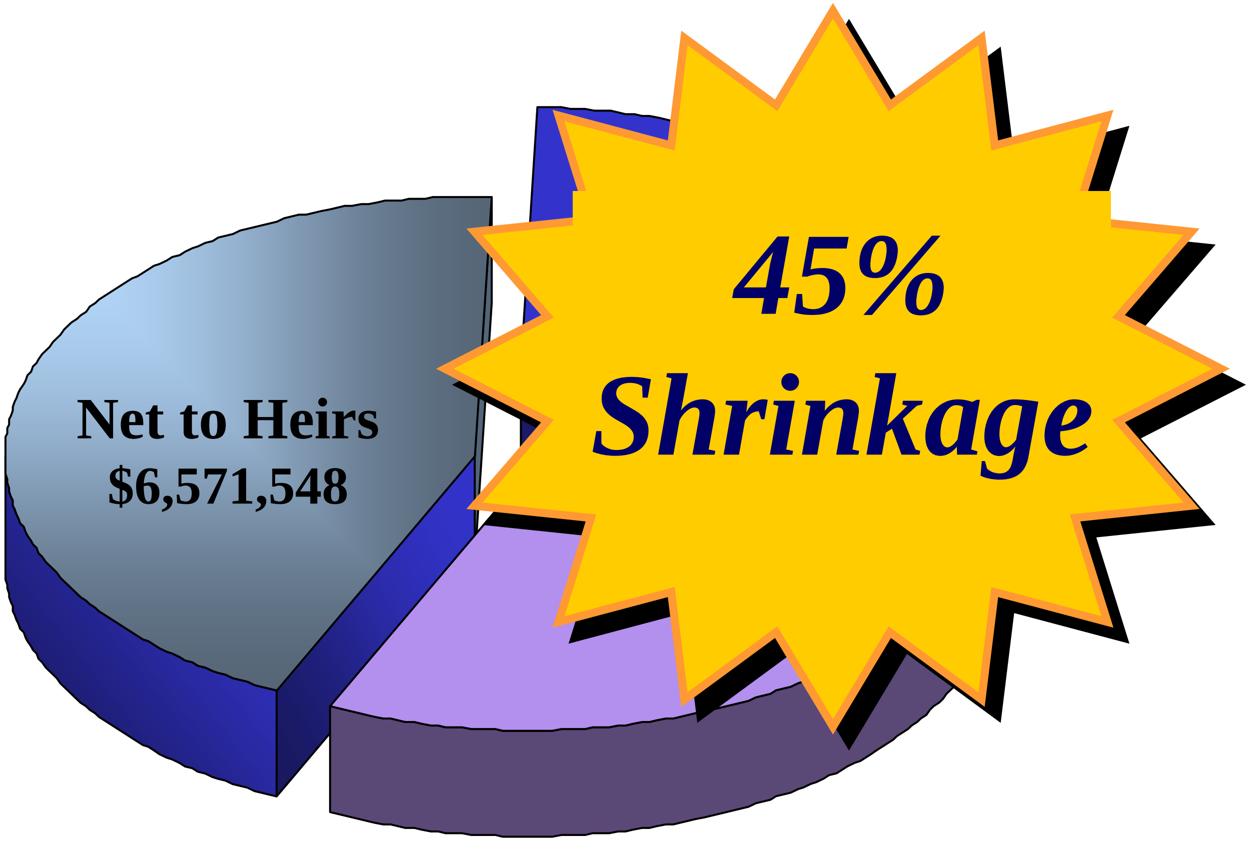
Alwin C. Ernst Estate



Alwin C. Ernst Estate



Alwin C. Ernst Estate



Discuss Here the

“Estates of 4 Famous People”

