Farm Succession and Retirement Planning – Where to Start and What Questions to Ask

Russ Tweiten, CTFA, CRPC
SVP, Succession & Retirement Planning
Building a Plan: Team Approach

- CPA
  - Evaluates tax implications of planning

- Loan Officer
  - Compiles a balance sheet and cash flow

- Attorney
  - Drafts legal documents and provides opinions

- Insurance Agent
  - Provide levels of insurance in all aspects
Where to Start?

1. Time

5 to 10-year time frame:

- Parents need time to consider options
- Farming child needs time to learn management skills and grow confidence
- Time to utilize all available tools
- Gives parents time to transfer management responsibilities
- Allows for changes and adjustments in plan
Where to Start?

2. Communication – “The Glue or the Gunpowder”

• Are the parents on the same page?
• Do the parents understand the farming child’s expectations?
• Do the farming children understand the parent’s expectations?
• If farming or ranching with a sibling or neighbor, have all parties talked about the future of the operation?
• Is there a formal plan to ensure good communication is sustained and maintained?
Need for Written Documentation

If it is not in writing, it does not exist!

Examples:
• Farm transition plan between parents and farming child and all we do is just talked about.

• Estate plan not complete or is not monitored to take into consideration the changes that have been talked about in the shop or at the lunch table.

• No buy-sell agreement between co-owners of a business entity (partnership, corporation, etc.) One co-owner dies unexpectedly. What happens?

• Hand-shake deals—yep we still see them!
Transition and Retirement Planning
Ideas to move your operations to the next generation
Farm Transition to Next Generation

Questions to ask

• Is everyone on the same page with the plans to transfer? Is there a shared vision?
• What are your expectation for farm related assets?
  • Parents, farming and non-farming children should be on the same page
    • Plan for land to include any improvements
    • Plan for machinery, equipment and vehicles
    • Plan for the building site and “headquarters”
    • Plan for other assets such as inventory, beet stock, and co-owned assets with a sibling or neighbor (is there a buy sell or operating agreement in place about who can own)

• “Blood Test”: Is the successor and spouse committed?
• Will the Size and Scale of the farm support everyone?
Farm Transition to Next Generation

Questions to ask

• Management Skills: Transition of management vs. the transition of assets. Assets fairly easy to transition. Not so much with transition of management.

• Senior farmer: Are you a mentor or meddler?

• Work Ethic: Does your future farmer have an owner’s mentality or an employee’s mentality?
  • Outside/off-farm experience is a big plus

• When will the Sr. farmer be out of the ‘business’ of farming?
Farm Transition to Next Generation

The Transfer - A Process Over Time

- How will the next generation move up?
  - Gifting, buying, or combination—maybe take over rented land?
- How will parents move down?
  - Gift or sell an entity interest if farming via an entity
  - Gift or sell land or equipment if farming as a sole proprietor
  - Maybe parents makes fewer management decisions, and successor(s) takes on this role. Next generation is involved in an increasing number of financial decisions. *Are they ready for this?*
  - Planting and business decisions shared
Obstacles to a Smooth Transition

1. Poor Communication
2. Debt
3. Poor Communication
4. No Plan to transfer assets, especially machinery and land
5. Poor Communication
6. Late Start (Dad waited to transfer assets to the “boys” when he was 78 and they are 53 & 56)
7. Poor Communication
8. Worry about Fair v. Equal = Seize Up!
Why not just sell these and raise cash?

Tax Issue at about the same time deductions go away

- Machinery usually depreciated and has very little, if any basis.
- Sale of a depreciated asset, like machinery, is fully taxable at highest marginal bracket. ORDINARY INCOME, NOT CAPITAL GAINS.
- Equipment passed to heirs at death receives a step-up in basis to market value at death. Does a farming child want to wait? *Whose name is on the Schedule F. Just Dad’s or both Mom and Dad?*
- **Avoid installment sales** as 100% of the tax is due in 1st year of the sale. Taxes on the sale of machinery, bins, and equipment as well as buildings cannot be paid over time without triggering installment sale tax rules.
Transition- Machinery, Bins, Grain Handling, Etc.

**Idea:** Lease *New* Equipment, Bins, Grain Handling & Buildings

- Place both the senior and junior farmer on the same lease.
- Either can make the lease payment.
- Have the successor make the buy-out. Successor now owns the asset, has some basis, and can depreciate the equipment/building/bin based on the amount of the buy-out. No gifting or selling on the part of the farming parents.
- Keeps senior farmer and successors working capital strong
Transition - Machinery - How do I Start this Process?

