

*Ninth Annual Mid-South Agricultural and
Environmental Law Conference*

*Estate Planning & Taxation: Latest Updates, Pitfalls,
& Pointers*

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*The Greater Mississippi River system includes over thirteen thousand miles of naturally navigable, interconnected waterways—**more than the combined total of all the world's non-American internal river systems**—and it almost perfectly overlaps the largest contiguous piece of arable, flat, temperate-zone land under a single political authority in the world.*

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- Smattering of topics – This is a brainstorming session.
- These ideas will not always work with clients, some are obstinate, too resistant to change and unwilling to solve a future problem today.
- My view is that part of our role is to provide all clients with good ideas and options for setting things up the right way. They can choose not to, but you earned your fee by making them think through the process and imagine the possibilities.

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Legacy

- All farmers and landowners love to talk about legacy.
- Many think they are leaving a legacy with the land when in fact they are leaving a legacy of conflict.
- How to avoid establishing a family legacy of conflict?
- Information, information, information is key.

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Scenario

- Mom and Dad have built significant farmland holdings and farming operation.
- Son works on the farm with Dad and rents some land on his own on the side. They share equipment.
- Sister is not involved in the farming operation, lives in the City, has no understanding of farming economics, but does feel strong attachment to the family farm and family legacy.
- This is a very common scenario and it is a disaster waiting to happen.
- Everyone in this room has likely made a lot of money on disputes that have these basic facts.

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- **Point 1** – No unnatural business partnerships.
 - Do not force people to be business partners under a vague operating structure, particularly if they would not be natural business partners.
 - If they do not get along or have strongly different opinions and outlooks on life, they will not make good business partners.
 - You would not go into business yourself with someone who did not feel like a partner, so why force your kids to?

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- **Practice tip** - Present the option of splitting the farm into separate 100% owned tracts, as opposed to undivided interests, as a normal and common sense path.
- Most people fall back to undivided interests because it is easy, but often it is not the right answer.
- This is easier said than done, however, getting at least some portion of the land into separately owned tracts can be beneficial for Son and Daughter.
- Pros –
 - a. Provides Son with land he can use as collateral to buy more land and grow his business operation.
 - b. Provides Daughter with feeling of control over her inheritance and gives collateral base for buying beach house.
 - c. Structure should be flexible enough to allow best use of the assets – not so rigid that the farm earns a 3-4% return each year and the real value sits unutilized.
 - d. Trust terms at time of distribution can still provide Son with right of first refusal to purchase family land.

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Point 2 – No surprises.

- Provide a bullet point list of trust terms, lease terms, buy-out rights, etc. to all children.
- Surprises or unmet expectations are never good. *Do not allow your clients to provide the spark that starts a fire between their children.*
- Many families want to provide Son with opportunity to continue farming the land after Mom/Dad die. If they choose to go this route, then make sure the lease provisions and farm operations are transparent enough to avoid a dispute.
- You would not expect someone to be a co-owner in any other type of business and not have full access to the corporate books and records and input on major decisions.
- Why treat the farm differently?

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Practice Tip

- Farm lease terms can provide for semi-annual reports on the farm, crops planted, improvements made, on farm yields, county average yields, contract prices, input prices, real estate taxes, etc.
- Essentially providing a balance sheet and income statement for the farm to the Sister.
- She may never look at it, but the point is that she can if she chooses.
- More problems and suspicions arise from lack of clarity than from answers in black and white.
- Information and communication on the decision making process will build trust between business partners. If it does not, then it is never going to work anyway.

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Point 3 – Liquidity

- Many clients want to force the family to hold the farm perpetually and restrict their ability to sell, exchange, transfer or mortgage the property.
- Predicting the future is a fool's errand. The combination of crop prices, specialty crop operations, solar leases, wind farms, hunting sites, etc. should give anyone pause before restricting land uses for decades/generations.

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Practice Tip

- Consider an entity structure that provides for perpetual management of the family land and assets, but leaves the actual decision making to the next generation.
- A family trust or LLC can provide for different levels of voting for different types of decisions.
- Categories can range from simple majority vote for basic decisions, 2/3rds or 3/4ths supermajority vote on a list of “Major Decisions”. This would include land sales, acquisitions, exchanges, loans over a certain amount, and farm leases.

