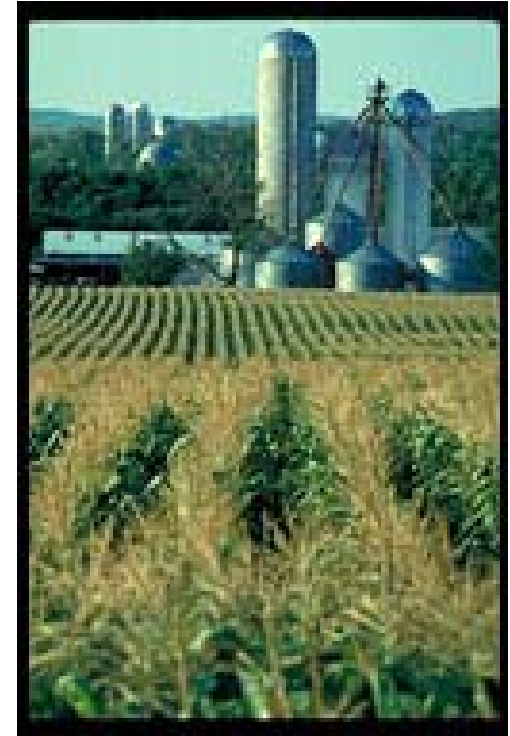


# Farm Transition & Estate Planning:

PorkCast Online Seminar Series  
May 6<sup>th</sup>, 2008 1:00 pm

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# Farm Transition & Estate Planning

- Set the Stage:

- Need to complete **BOTH** a farm business transfer plan **AND** a personal estate plan.
- Both need to be done simultaneously.
- Both need to compliment one another.
- A problem with one will cause a problem with the other.

# Preparing to Transfer the Farm Business

# Farm & Family Transfer Goals

- Begin transfer process with establishing goals.
- Goals are the “What” of the transfer process:
  - “What” you want or do not want to have happen?
- Examples:
  - I/we want to keep the farm business in the family and keep the farming heir(s) on the farm.
  - I/we want to transfer the farm business with the minimum of tax obligation.
  - I/we want to protect the farm business from lawsuits.
  - I/we want to protect the farm business from divorce.

# Issues to Consider

- Retiree's willingness to let go.
  - Transfer assets PLUS business management/control
- Retiree's emotional readiness for retirement.
- Relationships between family members.
- Will the farm support multiple families?
- Does the entering farmer have management capability?
- Other key questions to discuss with family members.

# Goal Requirements

- Goals need to be in writing.
- Goals must be written in specific terms for specific results.
- Goals must be attainable & realistic.
- Goal setting must be dynamic & flexible.
- Goals must have a timeline.
- Farm and family goals may conflict, requiring prioritizing and ranking.



# YOUR GOALS

- Answering the following questions should help you develop your goals:
  - What do you want from or for your farm business?
  - What do you want for your family?
  - What do you want for yourself?
  - What do you want in your retirement?

# Goal Worksheets

- Example worksheets to begin goal setting process:

Worksheet #1 Developing Goals Individually

Worksheet #2 Blending & Prioritizing Goals  
(each generation separately)

Worksheet #3 Prioritizing Overall Goals  
(blending generations together)

# Goal Setting Worksheet #1

## Individual Goal Setting

**Directions:** Begin by entering your personal, high priority goals within each of the categories. Then enter your short term goals in the appropriate columns. Each member of the retiring and succession farm family should list their goals on a separate Worksheet # 1.

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**Your High Priority  
Long-Term Individual  
Goals**

**Your High Priority  
Long-Term Family  
Goals**

**Your High Priority Long-  
Term Business/Career  
or Retirement Goals**

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## Short-Term Goals That Support the Long-Term Goals

**Individual**

**Family**

**Business/Career  
or Retirement Goals**

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# Goal Setting Worksheet #1

## Individual Goal Setting

Your High Priority  
Long-Term Individual  
Goals

Own 1,000 acres  
farmland

Your High Priority  
Long-Term Family  
Goals

College costs paid  
for kids

Your High Priority Long-  
Term Business/Career  
or Retirement Goals

Maintain farm base  
Expand when possible

## Short-Term Goals That Support the Long-Term Goals

Individual

Pay down debts

Family

Save \$10,000/Year

Business/Career  
or Retirement Goals

Buy one piece of  
machinery each  
year

# Goal Setting Worksheet #2

## Blending Goals (generations separately)

**Mutual Goals**: Directions: In a team effort, take a look at Worksheet #1 together. From that list of goals, the retiring family and the succession family should independently discuss the priority goals and write the goals that you, as a transfer team, view as high priority in each category. Each of the families should have their own Worksheet # 2 completed.

