Don’t Bet The Farm! Estate Planning For Farm Families

Even if you’ve got the best poker face, there is one thing that no farmer should ever gamble with: the farm or the legacy value of the estate.

One of the central challenges facing farmers today is keeping ownership of the farm in the family from generation to generation. According to the USDA, 98% of the farms in the United States are family farms, and 70% of the nation’s farmland will change hands in the next 20 years. Disturbingly, most of the industry is unprepared: 89% of farmers don’t have a farm transfer plan. Many of these business owners will end up wasting a great deal of wealth by failing to successfully transfer the farm. Yet, with the proper understanding and correct planning efforts, you can ensure that your farm is properly divided among the next of kin.

To begin making your plans, you first need a basic understanding of the current regulations. At the federal level, the recent fiscal cliff legislation (American Taxpayer Relief Act of 2012) allows for up to $5.25 million per person to be transferred without incurring estate tax. In the case of a farm owned by a husband and wife, this would allow for up to $10.5 million. However, anything above that amount is taxed at 40%—this rate was increased from 35%.

One loophole most farmers are not aware of is that they can reduce the overall valuation of their farm with what’s known as Internal Revenue Code Section 2032(a): Special Land Use Valuation. This provision allows farmland to be valued at a lesser amount for estate tax purposes. Lower valuation will reduce potential estate taxes. While the process can be complicated, it’s actually very helpful and something you can discuss with a financial professional.

There is also a state inheritance tax to consider depending on the relationship to you of your heirs. In Iowa, for deaths after July 1, 1997, there is no state tax on transferring the estate to children, step-children, or grandchildren. However, there are other situations of family estate transfers in which taxes can be assessed.

In practice, let’s say that you and your spouse own a farm. Through sweat and determination you’ve built it up to an operation valued at $13 million. You have three children—a daughter and two sons. Your daughter and one of your sons work on the farm, but the other son was interested in technology and became a computer programmer. Now, you are challenged with the tasks of transferring the farm to your children, without owing a fortune in taxes, and finding an equitable solution for your son who works with computers and not interested in the farm.

Looking at the rules above, the state tax on estate is not a concern, but the federal tax certainly is. At $2.5 million over the exemption level, your children will be faced with owing the government $1 million when you pass away. How can we reduce that amount?

For a business that is incorporated, one strategy is to use your annual gift tax exemption. Each person is allowed to gift $14,000 per year. For you and your spouse, this means you could gift a total of $28,000 to each of your sons and your daughter, for a total of $84,000 annually, without paying taxes. This amounts to over a million dollars in 12 years. If there are still concerns over estate tax liability, the son and daughter in the business could take out a life insurance policy on their parents (you) to cover the tax. Otherwise, the kids have to pay the estate taxes out of pocket or borrow the amount.

Lastly, you need to consider what to do for your son who is not interested in inheriting the family business. One possible option is to use life insurance to ensure that he receives the same amount his siblings will receive in dollar value. Since your farm is worth $13 million, you could take out a life insurance policy worth $4 million, roughly 1/3 of the overall value. If this method is too costly or not possible, there are other ways to leave aside an amount for the non-participating family member. As always, it's vitally important to consult experts when determining optimal solutions for your farm succession planning, estate planning, and tax issues.

In the end, don't gamble on your estate transfer when there is an optimal way to transfer it to your children without sacrificing a huge amount of value! Do your homework and speak with a qualified financial expert. Create a succession plan for your family and you'll be ahead of the game and 89% of the industry. Now that's a winning hand!

About Curtis Cloke, CLTC, LUTCF

Long before Curtis Cloke was a financial life planner, he spent his childhood between the knees of his grandfather, riding on a John Deere B or an International 560 across his farm in Stockport, Iowa. A life-long resident of the "American Heartland," he has a thorough understanding of today's ever changing agribusiness environment with a passion for helping farmers with their unique wealth transfer, legacy perpetuation, retirement income, and other financial planning needs.

Recognized in 2009 as a top five finalist for Senior Advisor of the Year by *Senior Market Advisor* magazine, Curtis is a member of the National Insurance and Financial Advisors Association (NAIFA), currently serving as President of the Southeast Iowa Association. He is a member of the Society of Financial Service Professionals (FSP) and is a qualifying member of Top of the Table with the Million Dollar Round Table (MDRT). He is a former volunteer advisory board member to the Small Business Development Centers (SBDC) of Iowa in Ames, Iowa, where he represented the Southeast Iowa Region. In addition, he currently serves on the Des Moines County Community Foundation Board located in Burlington, Iowa.

Heartland Co-op has assembled an expert team to help implement the most up-to date and effective wealth preservation and Farm succession strategies.

If interested in learning more, contact:

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Resources

http://www.iowa.gov/tax/forms/60061.pdf

http://www.farmestateplan.com/estate_planning/2032a

http://www.forbes.com/sites/deborahljacobs/2013/01/02/after-the-fiscal-cliff-deal-estate-and-gift-tax-explained/