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- **Estate Tax Planning.** As of now exemption levels are high and cover a significant amount of assets, but land values are increasing quickly and many families are now in the danger zone of being over the exemption amount. There is no predicting what will happen between now and 2025, when the current exemption is to sunset, however, there are options:
 - a. **Typical Family LP/LLC Gifting Strategy** – Transfer land into an LP/LLC. Create voting and non-voting shares. Parents retain voting shares and transfer some portion of non-voting shares to children or trusts created for children. This does many things:
 1. Gifts land to next generation at a discount to the current market value (marketability/minority interest discount);
 2. Freezes the value of the land made at the time of the gift for estate tax purposes;
 3. Lowers the value of the remaining interest held by parents;
 4. Allows parents to retain voting control over the assets during their lifetime;
 5. Transfers the income stream from the assets to the next generation, which prevents parents’ estate from growing larger each year due to income.

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- b. **Section 6166** – the “Last Resort Plan” – IRC Section 6166 is a little known estate tax mechanism.
- The basic rules allow the Estate to pay estate tax arising from “family owned businesses” over a period of up to 14 years, instead of being due 9 months after the decedent’s date of death.
 - The first 4 years of the 14 years can be paid interest only, with regular payments of principal and interest beginning in year 5.
 - The interest rate is set at 2% on the tax due for the first \$1 Million of the estate and the remainder is set at a rate of 45% of the Section 6621 interest rate. As of now that interest rate is around 4%.
 - The interest only period can give the family sufficient time to settle out the Estate, normalize farm income, and complete the transition to the next generation before being required to make principal payment.
 - Longer amortization terms may favor bank loans over this option, but the interest rate differential must also be factored in.

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Section 6166 – Additional Requirements

1. The “family owned business” must represent at least 35% of the value of the Estate.
2. The decedent must have been an “active participant” in the family owned business. Farming operations, including the value of the land, qualify for this, and in addition, crop share landlords who are “material participants” in the farming operation also qualify as “active participants”.
3. Land leased on a cash rent basis is not deemed to be a family owned business and does not qualify for the payment extension. This can be a very costly and important distinction.
4. The Estate must be at least a 20% owner in the business.
5. **Practice Tip** – Include terms in written farms leases that specify the landlord is a “material participant” in the farming operation.

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Section 2032A – Special Use Valuation

- More commonly used than Section 6166
- This Section allows the market value of an asset to be adjusted down to the value attributed to the cash flow it produces as opposed to the value of the land itself.
- Calculation provides for the cash rent value of the land divided by the average annual interest rate on Federal Land Bank loans.
- Example: \$200/acre cash rent divided by 4% = \$5,000 per acre valuation on land.
- In some areas the interest rate is higher than the current rental income on farmland. This is essentially a “cap rate” valuation metric.
- The maximum discount in value that can be claimed from 2032A election is \$1,230,000 for 2022. Adjusted for inflation, with a large increase expected for 2022.
- \$1,230,000 discount in value at a 40% estate tax rate equates to a maximum of \$492,000 in tax savings.
- This tool will not cure a large estate tax problem, but can certainly help smaller estates that are near or slightly over the estate tax limit.
- Short list of requirements for the election:

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- **Blended Families.** All of the above issues become even more complex with blended families. Opportunities for creative planning abound in this area.
 - A. **Scenario 1** – Wife’s family owns farmland. Wife wants to ensure husband has income stream from land if she dies first, but also wants to ensure land is ultimately distributed to her children.
 1. Husband and Wife’s Revocable Trust can provide at Wife’s death (assuming she is first spouse to die), the farmland is transferred to an irrevocable sub-trust, providing for income to be distributed each year to Husband, no principal distributions of farmland, and termination of Husband’s income rights upon remarriage or cohabitation.
 2. Trust can also provide a cap on income amount to Husband, with remainder being distributed to children. Examples would be: income not to exceed \$100,000 annually, or provide for 60% of income to Husband remaining 40% equally between children.
 3. Remainder of joint assets of Husband and wife remain in the Revocable Trust, which is revocable and can be amended by surviving spouse.

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B. Scenario 2 – Parents own farmland.

- They want to ultimate ownership of land to remain in the bloodline, but also want to provide for income to spouses of children.
- At parent's death, land is transferred into an irrevocable trust for the benefit of child.
- At child's death, then income is split between surviving spouse and children in a manner similar to above example.