**Idea:** Gift or sell “old” equipment and have the successor buy the new equipment and **pay the boot**
- Transfers Equity
- Allows successor to depreciate a portion of the new asset when they pay the boot
- Reduces parents' obligations associated with machinery ownership
- Parents can focus on retirement and maybe debt management
- Allows farming child to make a management decision
- Be sure to document this transfer if gifted to avoid a tax to the parents on the trade amount when successor trades off a piece(s).
Need Income from Machinery or a building site?

Idea: Lease some or all of your equipment and maybe the building site to the successor.

- Avoids the up-front tax on depreciation with installment sale
- Provides retirement income stream to parents
- Tie the machinery and or building lease with a land rental arrangement and avoid Self-Employment Tax on lease payments
- If the bin site and buildings are leased be sure to include a Severance Agreement if land underneath is sold on a contract for deed.
Idea: Gift all or some of the equipment and increase cash rent for land

Example:
- $500,000 of machinery gifted
- “Pay” over 15 years
- $500,000/15 years = $33,333/year
- $33,000/1200 acres = $28/acre rent increase
- Avoids the tax on depreciation with an installment sale or a tax on the sale of the machinery to a successor. Keeps working capital strong and spreads out the tax bill.
Transition- Land-What Should I do with Land?

Usually, the last asset to transfer (if at all)
- Parents’ retirement income
- Parents’ security
- Young and Beginning Farmer programs—family land or new land?

Basis and tax issues need to be considered
- Gift Land (w/ no life estate); parents' basis in land transfers to the kids
- Death (Will, Trust or Life Estate transfers); land steps up in value to date of death value

Appreciation of land values creating problems in families-talk about this
- Most successors can’t afford to buy all of the land from the estate
- Non-Farmers can feel cheated if they do not inherit land
- Is it fair to the farmer to have to buy parents’ land at age 60+
Ideas for the Land

Initially:

• Have successor rent land. Might be beneficial to rent non-family land first to build relationships. Then, as senior farmers get closer to retirement, begin renting family land to successor.

• Idea is to transfer acres (not ownership) over time to farming child.

Later on:

• Lots of rented land? Should we keep the successors balance sheet strong to buy land currently outside of family (non-family rented land). Unpredictable.

• The idea is to broaden the base of the farming unit if possible.
Retirement Planning
Retirement Planning

What is the profitability and level of debt?

What are retirement income sources:

- ✓ Land (Rent, CRP, Contract for Deed, Life Estate)
- ✓ Machinery (Sale is taxable—**watch installment sales**)
- ✓ Grain Handling (Sale is taxable—**watch installment sales**)
- ✓ Buildings (Sale is taxable—**watch installment sales**)
- ✓ Stock (Capital Gains tax on sale)
- ✓ Wages and Salary as an employee
- ✓ Retirement Plans? (Ordinary Income—not required to withdraw until 72)
- ✓ Social Security (Eligible at 62, no reduction at full retirement at age 66+)
Retirement Planning

Social Security and Medicare (2023)

Self Employment (S/E) Taxes for 2023 on first $160,200 are 15.3%
- After $160,200 then S/E (Medicare) tax is 2.90%

Eligible to take Social Security at Age 62 & Medicare at age 65
- At Age 62, Social Security benefits are reduced by about 30% (permanent reduction).
- In 2023, if annual “earned income” is over $21,240, benefits are reduced $1 for every $2 over $21,240. In year of retirement age (66 for most of us), this increases to $56,520/year and reduces $1 for every $3 over $56,520.
Retirement Planning—How do I control my taxes?

• Deferring using smaller contracts so contracts can be brought back into future years if income is needed.
• Lease machinery and or building sites to a successor or perhaps to a neighbor if no successor.
• Gift grain to charities, children or grandchildren.
• Start planning 2 to 4 years before retiring.
• Fill up 22 and 24% brackets.
• Retirement planning with a successor will take longer and will look differently than a retirement plan with no successor.
Retirement Planning—How do I control my Taxes?

• Use a Defined Benefit Pension and maybe couple with a 401(k) if no employees, little or no debt, depreciation is disappearing and loosing tax deductions. Can really help with an auction.

• Is the spouse a farm employee? Should they be in the final 2 to 4 years? If so, they would qualify for the pension and 401(k). Downside are payroll taxes.

• Is there a place for a Charitable Remainder Trust? Especially for the charitably inclined who do not have a successor, want to sell machinery tax free and have more money to invest to generate retirement income.
Estate Planning
Planning for death and disability
Estate Planning

Does your estate plan match the transition plan you have designed?

Components of an estate plan

- Wills
- Trusts
- Durable Power of Attorney
- Health Care Directive & Living Will
- Proper titling of property
- Proper beneficiary designations
Why do I need a Will or Trust?