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**Your High Priority Long-Term Individual Goals**

**Your High Priority Long-Term Family Goals**

**Your High Priority Long-Term Business/Career or Retirement Goals**

---

# Goal Setting Worksheet #2

## Blending Goals (generations separately)

---

**Your High Priority Long-Term Individual Goals**

**Parents buy home in town**

**Children buy farmstead**

**Children buy more farmland**

**Your High Priority Long-Term Family Goals**

**Buy life insurance on parents for siblings inheritance**

**Parents have cash reserve for retirement \$200,000**

**Everyone understands goals of transfer plan**

**Your High Priority Long-Term Business/Career or Retirement Goals**

**Farm operation transferred to next generation**

**Have equipment transferred in 10 years**

**Parents sell crops and livestock as quickly as possible with the least taxes due**

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# Goal Setting Worksheet #3

## Prioritizing Goals

- A.** Which goals are most important for family well-being, business success, and/or retirement success?
- B.** Which short-term goals, if attained, would help you achieve your long-term goals?
- C.** Which short-term goals conflict with or impede your long-term goals?
- D.** Which goals are so important that they should be attained even if it prevents you from reaching other goals?
- E.** List your top five goals by priority.

# Prioritizing Goals

## Example

- A. Transfer sufficient assets for next generation's success.
- B. Sell non-essential assets.
- C. Develop cash reserves to provide flexibility.
- D. Continue to own land until death.
- E. Top 5 goals by priority:
  - 1.) Keep land ownership until death for basis increase.
  - 2.) Transfer control of farm operation to next generation.
  - 3.) Gift \$12,000 worth of equipment each year.
  - 4.) Establish life insurance policy for non-farm siblings.
  - 5.) Create cash reserve of \$200,000 for senior generation.

# Major Tax Considerations When Transferring Assets

# Asset Basis

# Determining Basis

- What is “basis”?
  - When selling an asset, you must pay tax on the difference between the selling price and your “adjusted basis” (cost plus improvements minus depreciation) for the asset.

• Example: Sell land for	\$200,000
Adjusted basis	<u>\$ 50,000</u>
Taxable gain	\$150,000

# Determining Basis

- If you **purchased the asset**:
  - Your basis is the amount you paid for the asset, plus improvements, less any depreciation taken over the period of time you owned it.
  - Example:
    - Tractor purchased for \$120,000.
    - You have depreciated \$42,850 over three years.
    - Your adjusted basis is \$77,150.

# Determining Basis

- With **gifted assets**:
  - Your basis is the same as the donor's adjusted basis before the gift was given to you.
  - Example: You receive a gift of a tractor valued at \$24,000. The donor's adjusted basis was \$2,500.  
  
Your basis is \$2,500.

# Determining Basis

- With **inherited assets**:
  - Your basis is the Fair Market Value (FMV) or Special Use Value assigned to the asset as it passed through the decedent's estate.
  - **Example**: You inherit land from your mother valued at \$185,000 in her estate. Her basis was \$42,000.

Your basis in the land will be \$185,000.

# “Stepped Up” Basis

- Assets that pass through an estate receive a “stepped up” basis.
- The “stepped up” basis is usually the Fair Market Value (FMV) on the date of death.
- Incentive to hold “low basis” property until death to achieve the “stepped up” basis for the heirs.

# Capital Gain Tax

# Capital Gain Tax

- Prior to the 2003 tax law change, rates were 10% and 20% (were as high as 28%). **Now 5% & 15%.**
- In 2008, 2009, & 2010 (for taxpayers in the 10% and 15% Federal tax brackets) the 5% capital gain tax rate will drop to 0%, but then former rates (10% & 20%) come back unless changed by Congress.
- Farm building sales may be subject to different tax rates (25%). Collectables 28%.

# Capital Gain Tax

- **Three additional points regarding Capital Gain Tax:**

- \* MN. taxes must also be paid on capital gain income (rate is 5.35 – 7.85%).
- \* When planning a farm transfer, maximize the use of lower Capital Gain Tax rate.
- \* Sales of capital assets are not subject to the 15.3% Self-Employment tax (Social Security/Medicare).

