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Estate Planning*

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Introduction

No matter your age, as a landowner, a business person, or simply a homeowner with valuables you want to go to someone special, you should be concerned about the future of your business or the distribution of the property in question to the right individual or organization. The intent of estate planning is to plan for the successful distribution of property in accordance with the wishes of the deceased and to do so with a minimum of delay and anguish immediately after the death of an older generation. This is typically one of the most emotional times of our lives and it is best to have the estate distribution plan already in place before this emotional event happens. It helps with the stability and viability of the business to have that plan in place and it can save on federal and/or state estate taxes.

So, what if you don't think you have enough assets to worry about an estate tax? Most professionals would argue that estate planning is not only about avoiding taxation but also about ensuring that your wishes are known to your heirs and that the assets go to those you want to have them.

Estate Taxes

While the federal estate tax cannot be left out of any discussion on estate planning, it is not always the main issue that needs to be addressed. In some areas and occupations, the majority of estate planning is conducted by taxpayers who anticipate some part of their estate being subject to the estate tax (federal and/or state). In other areas and occupations, the gain of the estate value does not meet the high federal estate levels and the planning is mainly focused on distribution of assets. Even if your estate isn't large enough to be concerned about the federal estate tax, your

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state estate tax may be a different story, as many states also have an estate tax. A farm, ranch or forest estate containing land and possibly mineral or other assets that likely increased in value over many years could result in an estate that is taxable (at the federal and/or the state level) when it is included with all the assets owned and controlled by the deceased. With estate tax rates as high as 55%, do you really want your heirs to only receive the remainder of your estate instead of the majority of the estate? It is even worse when the estate tax bill puts the viability of the business into financial jeopardy or causes assets such as land or timber to be sold when other assets are unavailable. With proper planning, estate settlement costs and taxes can be minimized allowing more of the estate to go to the intended heirs. Presented here are some steps to take to aid in the future transition of your property.

Talk to your potential heirs

It is very important that you discuss with your potential heirs what your vision is for the ownership and management of your business and the assets. If your son/daughter has no interest in managing the land and would sell it for development, it might make more sense to leave them another asset and leave the land to your favorite nephew or employee who has always had a love of the land. Also, by discussing your wishes with your heirs while you are still around, your heirs can better understand your distribution choices. Families have been torn apart by inheritance disputes.

Assemble a team

It is critical to have an advisory team that can assist with the estate planning process. Your team should consist of individuals who are knowledgeable about state and federal estate transfer and estate tax laws. An attorney and an accountant who understand the estate planning process and the distribution of various types of assets that you own (such as farm land) would be beneficial to have on the team. If you own forest land, it is wise to include a forester on your estate planning team.

Prepare a will or a trust

It is not enough to just discuss what you would like to do with your assets. A formal document such as a will or trust should be drawn up to distribute your assets. Without one of these critical documents, a state's law of descent will dictate who gets what share of your assets. In instances where an estate tax is due and cash is not available, state and federal laws and the probate judge will decide in what order assets are sold to pay the tax. **Proper estate planning can minimize settlement costs and can direct who gets specific assets, thus minimizing conflict during the estate settlement process.** While there are estate planning documents available on the internet, state laws may require different information.

Know the value of your property

Most people are aware of the value of their retirement fund or their house. But do you know the market value of your land and all the business assets? Is your land located near a growing urban

center? Assets in an estate are valued at fair market value (unless section 2032A special use valuation is elected for the land and/or timber). Land value can quickly increase the value of your estate when it is valued at the full fair market value (as opposed to the “current use” value that some property owners may know from a property tax assessment). Knowing the value of the land will help with the estate planning process. Once you are aware of the value you will be transferring you can pursue appropriate options. Conservation easements, charitable donations and gifts are some of the options for reducing the tax burden upon your death. These options should be discussed with an accountant and attorney with knowledge of agriculture and forestry provisions in the Internal Revenue Code.