Handouts

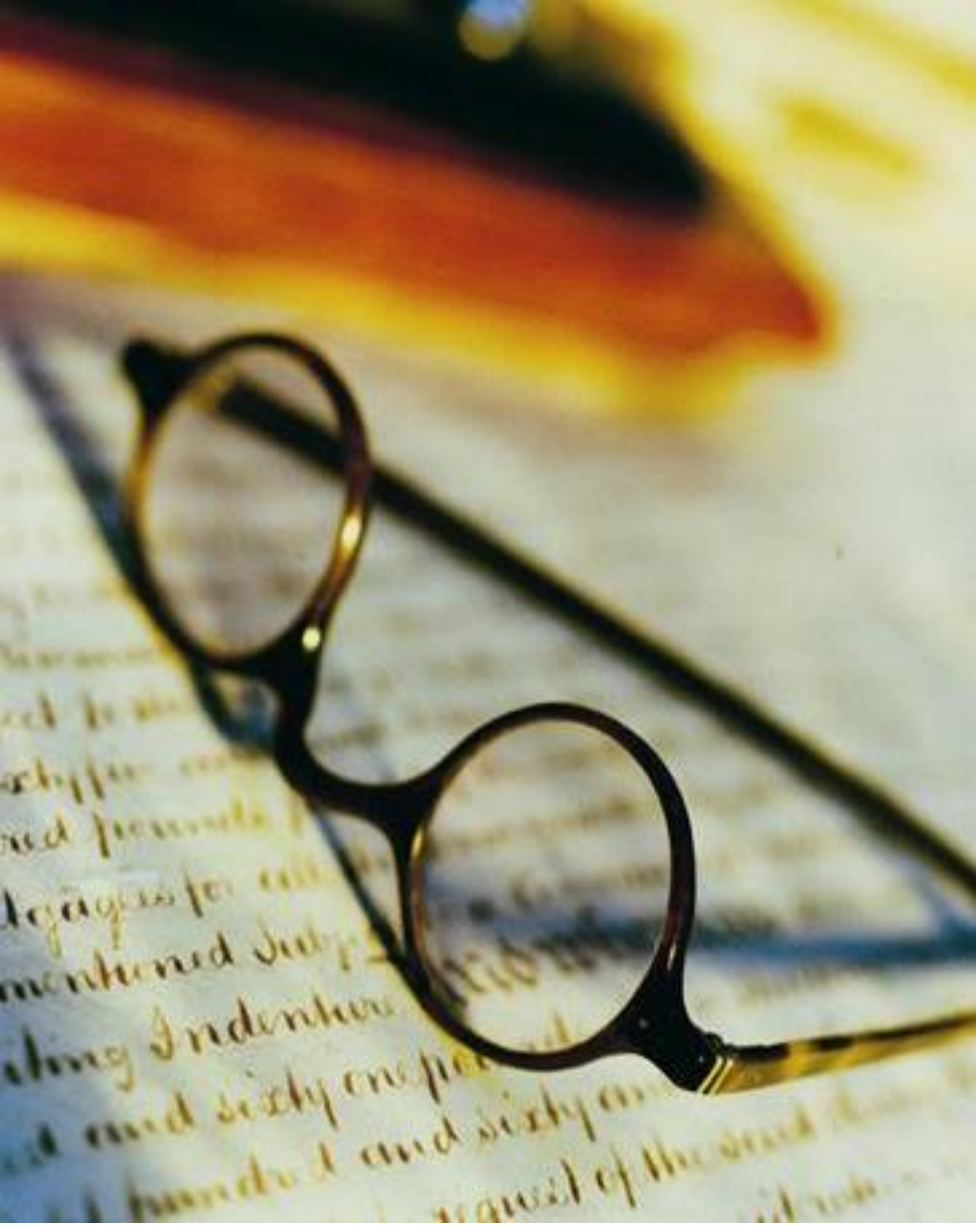
Advanced Directives

The Advanced Directive or “Living Will” is the best method to control medical care when you’ve lost communication

- Assign an Agent
- Describe your desire for pain relief
- Limit medical treatment, if desired

Power of Attorney

- Assign Responsibility and ability to act on your behalf.



Protecting Assets from Medicaid

Protecting Assets from Medicaid

- The Homestead Rule
- Detached Property
- Asset Retention Limits
- Equipment and Other Business Assets
- Income Limitations
- Spend-down
- Liens

Protections for the Community Spouse

- Community Spouse Resource Allowance (CSRA):
  - Minimum \$28,001
  - Maximum \$99,540
- Increased CSRA:
  - Permitted, but rarely used. Minnesota follows the income-first rule.
- Annuities
  - Actuarially sound annuities are permitted (but restrictions apply; check with attorney).
- Monthly Maintenance Needs Allowance:
  - Minimum \$1,604.00
  - Maximum \$2,488.50

Transfers

- Average monthly cost of nursing home care according to state:

$4,198.00

Income

- Is the state an "income cap" state?