To determine how your assets are distributed and who manages your affairs after your death.

- **No Will or Trust?** Defaults to State law
- Will based estate plans go through probate. Trust based estate plans, if funded properly, avoid or minimize probate.
- Ensures children are raised by someone you have chosen.
- Ensures financial assets are managed by someone you trust, especially assets left to your children.
- Control estate taxes.
- Keep the farm/ranch together by transferring a business so that it stays in-tact.
- Wills can spin off trusts to own assets for the benefit of heirs.
Need to have an Updated Estate Plan

When was the last time the Will or Trust was Reviewed?

Ensuring the plan works as you intend

Ensuring the plan is updated, well thought out, and tested is essential. Especially when a next-generation farmer is taking over.

Run the balance sheet through your will or trust.

If there are buyout provisions, can the farm afford them?
Is the goal to be Fair or Equal?

“I want to be equal but fair.” – Hmm?? Both at the same time??

- Usually, equal is unfair if there is a successor.
- Equal means the estate is split up in equal shares.
  - A $4 million farm; 4 kids (1 farming) means each child has $1 million in their name at parent’s death.
- Fair means the farming child might get the machinery, the bin site, and shop, and is “favorably treated “ with land, while non-farming children receive non-farm assets, life insurance (not always), or land rent, or sale proceeds.
  - Is the farming child willing to share their life’s work with their non-farming sibling?
Proper Asset Titling

Asset Titling is crucial to assure that the will or trust functions the way you want.

Examples:

• Land held as joint tenants with the right of survivorship is not handled by your will.

• If you have a revocable living trust, and your assets are not properly titled/controlled by the trust (“funded”), the trust will not avoid probate at your death.
Estate Taxes

Is my Estate Taxable?

Unlimited amount can be transferred to a spouse

Federal Estate Tax Exemption for 2022 - $12,060,000 per person.
- Portability between spouses can bring this to $24,120,000
- For estates that exceed the exemption, the amount exceeded is taxed at 40%.
- 2023 Exemption amount – increase of $860,000! ($12,920,000/$25,840,000)
State Estate Taxes

North Dakota, South Dakota, and Wisconsin are coupled with Federal law.
  • No specific or separate state estate tax.

Minnesota is decoupled from Federal law.
Minnesota Estate Taxes

Minnesota Estate Tax Exemption:

2022/2023 - $3,000,000

- + $2,000,000 for qualified farmland & business assets for a total of $5,000,000/person
- NO PORTABILITY between spouses – need to use disclaimer/bypass trusts
- For estates that exceed the exemptions, there is a graduated tax scale
  - current rates range from 13% to 16%
Minnesota Estate Tax: Non-Residents

May affect non-Minnesota residents if they own real estate in Minnesota

• Real Estate owned by non-MN residents may be exempt from Federal estate tax but not exempt from MN estate tax

• Only available for Minnesota residents. Thus, limited to $3 million; do not get an additional $2 million, for a total of $5 million.
Gifting Rules for 2022

### Annual Exemption

$16,000 per Grantor/Recipient/Year

- No taxes and no tax return on the first $16,000
- Each recipient can receive $32,000 as a combined gift from parents. If you include your child’s spouse, an additional $32,000 ($64,000 combined) can be given without any IRS reporting.

### Lifetime Exemption

$12,060,000/Person

- If a gift exceeds $16,000 or $32,000/$64,000 then a federal gift tax return is required
- No taxes if the combined total is under $12,060,000/person or $24,120,000 if married

MN has a three year “claw back” rule.
### Gifting Rules for 2023

**Annual Exemption**

$17,000 per Grantor/Recipient/Year

- No taxes and no tax return on the first $17,000
- Each recipient can receive $34,000 as a combined gift from parents. If you include your child’s spouse, an additional $34,000 ($68,000 combined) can be given without any IRS reporting.

**Lifetime Exemption**

$12,920,000/Person

- If a gift exceeds $17,000 or $34,000/$68,000 then a federal gift tax return is required
- No taxes if the combined total is under $12,920,000/person or $25,840,000 if married

MN has a three year “claw back” rule.
Gifting Example

$316,000 Gift of Machinery to a child

• $16,000 applies to the annual exemption
• What happens with the remaining $300,000?
  • A gift tax return (IRS Form 709) is filed for $300,000. $300,000 is subtracted from the $12,060,000 estate and gift exemption (the Unified Credit). No tax is due.
  • Estate and Gift Tax exemption is now reduced to $11,760,000.
  • $316,000 is passed, tax-free, to a successor
Estate Planning - Land

Land Transfer Ideas Through your Will or Trust

**Equal**
- Each child has an ownership interest in the parcel
- Ownership can fractionalize over time (1/5 heir with 3 kids – 1/15 for grandkids)
- Will this bring the non-farmer into the farmer’s business. Can this land be mortgaged if needed?