Consider lifetime gifts

Under current tax law, you may give up to \$13,000 a year to an individual (related or not). If you are married, together you may give up to \$26,000 a year to an individual. This is a great way to reduce the estate now and allows you to see the joy that gift will bring. Gifts that are in excess of the annual exclusion will reduce the estate tax exclusion amount and are therefore not taxable.

Think beyond spousal transfer

It is certainly easy to plan if you pass everything in your estate directly to your spouse. The current tax code allows you to leave all your assets to your spouse tax-free. (This is true in 2012, but may not be true in the future). The problem with this strategy is that when the spouse later dies, all assets are included in the second spouse’s estate and only that individual’s estate tax exemption is available to reduce the estate. If the estate is large, this may be a major issue. One way to reduce the size of the estate going to the spouse is to use some of the estate tax exemption upon the first spouse’s death and pass assets to the children or another non-spouse recipient. This allows more of the combined estate value to pass tax-free and it may also meet your wishes and help the younger generation maintain the viability of the business.

Be aware that the numbers are always changing!

While we hope that our assets continue to increase in value, it is important to remember that limits in the tax code (such as the Annual Gift Tax Exclusion, Federal Estate Tax Credit and any applicable State Estate Tax Credit) may also change. Some of the numbers are currently indexed for inflation (gift amounts) while other numbers can be set for some years with a provision to revert back to early levels. For example, in 2013 the estate tax exemption will revert to 2001 levels without federal legislative action in 2012. Even in the interim years, the federal estate tax threshold levels changed. Your estate plan should be flexible enough to accommodate these changes. However, an estate plan should always be reviewed every 5 years. As we get older, and estates get larger, it should be reviewed even more often.

The two most common arguments heard about not conducting estate planning are: 1) I don’t have a large enough estate to need to have an estate plan and 2) estate planning costs too much.

It is easy to see how the land value can quickly become a large proportion of the estate when appreciating land is included. In the case of forest land, both land and trees have been accumulating value. Estate tax laws change often and there is no guarantee that the current amount of the estate that is exempt from the tax will continue past the next federal and/or state legislative session. Secondly, while estate planning does cost money, the alternative is a long period where the assets are tied up in legal proceedings and in the end this quite often costs more than what proper planning would have cost. In addition, it may not be what you – the current owner of the property – wanted to happen with the property. Peace of mind can be worth a lot in this case.

Do yourselves and your heirs a favor and think about the future of your business and personal assets and how to pass these assets on with minimal expense and disruption. The future is never certain but steps can be taken to mitigate the financial and emotional impact of future events.

IRS Publications

For more information on estate taxes, see IRS Publication 950 “Introduction to Estate and Gift Taxes,” found on the IRS website at www.irs.gov. Also refer to the instructions for IRS Form 706 “United States Estate (and Generation-Skipping Transfer) Tax Return” and IRS Form 709 “United States Gift (and Generation-Skipping Transfer) Tax Return.” To view or download publication or forms, click on “Forms and Publications”. Then click on “Publication number” under “Download forms and publications by:”. Type the publication number in the find box to search for the publication. Publications may be viewed online or downloaded by double clicking on the publication.

Additional Topics

This fact sheet was written as part of Rural Tax Education a national effort including Cooperative Extension programs at participating land-grant universities to provide income tax education materials to farmers, ranchers, and other agricultural producers. For a list of universities involved, other fact sheets and additional information related to agricultural income tax please see RuralTax.org.

An excellent source of more information on Estate planning can be found at the University of Minnesota Center for Farm Financial Management.

<http://www.cffm.umn.edu/Publications/pubs/FarmMgtTopics/EstatePlanningSeries.pdf>.

For forest landowners the publication “Estate Planning for Forest Landowners: What will become of your timberland?” is an excellent resource. It can be found at

<http://www.srs.fs.fed.us/pubs/31987>.

Also, don’t hesitate to contact your local University Extension office for further assistance.

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