NO

Estate Recovery

- Has the state expanded the definition of "estate" beyond the probate estate?
  - No (but exceptions apply; check with attorney)

- Has the state included a hardship?
  - Yes

Common Estate Planning Strategies

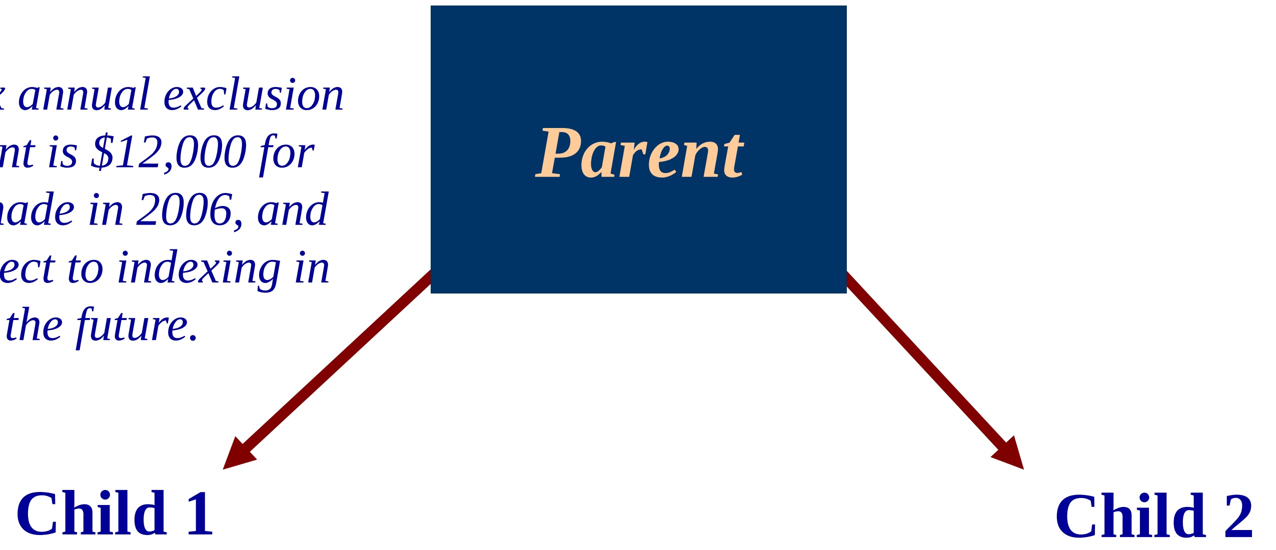
Common Estate Planning Strategies

- Outright Gifts
- Family Farm Owned Business Deduction
- Grantor Retained Trusts
- Charitable Remainders Trusts
- Irrevocable Insurance Trusts
- Wait-and-See Trusts
- Family Limited Partnerships

Outright Gifts

Outright Gifts