# Federal & Minnesota Estate & Gift Tax

# Federal Estate Tax

Estate taxes will be assessed on any estate that exceeds the Applicable Exclusion Exemption. The amounts vary year by year:

<u>Year:</u>	<u>Exclusion:</u>	<u>Credit:</u>
2004 – 2005	\$1,500,000	\$555,800
2006 – 2008	\$2,000,000	\$780,800
2009	\$3,500,000	\$1,455,800
2010	No Tax	No Tax
2011	\$1,000,000 ?	\$345,800 ?

# Minnesota Estate Tax

- The phase-down and eventual repeal of the federal estate tax brought about by the 2001 change in federal tax laws, meant that Minnesota would eventually receive no revenue from estate taxes.
- The 2001 Minnesota Legislature imposed a “stand alone” estate tax.
- This will have different consequences for different individuals, depending on the value of their assets and provisions of their estate plan.
- **NOTE:** Even though no Federal Estate Tax is owed, a Minnesota Estate Tax may be owed.

# Federal and Minnesota Exemption Amounts

<b><u>Year of Death:</u></b>	<b><u>Minnesota Exemption Amt:</u></b>	<b><u>Federal Exemption Amt:</u></b>
2004	\$850,000	\$1,500,000
2005	\$950,000	\$1,500,000
2006,2007,2008	\$1,000,000	\$2,000,000
2009	\$1,000,000	\$3,500,000
2010	\$1,000,000	Estate Tax Repealed
2011	\$1,000,000 ?	\$1,000,000 ?

# Non-Taxable Gifts

- Gifts to a spouse (US Citizen), regardless of amount (called Marital Deduction).
- Gifts to a spouse (non-US Citizen) up to \$120,000.
- Generally gifts to a qualifying charity, regardless of amount.
- Up to \$12,000 per donor, per recipient, to any number of recipients in a calendar year (Annual Exclusion).
- Each spouse has an Annual Exclusion. Couples can therefore gift \$24,000 to any number of recipients every year, without being taxed.

# Taxable Gifts

- Amounts that exceed Annual Gift Exclusion (\$12,000) given to someone other than a spouse or qualifying charity.
  - Gift tax Form 709 must be filed if gift exceeds \$12,000 (\$24,000 for couple).
  - No tax due until gifting exceeds \$1 million Lifetime Gift Exclusion, per donor.
- Gifts that exceed \$1 million Lifetime Gift Exclusion per donor:
  - Tax is due immediately.
  - Form 709 must also be completed.
- Any tax due is imposed on the person transferring property rather than on the recipient. However, IRS can collect a decedent's unpaid tax from those receiving the property.

# Sample Calculation #1:

Total Gross Estate ('07)	\$2,200,000
Less Allowable Deductions	-36,000
Tentative Taxable Estate	2,164,000
Less State Tax Deduction	-111,920
Taxable Estate	2,052,080
Plus Taxable Gifts	<u>+16,000</u>
<b>Total</b>	<b>\$2,068,080</b>

Tentative Tax ('07)	\$812,116
Less Unified Credit ('07)	<u>-780,800</u>
Federal Estate Tax	<b>\$ 31,316</b>

<b>Federal Estate Tax**</b>	<b>\$ 31,316</b>
<b>Minnesota Estate Tax**</b>	<b>\$ 111,920</b>

**\*\*Above are estimated taxes as of 8/1/07. Final tax forms & instructions for 2007 were not available at time of printing.**

# Federal Estate & Gift Tax Rates

<u>Year</u>	<u>Highest Estate Tax Rate</u>	<u>Highest Gift Tax Rate</u>
2001	55%**	55%**
2002	50%	50%
--	--	--
2006	46%	46%
2007 – 09	45%	45%
2010	Repealed	35%
2011	55%**	55%**

\*\*Note: A 5% surtax is imposed on amounts over \$10 million.  
Rate drops back to 55% for amounts over \$17,184,000.

