FARM JOURNAL Legacy Project

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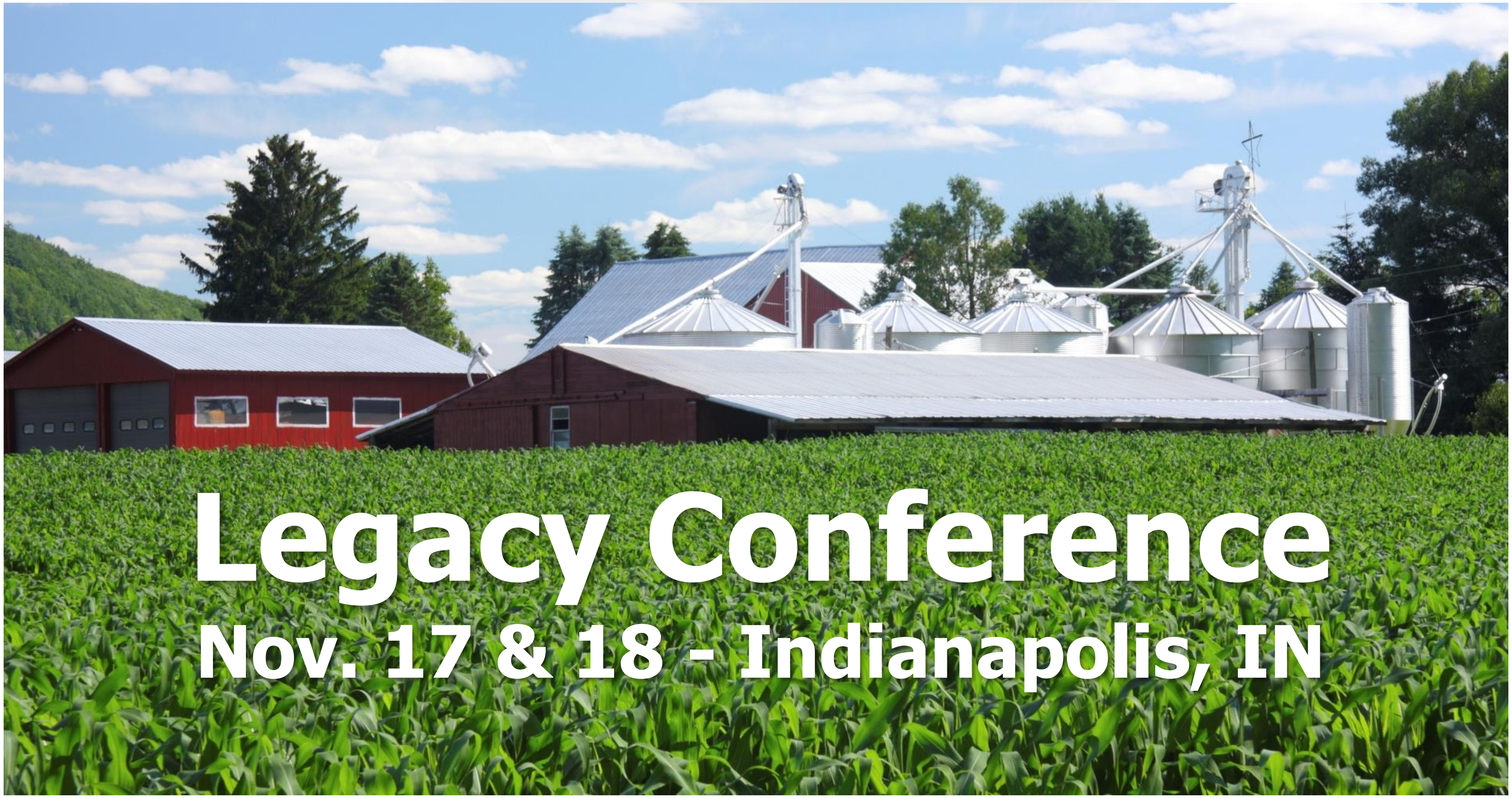