Gift tax annual exclusion amount is $12,000 for gifts made in 2006, and is subject to indexing in the future.



$12,000/donor/donee

Gifting Through the Unified Credit

Husband - $2,000,000

► Gift to Children

Wife - $2,000,000

- Requires a gift Tax Return
- No Stepped-up basis
- Cannot retain control or enjoy the benefit of Gifted property

Gift Challenges

- Estate Growth exceeds tax free gifts
- Gift assets may be essential to owners
- Gifting the Farm requires restructuring and valuations

Family Farm Business Deduction

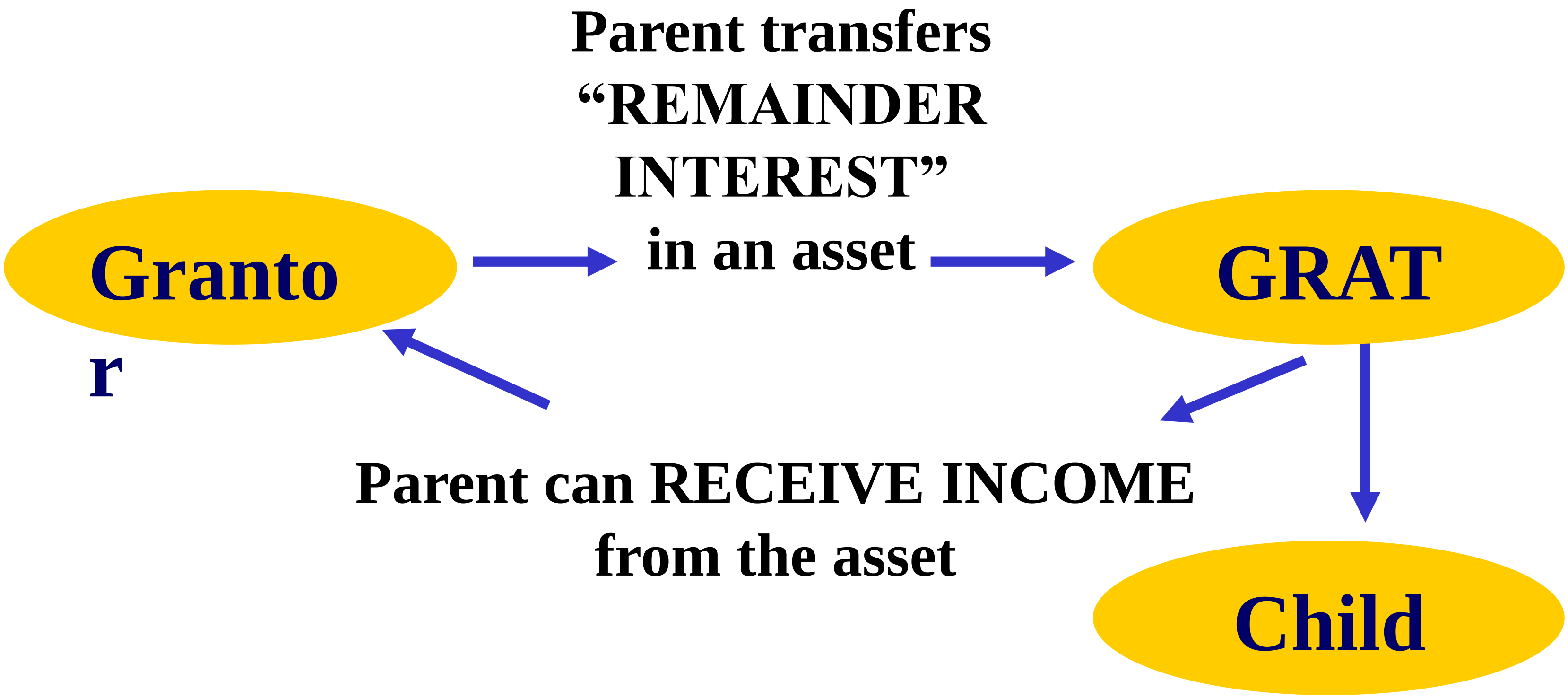
If elected, Applies To Estates Prior To 2004 or After 2010

