

# Farm/Ranch Transition & Estate Planning



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# Estate Planning Questions

- What assets do you own?
- What are your assets worth?
- How much debt do you have?
- How are your assets titled?
- Who do you want to give them to?
- Do they want them?
- When do you want to give it to them?
- How long do you want to manage the ranch?

# What is Probate?

- Court action to prove the validity of a will
- Inventory the property of decedent
- Value the property of decedent
- Pay debts and taxes (estate, income, real estate, etc.)
- Distribute property as the will directs

# Probate Estate vs. Taxable Estate

- Assets may be part of the taxable estate and not the probate estate
- Anything a person has an interest in at the time of death goes into the taxable estate. This includes more than probate property, such as
  - Property transferred with Powers of Appointment
  - Value of an annuity
  - Joint tenancy with survivorship property
  - Life insurance proceeds if owned by the decedent
  - Interests retained from previous Life Time transfers

# Avoiding Probate

- Why? Not always a good idea
- How to accomplish and still control assets:
  - Joint tenancy with right of survivorship
  - Payment on death bank accounts
  - Naming beneficiaries for retirement accounts
  - Register stock, bonds, brokerage accounts in “transfer on death” forms
  - Life estate deeds to intended grantees
  - Living trust
  - Life Insurance
  - Lifetime gifting (you lose control with this option)

# Minimizing Taxes

- Big Rule – at each gift, during life or at death, there will be.....**transfer taxes**
- Estate tax occurs at the time-of-death gifts (Will, etc.)
- Gift tax occurs on lifetime gifts
- Estate and gift tax credits are tied together in Unified Credit, currently \$5,000,000 and \$10,000,000 for a couple

# Estate Tax Marital Deduction

- No estate or gift tax imposed on gifts between spouses but, may leave a credit unused and no stepped up basis
- If all property owned jointly, no estate tax imposed on death of first spouse, but all assets will be taxed on death of surviving spouse
- For larger estates(over \$5,000,000) you will want a gift to spouse and a gift to a trust for spouse

# Unified Credit

- Offsets unified gift and estate tax liabilities
- After 2011, gift estate tax credit amount is \$5 million per person and \$10 million credit for a couple

# Federal Estate Tax Rate 35%

# Unified Credit

- Each person has ONE unified credit
- Where an estate is large (over \$5 million), take advantage of both spouses' unified credits
  - Do not use joint tenancy
  - Use credit shelter trust or marital by-pass trust as part of will

# Estate Planning Levels

- Estates of less than \$3,000,000
  - “I love you will”-all to spouse with a disclaimer trust
- Estates between \$3,000,000 and \$5,000,000
  - Use each individual’s credit with marital trust
  - Reduce value of taxable estate
- Estates over \$5,000,000
  - Use both credits
  - Reduce taxable estate: lifetime annual gifting, special use valuations, family business entity discounts, conservation easements

# Disclaimer Shelter Trust

- Used to take full advantage of credit amount or unified credit
  - During probate of first spouse, will assets are selected by spouse and transferred into trust for life-time benefit of surviving spouse
  - These assets are included in first-to-die's taxable estate and are excluded from surviving spouse's taxable estate at her death
  - Value of assets transferred into trust equal an amount necessary to avoid federal estate tax (the credit amount)
- Created as part of a will
- Risk: No way to ensure ranch is put in trust for kids

# Estates over \$5,000,000

- Reduce the size of the estate
  - Irrevocable trusts
  - Use of annual gift tax exclusion (\$13,000 per donee each year)
  - Use of special valuation procedures (IRC 2032A)
  - Discounting value for lack of liquidity or control
  - Insurance owned by someone else
  - ILIT funded with conservation sale

# Special Use Valuation

- Real estate used in family farm or closely held business: Section 2032A
  - Land is valued on basis of farm income products
  - Maximum reduction in value was \$750,000 now it is \$1,020,000
  - Heirs must farm for 10 years

# Discounted Value

- Interests in closely-held family corporations, family partnerships or LLCs
  - May be discounted for lack of marketability/liquidity
  - Also discounted for lack of controlling interests
  - I have discounted up to 40% off fair market value of the assets