# Proposed Federal Estate Law Changes



**\*\*Currently being discussed by Congress.  
See your attorney & accountant!**

# Farm Transfer: Overview of Strategies

# Transfer Strategies

- **Sole Proprietorship:**
  - One owner – operator
  - Limited liability protection
  - Maximum business flexibility
  - Individual income tax
- **Transfer requires asset sale, gifting, passing through estate, or combination of all three.**



# Transfer Strategies

- **General Partnership:**
  - Two or more people in business for profit:
  - Asset percentage contributed, determines percent ownership of each person.
  - Partnership pays no taxes – profit/loss to individuals.
  - Recommend a written partnership agreement.
  - Each partner fully liable for debts & obligations of partnership.
  - Partners can transfer ownership units to entering generation:
    - Units can be sold, gifted, passed through estate, or combination.

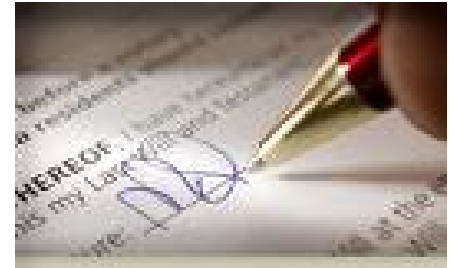


# Transfer Strategies

- **Limited Liability Partnership (LLP):**
  - **Reasons for forming:**
    - **Desire different partnership participation.**
      - **General partner(s) manage the partnership, have unlimited liability.**
      - **Limited partner(s) contributes assets only, limited liability based upon assets contributed.**
  - **Profit or loss distributions should to be made in the same proportion as the LLP ownership percentages with profit/loss to individual income tax.**
  - **Can transfer LLP units: sell, gift, pass through estate, or combination of all three.**

# Transfer Strategies

- **Corporation:**
  - **Separate distinct entity from individuals.**
  - **Types include S and C corporation:**
    - **S corp can elect to be a pass through entity**
    - **C corp may end up paying tax as an entity**
  - **Operating assets go into corporation.**
  - **Land should not go into the corporation.**
  - **Offers liability protection.**
  - **Corporation (all other entities) may be able to rent land from the shareholders without SE tax.**
  - **Easy to transfer shares of stock: sell, gift, pass through estate or combination.**



# Transfer Strategies

- **Limited Liability Company (LLC):**
  - Can have one or more members (shareholders).
  - Is a hybrid:
    - Functions as a partnership with regard to taxation
    - Functions as a corporation with liability protection
  - Role in transition process:
    - Exiting generation can sell, gift or pass through estate their LLC shares to entering generation.
  - Structure protects assets from law suits and other adverse actions if registered in “protective state”.
    - Protective states: Alaska, Arizona, Delaware, Nevada, Oklahoma, South Dakota & Wyoming

# Transfer Strategies

- **Selling Assets:**

- **Installment sale: difficult to accomplish (remember capital gains and depreciation recapture), all tax due first year of sale.**
- **Large, one-time sales can cause tax issues for seller.**
- **Large, one-time sales can be financially difficult for entering generation.**
- **With sales, there is no “stepped up” basis.**
- **Crop & market livestock sales are subject to SE tax.**
- **Piecemeal sales work well.**

# Transfer Strategies

- **Machinery & Livestock:**
  - **Piecemeal sale:**
    - Year 1: sell – item #1
    - Year 2: sell – ½ interest in item #2
  - **Piecemeal sale with gifting:**
    - Year 1: sell – item #1  
gift – ½ interest in item #2
    - Year 2: sell – item #3  
gift – remaining ½ interest in item #2

# Transfer Strategies

- **Gifting Assets:**

- **Federal law allows tax free gift of \$12,000 per donor, per recipient, per year (maximum tax free from couple of \$24,000).**
- **Gifts are valued at FMV for \$12,000 determination.**
- **Donor's basis (not FMV) goes with the gift.**
- **When utilizing a business entity, can gift ownership shares. If discounting (typically 25-35%), can actually gift more than the \$12,000 per recipient.**

# Transfer Strategies

- **When gifting assets ask yourself:**
  - **Do the gifts jeopardize the farming heir(s) and your goals for the farm?**
  - **Can you afford it?**

# Transfer Strategies

- **Gifting Assets – CAUTION!**
  - Deficit Reduction Act of 2005 (law Feb. 8, 2006)
    - Medicaid (Medical Assistance) look-back/disclosure period extended to 60 months
    - Gifts/non-compensated transfers of any amount make you ineligible for Medicaid for up to 60 months.
    - Period of ineligibility begins at the time of Medicaid application, once spent down to total assets remaining of \$3000 (individual).