- The deduction is the lesser of the unified credit equivalent or the adjusted value of the business
- The business must pass to a qualified heir
- The business must be operated by a qualified heir for five of any eight year period in the first 10 years after decedent's death
- Many other rules apply

Common Strategies

- Outright Gifts
- Grantor Retained Trusts
- Charitable Remainder Trusts
- Irrevocable Insurance Trusts
- Wait-and-See Trusts
- Family Limited Partnerships

Grantor Retained Annuity Trust



Common Strategies

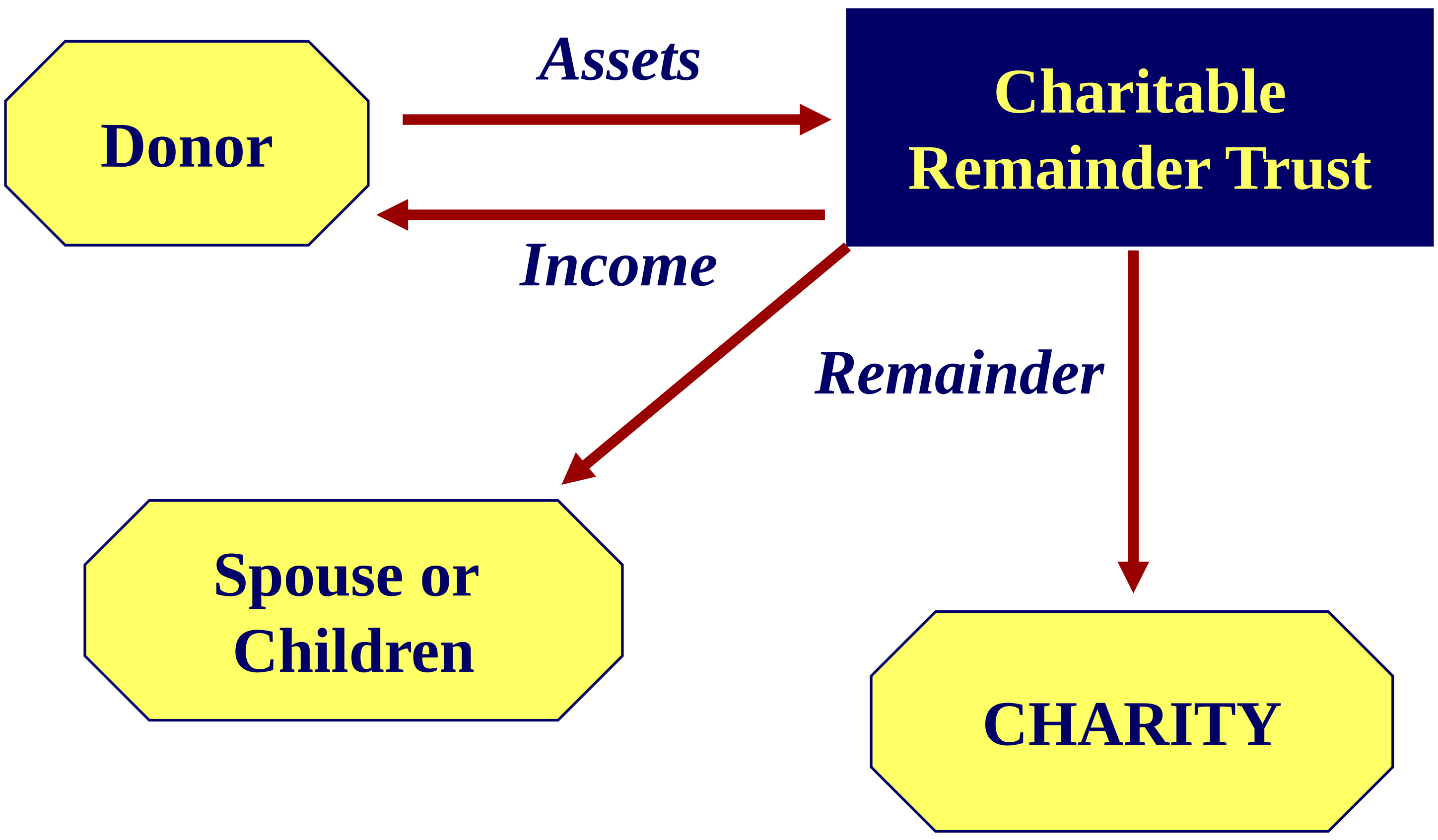
Clearance Sale!