# Property Basics

- Property
  - Real property.....land and structures attached
  - Personal property.....everything else
- Title of property
  - Fee simple absolute– a single owner or spouses
  - Tenants in common – multiple owners with undivided interests and does not pass at death
  - Joint tenancy – multiple owners with right of survivorship
  - Life estate – ownership for the period of the possessor's life
  - Community property-husband and wife

# Joint Tenancy

- With Right Of Survivorship: on death of one owner, other owner(s) automatically succeeds to entire property
  - Not community property
  - Not part of probate estate – avoids probate
  - Included in taxable estate
  - After death, not subject to decedent's creditors' claims
  - All joint tenants own property together
  - Joint tenancy can be destroyed by any owner (partition); also destroys right of survivorship.
  - If mortgage given by one tenant, joint tenancy destroyed; parties become tenants-in-common
  - Joint tenant's creditor can attach interest in joint tenancy property during life; creditor and other tenant(s) become tenants-in-common

# Taxation of Joint Tenancies

- Joint tenancy between spouses
  - Because of community property one-half of value of property included in estate of first-to-die; survivor gets step-up in basis as to one-half
  - No estate tax payable because property passes under unlimited marital deduction
    - But lost credit!
- Joint tenancy between non-spouses
  - All of value of property included in decedent's estate if other tenants did not pay for their interests

# Tenancy in Common

- No right of survivorship
- Right of possession is undivided
- Each owner may transfer interest, by will
- Value of interest is included in taxable and probate estates

# Life Estate Deed

- Property owner (grantor) deeds property to heir but reserves a life estate
  - Owns property for rest of life and cannot transfer by will
  - No changing mind
  - Avoids probate
  - Value of property is included in taxable estate
  - Inexpensive tools for estate planning
- Heir acquires legal interest
  - Heir becomes “remainderman”
  - Remainder interest can be pledged, transferred or attached
  - Heir gets stepped-up basis on death of life tenant

# Give it to them now with NO strings attached

- Gifts
  - Elements of a gift
    - Donor
    - Donee of the gift
    - Actual or constructive receipt of the gifted property
  - Gifts must be given free of any restrictions
  - Gifts in any amount are not income to the recipient
  - Gifts in excess of \$13,000/year per donor and per donee will reduce the unified credit of the giver

# Basis

- If you gift an asset, the recipient of the gift receives a tax basis in the asset equal to your own. This is what you paid for it and also put in to it.

# Basis Adjustment

- Heir receives the asset with a basis equal to FMV at time of death
- Time of death transfers only occurs in
  - Wills – probate transfers
  - Living revocable trusts
  - Life estate deeds
- But only gets stepped up basis if estate or gift tax is due (credit can avoid any payment)
- Heir can then sell asset and avoid capital gain

# Parts of a Trust

- **Settlor**
  - Creator of the trust
- **Trustee**
  - Holds title to and manages trust property
- **Beneficiary**
  - Person for whose benefit trustee owns and manages the trust property
- **Corpus**
  - The property that is held in trust
- **Trust instrument**
  - Document that embodies the terms of the trust

# Transferring Assets

- Trusts
  - Revocable or Irrevocable
  - Living trusts are established during the settlor's life
  - All trusts become irrevocable at the death of the settlor
  - Testamentary, credit shelter or marital by-pass trusts are established by a will
  - A living trust has no greater reduction on estate tax than a will

# Uses of Trusts

- Ensure ranch assets stay in family
- Manage property or investments for kids
- Avoid probate
- May help to reduce estate tax, Irrevocable trust

# Irrevocable Life Time Trust

- Can reduce value of taxable estate IF
- Settlor does not retain interest in income or corpus of trust
  - Trust must benefit others
  - No retention of life income
  - Enjoyment by beneficiaries cannot be contingent on death of settlor – must be present interest (some room to plan for minors)
  - Cannot retain power to change the transfer of property
- Transfers still subject to Gift Tax: over \$13,000 per person reduces unified credit but appreciation occurs outside of estate (good thing)