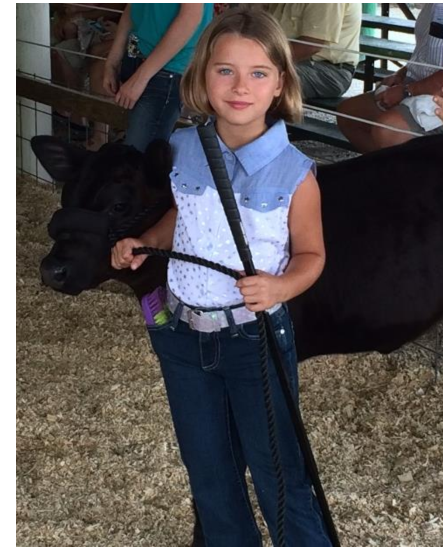
Legacy Conference

Nov. 17 & 18 - Indianapolis, IN

More Than Just a Will – Comprehensive Estate Planning

Polly Dobbs, Attorney

Speaker Introduction



Polly Dobbs, Esq. Owner,

Dobbs Legal Group, LLC

- Estate planning attorney passionate about helping farm families create holistic plans.
- Raised on a farm, left to do the city thing, thrilled to be back home raising the next generation on my family's farm.
- Conducts regular seminars and publishes written materials about succession of the family farm.
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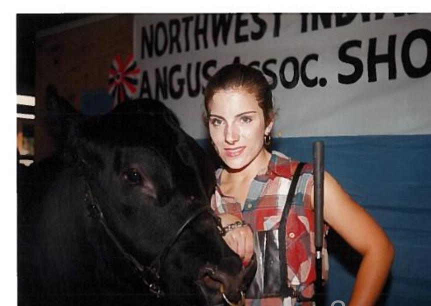

More Than Just a Will

- ✓ Focus on the planning aspect.
- ✓ Protect against disability.
- ✓ Who will care for you?
- ✓ How can you make sure your wishes are fulfilled after you're gone?

WHAT IF YOU GOT HIT BY A BUS TOMORROW?

- ✓ …and you didn’t die?
  - Court Appointed Guardian
  - “Not Dead Yet Documents”

- ✓ …and you did die?
  - Intestacy
  - Last Will and Testament
  - Trusts

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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.
  - Disagreements in medical care = court appointed Guardian of your Person.

NOT DEAD YET DOCUMENTS

- ✓ General Durable Power of Attorney
  - One for farm & one for personal matters
- ✓ Appointment of Health Care Representative
- ✓ Health Care Power of Attorney
- ✓ Living Will
- ✓ Life Prolonging Procedures Declaration

Ways to Pass Assets at death

- ✓ Intestacy- the do nothing 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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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
  - Example: half to surviving spouse and half to children
- ✓ Minor children inherit at age 18
- ✓ No preference expressed as to Personal Representative
- ✓ Your farm will be divided equally among those who take; like any other asset

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WHAT GOES IN MY WILL?

- ✓ Who's in charge – Personal Representative (Executor)
- ✓ How are taxes allocated
- ✓ Nominate Guardian for minor children
- ✓ Specifics about Tangible Personal Property ("the stuff")
  - Grandma's tea cup more important than the farm
- ✓ How to divide assets – perhaps including funding of trusts

PROPERTY NOT GOVERNED BY A WILL

- ✓ Wills do not affect the disposition of property that passes by operation of law or that passes pursuant to beneficiary designations. For example:
  - 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!

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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 an expenses.
- ✓ Many techniques can be used to avoid probate.
  - ✓ Revocable Trust
  - ✓ JTWROS
  - ✓ TOD/POD
- ✓ If probate becomes necessary, shop around for a lawyer who doesn't charge a fixed fee

LET'S TALK TAXES

- ✓ Upon death, up to $5.45 million (as of 1/1/2016) will pass exempt from Federal Estate Tax. A married couple can pass $10.9 million.

- ✓ During lifetime, you may give away up to $5.45M of your assets 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%.

LET'S TALK TAXES, continued

- ✓ Portability Election of unused exemption to surviving spouse. Can be a $5.45M mistake if not timely elected!

- ✓ **$14,000** annually to as many individuals as donor wishes, without reducing door's $5.45M estate tax exemption or triggering Gift Tax.

- ✓ State inheritance or estate taxes deserve special attention: Connecticut, Delaware, District of Columbia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oregon, Rhode Island, Vermont, Washington, Iowa, Kentucky, Nebraska, Pennsylvania
  - Tennessee repealed 1/1/2016
  - Indiana repealed 1/1/2013

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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 assts
- ✓ 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

A/B TRUST EXAMPLE

Trust A
Survivor's Trust
Remains Revocable

Survivor Gets
- All Income
- All Principal
- Right to amend
- Unlimited Power to appoint to anyone

First Spouse Dies

Trust B
Family Trust
Remains Irrevocable

Survivor Can Have
- All Income
- Principal for health, support and maintenance
- Some discretionary distributions with independent trustee

Tax on Assets over $5,450,000

Second Spouse Dies

No Tax

Children's Trust
- Assets can be held in this trust while children are growing in maturity
- The trustee manages estate and distributes it to children at specified ages

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

- ✓ If you're in a second marriage with children from a first marriage you can preserve assets for your children while providing lifetime support to surviving spouse. Provides protection if spouse remarries.