20 - 30 - 40% Off!

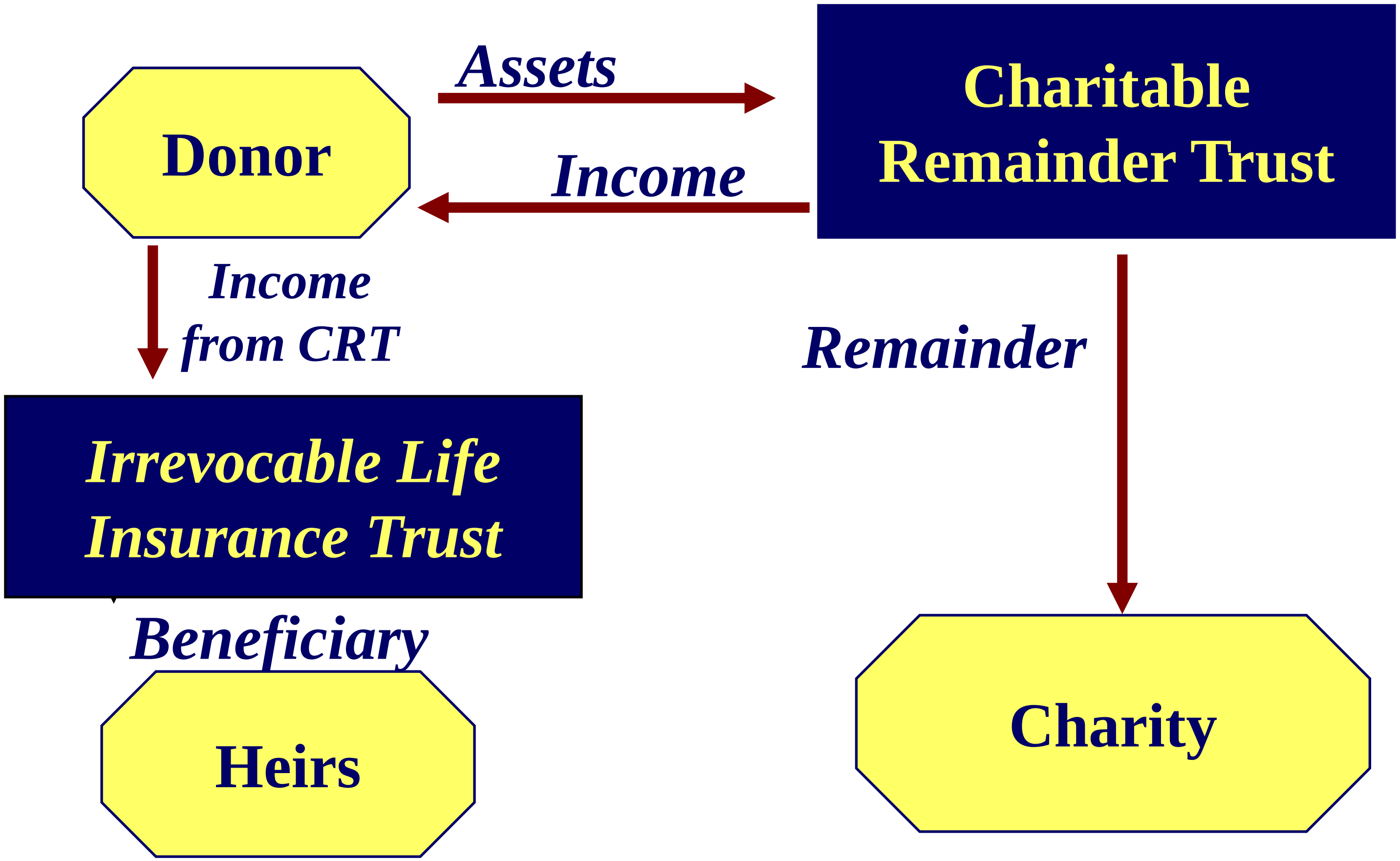
Common Strategies

- Outright Gifts
- Grantor Retained Trusts
- Charitable Remainder Trusts
- Irrevocable Insurance Trusts
- Wait-and-See Trusts
- Family Limited Partnerships

Charitable Remainder Trusts



Charitable Remainder Trusts & The Wealth Replacement Trust



Charitable Remainder/Wealth Replacement Results

- A sizable gift has been made to donor’s favorite charity.

Charitable Remainder/Wealth Replacement Results

- A sizable gift has been made to donor's favorite charity.
- A current income tax charitable deduction is available for the gift of remainder interest.

Charitable Remainder/Wealth Replacement Results

- A sizable gift has been made to donor’s favorite charity.
- A current income tax charitable deduction is available for the gift of remainder interest.
- The assets transferred to charity escape estate taxation.

Charitable Remainder/Wealth Replacement Results

- A sizable gift has been made to donor's favorite charity.
- A current income tax charitable deduction is available for the gift of remainder interest.
- The assets transferred to charity escape estate taxation.
- Donor receives cash flow from CRT (to pay premiums in the wealth replacement trust).

Charitable Remainder/Wealth Replacement Results

- A sizable gift has been made to donor's favorite charity.
- A current income tax charitable deduction is available for the gift of remainder interest.
- The assets transferred to charity escape estate taxation.
- Donor receives cash flow from CRT (to pay premiums in the wealth replacement trust).
- Amount passing to heirs has been preserved. Death proceeds in irrevocable trust provide attractive replacement for assets given to charity.

Charitable Remainder/Wealth Replacement Results

- A sizable gift has been made to donor's favorite charity.
- A current income tax charitable deduction is available for the gift of remainder interest.
- The assets transferred to charity escape estate taxation.
- Donor receives cash flow from CRT (to pay premiums in the wealth replacement trust).
- Amount passing to heirs has been preserved. Death proceeds in irrevocable trust provide attractive replacement for assets given to charity.
- Death proceeds are not includible in donor's estate.

