THE MECHANICS OF FARM AND RANCH TRANSITION PLANNING
An Overview of Basic Planning Tools and Issues

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The Transition Plan

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What is a Transition Plan?

Estate/generational transition planning is the entire process of arranging your assets and other affairs, both during your life and after your death, in a way that accomplishes your objectives for the disposition of your assets and the management of your personal concerns.

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What is a Transition Plan (contd.)?

In the context of farm and ranch operations, such a plan should facilitate the transition of the operation to the next generation (or the next owner) in a manner that meets the needs/goals of its current owners and addresses the expectations, *where appropriate and reasonable*, of the current (and/or future) operators.

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Implementation of a Transition Plan

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Implementation Considerations

- Management Transition
- Control Transition
- Gifting Considerations
- Estate Plan Coordination
- Entity Governance Documents
- Ability to Recraft Plan (Permanency/Flexibility Considerations)

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The Elements of a Thoughtful Transition Plan

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Elements of a Thoughtful Transition Plan

- Identification of Assets
- Review of Entity Form and Related Issues
- Articulation of Owner Goals
- Development and Implementation of Written and Executed Estate Plan

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Elements of a Thoughtful Transition Plan (contd.)

- Transition Considerations – How to Implement Transition in Management, Control, and Timing (Identify Implementation Mechanisms)
- Review of Potential Tax Exposure
- Build the Professional Team – Attorney, Accountant, Investment Advisor, Insurance Agent (e.g., Property, Crop, Health, Long Term Care), Farm Program Expertise

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The Hard Questions

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Issues to Consider/The Hard Questions:

- Your goals for the use of your assets during your lifetime
- Provision for a surviving spouse (and/or second marriage concerns)
- Disposition of assets when both spouses are gone
- Continuation of family business or farming operation
  - Control
  - Management
  - Transition Timeline

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Issues to Consider/The Hard Questions (contd.):

- Tax planning
  - Federal Estate Tax
  - Federal Gift Tax
  - Generation Skipping Transfer Tax
  - State Inheritance Tax
  - Income Tax
- Nomination of fiduciaries to manage your concerns if you are unable to do so or after your death
- Respecting the relevant entity form, if applicable

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Asset Ownership

(Accidental or Intentional Planning)

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Types of Asset Ownership

- Single Name
- Tenancy in Common
- Joint Tenancy
- Trusts
- Legal Life Estates
- Beneficiary Designations on Life Insurance, Qualified Retirement Plans, Investment Accounts, or Similar
- Payable on Death Designations
- Corporations (Shareholders Agreement), Partnerships (Partnership Agreement), and Limited Liability Companies (Operating Agreement)

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Reviewing Entity Form and Related Issues

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Know Your Entity

- What type of entity or entities is involved?
  - LLC
  - C-Corp
  - S-Corp
  - Partnership
- Are you respecting the entity form?
  - Regular meetings
  - Entity books up to date
- What are the financial implications of the entity form as interwoven with a thoughtful transition plan?
  - What do the operative agreements say about death and/or transition? If no agreements – state law governs.
  - What are the tax implications of the transition plan?

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Issues to Consider

- Entities are business management, transition, and tax planning tools
- Entities are <u>not</u> a substitute for an estate plan
- Entities do, however, need to work hand-in-hand with your estate plan (where possible)
  - They are a relevant consideration in estate plan development
  - Governance documents should be reviewed as part of any in-depth planning
  - Governance documents and estate plans should coordinate with each other (not always possible depending on who has control, whether members work well together, etc.)
- Entities provide another opportunity for considering the timing of control and management transition in addition to the estate plan structure

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Development of an Estate Plan

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Purpose of an Estate Plan

- Provides asset management assistance for Grantor
- Provides asset management assistance for spouse, children, or incapacitated beneficiaries
- Develops and implements plan for managing farm and ranch assets for the benefit of children in the operation as well as children off-operation or transitioning in some other manner
- May avoid probate and save estate settlement costs
- Saves (mitigates) estate and other transfer taxes

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Common Estate Planning Documents

- Will
- Trust
- Durable Power of Attorney
- Healthcare Power of Attorney/Living Will

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Wills

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Definition of a Will

- A will is a written plan for the disposition of property after death.
- Requirements:
  - Testator of sound mind (i.e., has capacity to execute the Will)
  - Testator of lawful age (18 years old in NE)
  - Will in writing
  - Will properly signed and witnessed (two witnesses required in NE)

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Types of Wills

- Simple Will – passes property to surviving spouse and, if none, to children or other named beneficiaries
- Pourover Will – executed in conjunction with a separate trust agreement and states that all testator's assets will pour over into the separate trust agreement, which will determine the distribution of the testator's assets

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Appointment of Fiduciaries

- Personal Representative – charged with collecting the decedent's assets and distributing them to new owners as well as paying taxes and paying claims
- Trustee – an agent who is charged with the management (typically, long term) of decedent's assets for the benefit of named beneficiaries
- Guardian/Conservator – individuals who are charged with the care of the decedent's minor children or a disabled beneficiary

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Trusts

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Definition of Trust

- A trust is an arrangement where one person transfers legal title to property to another person or entity who then manages the property <u>for the benefit</u> of one or more other people.