- ✓ If you have young children you need a trust

- ✓ Some have grown children with dependency problems, trouble handing money, bad marriages, or just don't want children to receive inheritance in a large lump sum

TRUST DISTRIBUTIONS

- ✓ This of Trust assets are “On a shelf” with trustee/gatekeeper in charge
- ✓ Beneficiaries receive distributions of the Trust’s income and perhaps principal on terms you set.
- ✓ Trust distributions can be made for health, education, and daily needs until a certain age, until an appointed advisor approves discretionary distributions, or throughout lifetimes.

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TRUST BENEFITS

- ✓ 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

- ✓ Trusts and LLE documents can only provide so much divorce protection, depending on a lot of factors, including how much control the beneficiary has. Ultimate discretion is given to the judge in the divorce proceeding.

- ✓ Best protection is a premarital agreement.

Prenup. Prenup. Prenup. Prenup. Prenup. Prenup. Prenup. Prenup. Prenup. Prenup.

PLANNING FOR THE FAMILY FARM:

- ✓ Have you asked your kids about this?
- ✓ You might be surprised!
- ✓ You decide what's fair. FAIR DOES NOT MEAN EQUAL.
- ✓ It's not a democracy.
- ✓ Once you decide – tell everyone – no surprises!

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Ideas & Strategies – First Right to Purchase

- ✓ 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.
- ✓ At death: Individual can leave the farm (or interests in LLE that owns the farm) equally to all children, requiring the off-farm children to offer their interests for sale to the on-farm child.

Ideas & Strategies – First Right to Purchase

- ✓ In either case, the document granting the first right can allow the purchase to be accomplished with a certain % as a down payment, and delivering a promissory note at a low interest rate for the balance due.

- ✓ Life insurance owned by the right-holder on the life of the landowner would help provide liquidity to accomplish the purchase in a lump sum.

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Ideas & Strategies – Dynasty Trusts

- ✓ Keep the farm in trust for your children's lifetimes – They never truly own it but receive its income
- ✓ You pick the trustee who'll have control and you dictate continued management or sale of the farm in the trust agreement.
- ✓ Provide asset protection
- ✓ Prevent land from being included in children's gross estate for tax purposes (allocation of GST tax exemption – tricky).
- ✓ You control ultimately disposition

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Ideas & Strategies – Divide it up

- ✓ Different tracts of land to different children, which they wholly own instead of co-owning the whole.
- ✓ All land to farming child and identify different assets for those who won't be involved in the business.
  - Off farm children
  - Subsequent childless spouse

Ideas & Strategies – Divide it up

- ✓ Are there sufficient assets to pull this off?
  - Summer lake house
  - Winter beach condo
  - Securities accounts
- ✓ Could there be with life insurance benefits to provide liquidity to balance things out? You might <u>not</u> want to own the insurance yourself.
  - Irrevocable Life Insurance Trust ("ILIT"), or
  - Direct ownership by children

Ideas & Strategies – What about your spouse?

- ✓ Blended families need special attention!
- ✓ Unlimited marital deduction for gift and estate tax is powerful.
- ✓ Strike the proper balance between spouse & children.
- ✓ Marital Trust can achieve marital deduction, provide income to spouse, protect farm for ultimate distribution to children upon spouse’s death.

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How's your Ground Titled? Maximize the Step Up!

- ✓ Step up in basis to fair market value at date of death is very powerful!
- ✓ Many farms are owned ½ by husband (or his trust) and ½ by wife (or her trust). That may limit the step up in basis for the whole farm at the second death. Re-examine titling!
- ✓ Old A/B trust planning may have "trapped" an interest in ground in the first deceased spouse's credit shelter trust – may be able to get it out so that it receives a full step up at second death

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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.

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Will the Kids Sell? What's your basis?

- ✓ Lifetime gifting may not be advisable if there may be a future sale.
- ✓ Careful analysis of Estate and/or Inheritance 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!?).

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, or a change in circumstances.
- ✓ Adjust if necessary.

Common Mistake #1

"I'm doing nothing because I'm worth less than $5.45 million," or the similar reasoning: "Because my wife and I are worth less than $10.9 Million."

1. You may have a false sense of security that their total assets are worth less than $10.9 million. What's your farm ground really worth today? What are your neighbors selling for? 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.

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'm going to give away the remainder interest, but hold on to the life estate to retain control and income stream."
  - Avoids probate administration? Yes
  - Avoids estate taxes? No!
  - Retained Interest 100% taxable on death
    - Pro – kids get a step up in basis
    - Con – 40% estate tax if farm is over $5.43M ($10.86 if married)
  - Compare: "I'm going to leave my farm to my child for life, remainder to my grandchildren."

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Common Mistake #4

✓ "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 #5

✓ "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.

Questions?

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