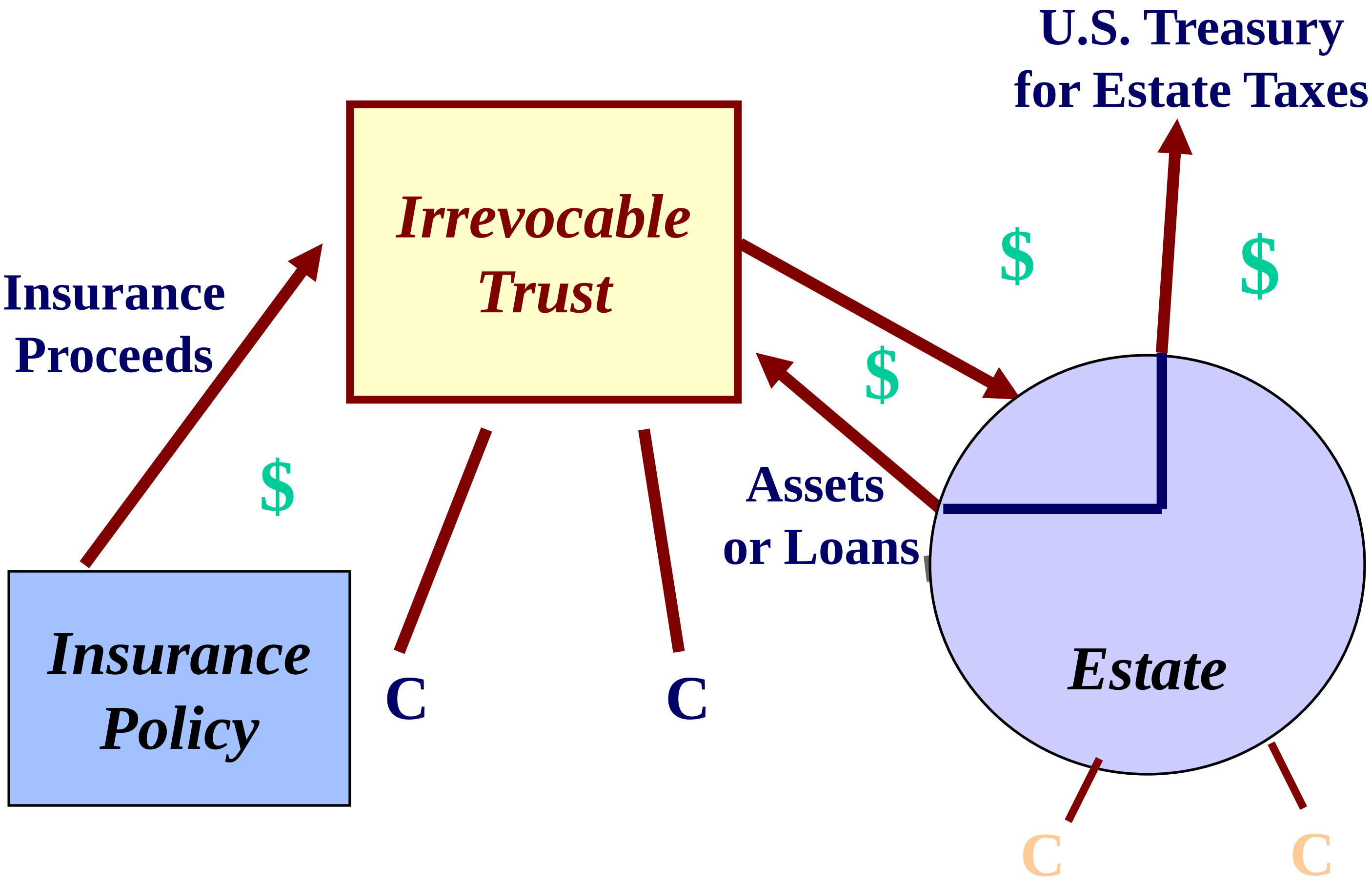
Common Estate Planning Strategies

- Outright Gifts
- Grantor Retained Trusts
- Charitable Remainder Trusts
- Irrevocable Insurance Trusts
- Wait-and-See Trusts
- Family Limited Partnerships

Mechanics of Irrevocable Life Insurance Trust

- Attorney drafts trust
- Client contributes cash to Trustee
- Purchase life insurance policy

How the Irrevocable Insurance Trust Provides Estate Liquidity



Common Estate Planning Strategies

- Outright Gifts
- Grantor Retained Trusts
- Charitable Remainder Trusts
- Irrevocable Insurance Trusts
- Wait-and-See Trusts
- Family Limited Partnerships

Wait-and-See Trust

Today. . .own policy

After one spouse dies

Policy → ***TRUST***

After Second Death

Death Benefit Cash → ***TRUST***

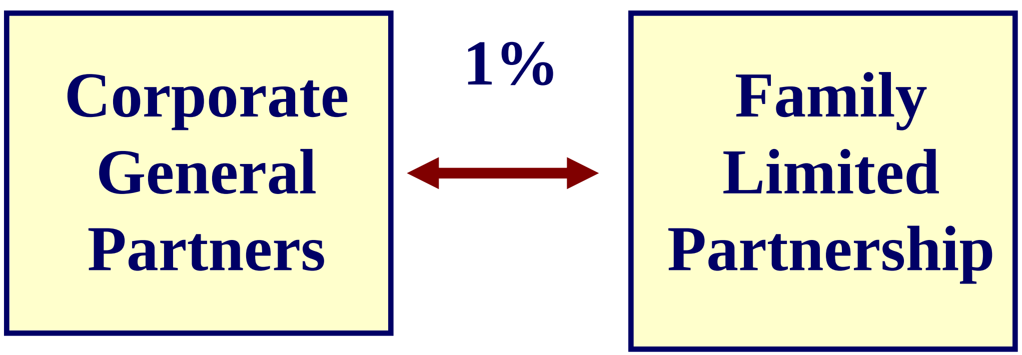
Common Estate Planning Strategies

- Outright Gifts
- Grantor Retained Trusts
- Charitable Remainder Trusts
- Irrevocable Insurance Trusts
- Wait-and-See Trusts
- Family Limited Partnerships

Family Limited Partnerships

Corporate General Partners

Family Limited Partnerships



Family Limited Partnerships

Benefits of a FLP

- Reduces <u>current</u> income tax liability.
- Centralizes ownership of assets.
- Shields assets from malpractice & liability claims.
- Lowers the value of your taxable estate.
- Minimizes probate expenses.
- Assets are not publicly displayed.
- Flexible, nothing is irrevocable.