**Specific**
- Each child inherits a whole parcel
- Land could leave the family
- Consider an Option or Right of Refusal for the farmer to rent and/or buy land

**Farmland Trust**
- Land goes into a Trust at first or second passing
- Why? To Protect land, time for farmers to buy, equal distribution of rents or sale proceeds, irresponsible heirs, children not in agreement, pays rent to non-farmers for a fixed period of time then land goes to successor.
Estate Planning - Land

Land Transfer Ideas While Alive

Entity Owned (Land Partnership or Limited Liability Company)
• Keeps land together - “Land Legacy”
• Can protect land with a Buy-Sell Agreement that can restrict who owns
• Heirs inherit ownership in the entity vs. inheriting land
• With the correct setup, farmers stay in control
• With a Limited Liability Company, need to consider Anti-Corporate farming laws in each state

Life Estate
• Allows parent to transfer land to child and legally retain income rights. Good way to transfer equity to a child who needs to buy land.
• No Probate and land receives a step-up in basis
• Nursing Home protection is a big plus

Revocable Living Trust Owned
• Land can remain in Trust or transfer to children
Estate Planning - Machinery

Usually left to the farming child

• Any machinery owned at death receives a step up in basis to market value – no step up in basis for leased equipment.

Another idea:

• Can be left to all children to “equalize” the estate
  • Farming heir is typically given the option to buy from the estate at a reduced price (50% of value for example). Seeing less and less of this.
  • If the discount is steep enough, proceeds only to non-farmers.
Estate Planning – Farm Site

• If farm site has infrastructure (bins, shop, etc.) then typically left to the farming child.

• If the personal residence can be separated and a farming child will not live there, then the personal residence is an idea for non-farmers.

• If a farming child has erected bins, a grain handling system, or other outbuildings and does not own the land underneath, it’s important that they own the land at some point:
  • Important for lenders (FSA, Banks, Farm Credit)
  • We see many successors who put up bins and buildings on parent’s land and no one talks to them about ensure the parents will or trust leaves the farm site to the successor. A very tough MN case in the works right now that underscores why we always recommend this.
Asset Protection
Give yourself time to consider all your options
Asset Protection – Long Term Care Costs

• Average stay about 3 years.
• Costs vary – between $8,000 to $12,000+ per month.
• States are required to recoup Medicaid payments
• Attitudes about paying these bills vary—some want 100% protection while others feel an obligation to pay.
• Three choices (usually a combination):
  • Pay on your own
  • Insure
  • Apply for assistance
Asset Protection – Long Term Care Costs

When applying for Medicaid, there is an income limit and an asset (resource) limit.

In order to be eligible for Medicaid, one cannot have assets greater than the limit.

- Married with one spouse in long-term care and one not
  - Personal residence and homestead
  - 1 car
  - Available assets of $3,000 for applying spouse and $137,400 of joint assets for non-applying spouse
  - Prepaid burial plan
  - 100% of their income; community spouse may keep some of the institutionalized spouse’s income if the community spouse’s income is less than the established limit

- Single person or married, both in long-term care: cannot have assets greater than $3,000 per person.

Medicaid Lookback Period: 60 months (5 years) that immediately precedes one’s Medicaid application date.
Family Meetings
A way to engage both farming and non-farming children in the planning and transition of your operation
The Family Meeting

Why?

• Puts everyone on the same page
• Everyone hears from the parents
• Gives children a chance to ask questions
• Should children’s spouses attend?
• Eliminates or minimizes surprises
• Litigation and lawsuits are on the rise
  • Law firms committing many resources to estate and probate litigation—full-time work for some attorneys!
The Family Meeting

When to meet with your family?

• Transition planning—initially meet with parents and farming child(ren) separately so we know the goals. At the parent meeting discuss how and when to meet with non-farming family members (each farm is different—some will not have a family meeting).

• When the estate plan is completed.

• What about children’s spouses? We encourage their attendance, but in some cases this is not a good idea. This will take some discussion to determine who attends.
Summary

What makes a good plan great?

**TIME** to think, plan and adjust

Open, honest and ongoing **COMMUNICATION**
Questions?
Thank You!

Russ Tweiten, CTFA, CRPC
SVP, Succession & Retirement Planning

1900 44th Street South
Fargo, ND 58103

Russ.Tweiten@AgCountry.com

Office: 701-429-7307
Appointment Scheduling w/ Julie: 701-499-2517