# Financial Considerations in Transferring the Farm

# When looking at retiring.... Ask Yourself Three Questions

- 1.) How much money will be needed in retirement?
- 2.) What will my expenses be in retirement?
- 3.) What are my sources of retirement income?



# Inflation Factor

Years to Retirement	3%	4%	5%	6%	7%	8%	9%
1	1.03	1.04	1.05	1.06	1.07	1.08	1.09
2	1.06	1.08	1.10	1.12	1.15	1.17	1.19
3	1.09	1.13	1.16	1.19	1.23	1.26	1.30
4	1.13	1.17	1.22	1.26	1.31	1.36	1.41
5	1.16	1.22	1.28	1.34	1.40	1.47	1.54
10	1.34	1.48	1.63	1.79	1.97	2.16	2.37
15	1.56	1.80	2.08	2.40	2.76	3.17	3.64

**Utilize these inflation factors to figure out how much income will be required when you plan on retiring.**

**Example: You plan on retiring in 4 years and you need \$50,000 today to cover your retirement lifestyle. You expect inflation to be 5% per year. In four years you will need  $\$50,000 \times 1.22 = \$61,000$  of annual income to meet your forecasted expenses**

**\*\*Source: Dr. Sharon Danes, University of Minnesota**

# Examine Retirement Expenses

- List your current expenses.
- Determine if your retirement expenses will increase or decrease.
- Estimate retirement expenses.

# What are my sources of retirement income?

Social Security

Land Rent

Equipment Rent / Sale

Crops and Livestock

Employer Pension Plans

IRA's, Other Retirement Plans

Investments



# Net Income

- **Combined Net Income (farm and non-farm from both generations) must be sufficient to cover:**
  - **Family living needs of both generations.**
  - **Cover tax liability for both generations.**
  - **Service principal payments of term loans.**
  - **The rest is available for capital purchases.**

# **Farm Transition:**

## **Treatment of Heirs**

### **Financial Assistance**

# Treatment of Heirs

- Develop & implement a transfer plan:
  - Helps secure your goals for the farm business.
  - Secures future of farm heir(s).
- Provide protection in your estate plan for the farm heir(s):
  - Reasonable, sensible provisions for the farm heir through purchase agreement or buy-out provision.

# Treatment of Heirs

- **Things to consider:**
  - Non-farm heir(s) may have already received part of their inheritance (college tuition, down payment on house, etc.).
  - Farming heir(s) helped create part of the final estate of the parents.
  - Parents want the farm to stay “in the family” and the farm heir(s) are the only ones that share that goal.
  - Farming heir(s) may have to attend to the needs of the parents in their later life.
  - **Fair may not mean equal !**

# Financial Assistance

- **Financial assistance for beginning farmers:**
  - **Minnesota Rural Finance Authority (RFA):**
    - Have available several programs for beginning farmers in Minnesota.
    - Loans are backed by RFA.
    - Have net worth limits.
    - Management skills requirement.
    - Reduced interest rates.
    - Application process and fees.
    - Requires cash flow and other paperwork.
    - 800-967-2474    [www.mda.state.mn.us/agfinance](http://www.mda.state.mn.us/agfinance)



# Financial Assistance

- **USDA financial assistance for beginning farmers:**
  - **Farm Service Agency (FSA) Farm Loan Program:**
    - Credit & financial supervision to family-sized farmers.
    - Emphasis on helping beginning farmers enter farming.
    - Goal: borrowers make financial progress to qualify for commercial credit.
    - Loan types:
      - Operating & farm ownership
      - Direct & guaranteed
  - Contact: local FSA office staff in your county

# Financial Assistance

- **Do not forget your local lenders:**
  - **FSA Guarantee Loan assistance**
  - **Direct loans from the local lender**
  - **Local contacts and local service**

# Estate Planning and the Transition Process

# Will vs Trust

# Wills

Legal document that includes:

- Name Personal Representative for your estate.
- Instructions for distribution of your assets (is a court directed process).
- Better than dying without a Will (intestate).
- Name(s) of guardian(s) for your minor children.
- Can include “blood line” language.

# Wills

- Triggers probate process:
  - Own \$25,000 of assets or any real estate
- Probate process:
  - Court supervised process
  - Time - 12-18 months on average in MN
  - Cost – 2 to 3% of estate value
  - Open to the public
- No protection from law suits, adverse actions.
- No disability planning.