Common Estate Planning Strategies

- Outright Gifts
- Grantor Retained Trusts
- Charitable Remainder Trusts
- Irrevocable Insurance Trusts
- Wait-and-See Trusts
- Family Limited Partnerships

Valuing the Farm

What is the Fair Market Value of a Farm?

"The price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts."

Remember…the reality is that the estate must make a good faith valuation of the property and the IRS can challenge that value. The best method to obtain a value that will withstand scrutiny is to hire a competent appraiser

Three Common Methods of Valuation

1. Market Data – An arms length sale of the property being valued, or if available, comparable values.

2. Capitalization of Income – The projected net income of the property from the highest and best use of the property capitalized at a rate that reflects a fair return on this investment.

3. Redemption Cost – An estimate of the cost of replacing a structure combined with an appraisal of the land.

Alternative Valuation

The highest and best use provision is eliminated and the property is valued as a farm under section 2032(a) of the Internal Revenue Code.

1. Must be elected.
2. The owner must be a citizen or resident of the U.S.
3. Cannot reduce the value by more than $840,000 (2003).
4. Must have been farmed for 5 of the last 8 years (retirement or disability exceptions).

5. 50% of the adjusted gross estate consists of farm that was passed to a qualified heir.
6. 25% of the adjusted gross estate is farm real property.
7. Must continue to be operated as a farm for 10 years.

The most commonly used method of valuation under this provision is the cash rental approach:

Annual Gross Cash Rental,

minus Property Tax,

all divided by the

Federal Land Bank Loan Rate

How You Can Help!

- Estate inventory

Creating a Transition Plan

1. **Establish a process** – Meet with the owners to lay the foundation of the process. Which advisors will be used? Who is in the first meeting? (Usually just the owners and a primary advisor)

2. **Establish Goals**. What must be done to effectively transfer the business. What are their security needs now and in retirement? Do they have an intended buyer or someone who will receive the farm?

3. **What are the impediments to reaching these goals?** Is there an equality issue? What would disability do to the plan? How do they execute the plan with the least tax and legal cost?

Establishing the Process – The first meeting.

- Who do you want the farm to go to?
- When do you plan to transfer the farm?
- What is the value of the farm?
- What terms do you want for the sale or other transfer of the farm?

- What are your retirement goals?
- Is the farm the only source of income?
- Have you diversified the risk of having adequate funds for retirement?

- If the children will not be receiving or keeping the farm, do you have a potential buyer? Do you want a full buy-out or will you carry a note on the property?
- Are you willing to rent the farm for some period of time?
- Will you consider a reverse mortgage?

- Who do you want in the next meeting?
- What do you want to accomplish (e.g. determine if children want the farm, when, and under what terms).
- Have you discussed this topic with the children to determine their interest and issues? What is your plan to ensure harmony, if possible?

The process should end with wills, advanced directives, Power of Attorney, insurance, and agreements for purchase if appropriate.

The Second Meeting…

- A family meeting
- Communication, Communication, Communication
- Review discussions of first meetings
- Focus on results
- Design the family goals

Goals

List the most important goals for the family.

The following are examples…

1. Establish the who and how of transition of the farm.
2. Determine which children, if any, have an interest in working the farm.
3. Discuss and plan for equality of treatment between family members.
4. Establish a retirement plan, and a method of funding it.

5. Account for events that can deter the plan and implement methods of dealing with those risks.
6. Establish wills and advanced directives and Power of Attorney.
7. Execute any documents that are needed to implement the plan.

Risk Reduction

There are risks to any transition plan:

- ✓Disability
- ✓Nursing Home Costs
- ✓Change

Disability

A severe disability can significantly reduce income causing acceleration of transfer or general dissolution of the plan.

- Rental Income
- Social Security Disability
- Private Disability Plans
- Outside Income Group Plans
- Retirement Plans

Nursing Home Costs

- Rental Income
- Retirement Income
- Long Term Care Insurance

Dealing with Transition

The best laid plans often go astray.

Never has this been truer than with farm transition planning.

1. It must be updated periodically.
2. It requires an impetus at time of implementation. (Who's in charge of starting the transition)
3. The owners must deal with the emotional issues of change. (The Hero's Farewell by Jeffrey A. Sonnenfeld).

Final Tips

- Volunteer to be the quarterback.
- Start Now
- Communicate openly with family members about the transition goals and plan.

- Establish a vision and execute the documents to enable it to happen.
- Deal with family equity.
- Select advisors and empower them to do their job.

- Build a plan that makes you feel comfortable, and makes your family members feel they are being heard.
- Implement the tools that you feel are necessary to reduce the risks in the plan.
- Review the plan regularly.

Thank You!

Thank you for attending today. Please fill out the evaluation form.