# Living Revocable Trusts

- Will substitute – avoids probate of trust assets
  - Costs more to create than a will, but avoids probate costs
  - Particularly useful to avoid probate in another state where property is held
- Property remains part of taxable estate
  - Not useful for reducing value of estate for estate tax planning
  - Heirs do receive step-up in basis
  - Spouses can use to double unified credit with certain special IRS words

# Life Estate Deed

- Property owner (grantor) deeds property to heir but reserves a life estate
  - Owns property for duration of life but cannot transfer/will
  - No changing mind
  - Avoids probate
  - Value of property is included in taxable estate
  - Inexpensive tools for estate planning
- Heir acquires legal interest
  - Heir becomes “remainderman”
  - Remainder interest can be pledged, transferred or attached
  - Heir gets stepped-up basis on death of life tenant

# Give it to them when you die

## Wills

- Competency required to make a will
  - Know the nature and extent of your estate
  - Be able to formulate a plan of distribution
  - Know the natural objects of your bounty
  - Understand the relationship of the above
- Must be witnessed by two witnesses in the presence of the testator and each other
- Must be revoked and/or amended with the same formality with which they are made

# Living Will

- Living Will
  - Permanent vegetative state – what are your wishes with respect to life support
  - May ease difficult decisions for survivors
  - Should be part of estate planning documents
- Durable Power of Attorney for health care
  - Person to make the decision

# Durable Power of Attorney

- Grant of power to another to manage affairs
- Anticipates possibility of incompetence: avoids need for incompetency hearing or approval of guardian
- Statute defines powers
  - Should also include express powers for tax returns, life insurance matters, making gifts, transferring property into trust, accessing safe deposit box, dealing with retirement plans and Social Security
- May be *contingent* or *present*
  - Contingent – effective only upon incompetence
  - Present – effective when executed and continues in spite of incompetence

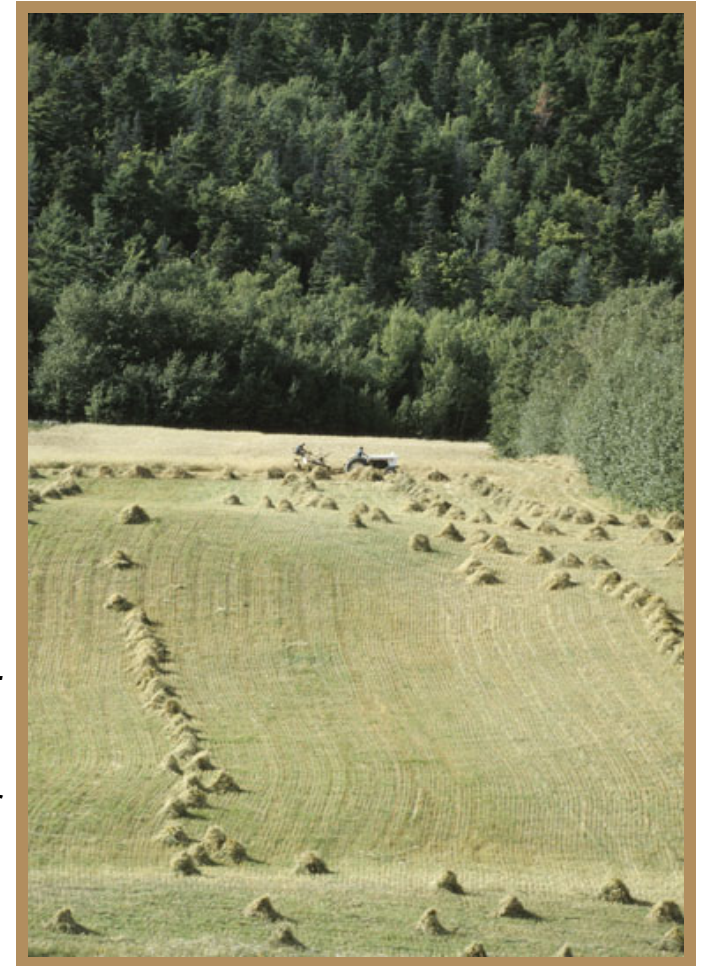
# Credits

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