# Trusts



# Trusts

- Provide a means of holding and managing assets (must “fund” the trust).
- Established while you are alive – you are in control.
- Can empower someone else (called trustee or co-trustee) to manage/care for your assets in declining years or if you become disabled or incapacitated.
- Offer protection from law suits, other adverse actions.
- Allows for disability planning.

# Trusts

- Trusts reduce or eliminate estate and probate costs.
- Assets are not subject to the probate process.
- Is a private document, so the contents are not subject to public disclosure.
- Can include “blood line” language.
- Focus on two of many trusts:
  - Revocable (changeable)
  - Irrevocable (not changeable)



# Power-of-Attorney

# Power-of-Attorney

- **Two Categories:**
  - **Statutory Power-of-Attorney (POA):**
    - Powers are governed by state law – can be changed at any time by legislation.
    - Utilizes “short form” to grant powers.
    - Powers are usually very broad and are typically take effective immediately.
    - Statute limits gifting to \$10,000 per person per year.
  - **Common Law Power-of-Attorney (POA):**
    - Powers granted must be specifically stated.
    - Can be either general or springing (starts at pre-determined time or event).

# Power-of-Attorney

- **Common Law Power-of-Attorney:**
  - Individual (grantor) decides on powers to be given.
  - Grantor authorizes powers to be effective immediately or upon disability.
  - These powers will remain in effect throughout grantor's life or incapacity.
  
- **Durable Power-of-Attorney:**
  - Both Common Law & Statutory Powers-of-Attorney can be durable.
  - Durable POA means will continue to be effective after disability.

# Health Care Directive

# Health Care Directive

- **Document completed by individual listing their wishes regarding medical treatment preferences.**
- **Must also include HIPAA designee**
- **You choose:**
  - **Health care agent**
  - **Direct when they become your agent**
  - **Instructions to your agent**
- **Put into place along with your Common Law Durable Power-of- Attorney.**

# Farm Transition: Putting a Plan Outline in Writing

# Transition Plan

- **Transition plan is your business “road map”.**
- **Listing of all your individual, family & business goals – “what” you want to have happen.**
- **Who should be involved (you decide):**
  - **Involve farming heir(s) and their spouse.**
  - **Your transition & estate planning team.**
  - **Involve other family members as you see fit.**

# Transition Plan

- Work with professional team to draft/finalize plan.
- All farming parties need to read & sign the final plan.
- Be certain the transition plan is consistent with your goals AND your estate plan.
- Share the plan with non-farm heir(s) when completed (**Fair does not always mean equal!**)
- Review the plan and modify when necessary.

# Transition Plan Example

- Parents buy a house in town.
- Children buy the farmstead.
- Land will remain in parents name until death and rented at 75% of high end rents to farming children. (Rents \$140, Children pay \$105).
- Equipment will be gifted at \$12,000 per year and children will buy all equipment not owned in 10 years.
- Livestock, grain and feed will be sold over three years with children buying what they want and need.

# Transition Plan Example

- Parents will provide labor as available, but children should be able to complete work without parents.
- Life Insurance on parents will go to non-farming heirs along with house in town.
- Household items will be divided among children equally.
- Farming children will get farmland.

# Transition Plan Example

- Parents will establish a revocable living trust and then “fund” the trust.
- Co-Trustees of trust are parents, if they are disabled then the children.
- Parents Establish Common Law Durable Power of Attorney documents with children.
- Parents Establish a Disability Panel: MD, specialist and children on this panel.
- Establish a South Dakota LLC.

# Developing a Transfer & Estate Planning Team

- Be clear and firm about your goals.
- Have goals written in plan outline format BEFORE meeting with your team.
- Decide who you need on your team (attorney, accountant, financial planner, banker, etc.).
- Seek out professionals and make a list.
- Interview the various professionals.
- “Hire” only those that take a “consultative” approach to your transfer & estate plan.



# Farm Transition & Estate Planning

- For more information:

- [www.extension.umn.edu/agbusinessmanagement](http://www.extension.umn.edu/agbusinessmanagement)

- On left of page click on “publications”

- Scroll down to farm transfer, estate planning, and business management headings

# Farm Transition & Estate Planning

## Questions ??