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Reasons for Establishing a Trust

- Provide asset management assistance for Grantor
- Provide asset management assistance for spouse, children, or incapacitated beneficiaries
- Develop and implement plan for managing farm and ranch assets for the benefit of children in the operation as well as children off-operation or transitioning in some other manner
- Avoid probate and save estate settlement costs (if the trust is fully funded at grantor's death)
- Save (mitigate) estate and other transfer taxes

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Trust Actors

- A person creating the trust is the "grantor," "settlor," or "creator."
- The person deriving the benefit from the property held in trust is the "beneficiary."
- Individual or entity holding title to the assets is the "trustee."

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The Trust Agreement

The controlling instrument that:

- Appoints the trustee
- Describes the time for establishing and terminating the trust
- Names the beneficiaries and determines their rights
- Defines the scope of the trustee's powers and duties
- Instructs the trustee in the management and ultimate disposition of trust assets

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Types of Trusts

- Testamentary Trusts
    - Created by a Will and irrevocable at death of testator
    - Property flows from the probate estate to the trustee instead of outright to beneficiary
    - Used to provide management for testator's survivors
    - Does <u>not</u> avoid probate
    - Can be a useful tool in the protection of spousal assets in <u>*specific and limited*</u> Medicaid contexts

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Types of Trusts (contd.)

- Revocable (Inter Vivos) Trusts
    - Created and operative during Grantor's lifetime
    - Used by Grantor to manage assets during lifetime, particularly if Grantor becomes incapacitated
    - Usually continues after Grantor's death
    - Can be part of an estate tax savings plan
    - Can be used to avoid probate <u>if</u> fully funded prior to death
    - May be revoked or amended
    - Provisions are confidential and agreement is not filed with court in probate proceedings
    - Can fund with a durable power of attorney if Grantor becomes incapacitated
    - Used in conjunction with a pourover will

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Types of Trusts (contd.)

- Irrevocable Trusts
    - Life insurance trusts, education assistance trusts, or other trusts used to remove assets from the taxable estate of the Grantor
    - Can provide protection from creditors or qualification for certain types of government benefits
- Charitable Trusts
    - Complex trust planning used to move assets to charities in a variety of ways and include certain tax benefits

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Trusts in Transition Planning

- Trusts are incredibly flexible tools that allow for significant creativity and direction, if needed, to manage a wide range of entity issues and/or family dynamics. For instance, trusts can be used to address each of the following issues (alone or in combination):
  - Control/Guidance in asset management after death
  - Assets preserved for next operators while sharing benefits with off-operation beneficiaries
  - Right of first refusal – purchase or rent
  - Put/Call options
  - Management of entity interests (i.e., voting control and oversight directions)
  - Planning for disabled beneficiaries
  - Financial guidance and controls
  - Asset protection in the event of a surviving spouse's remarriage

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Powers of Attorney

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Durable Power of Attorney

- Empowers an agent or agents of your choice to make a broad range of financial decisions on your behalf
  - Authority to act language should address gifting, access to safe deposit box, and a broad range of other financial issues such as tax returns, life insurance, retirement plans, Social Security, real estate, banking, etc.
- This document can be drafted so that it is effective both should you become incompetent and also should it simply be more convenient for you to have an agent acting on your behalf
- Helps avoid the necessity of seeking court appointment of a conservator to make these decisions on your behalf
- Agent is subject to fiduciary duties

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Health Care Power of Attorney/Living Will

- Names an agent to make broad range of medical decisions if you are unable to do so
  - Choose treatment options
  - Check you in and out of facilities
  - View your medical records
  - Change your health care providers
- Can also include an "Advance Health Care Directive" or "Living Will"
  - This is your personal and legally binding directive to health care providers not to take extraordinary measures to prolong your life if you reach a medically nonrecoverable state
  - Removes these difficult decisions from survivors
- Can help avoid the need to appoint a guardian to make these decisions for you

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Primer on Transition-Related Taxes

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Tax Considerations

- Federal Estate and Gift Taxes (2022) – Unified Credit
  - $12.06 million exemption per person (40% is top federal tax rate)
  - Portability issues
- Gifting Considerations (i.e., Annual Exclusion Amount $16,000 per recipient)
- Nebraska State Inheritance Tax
- Step Up in Basis – Capital Gains Issues
- 2026 (or earlier) Changes

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Long Term Care Issues

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Long Term Care Payment Options

- Private Payment
- Long Term Care Insurance/Long Term Care Hybrid Products
- Medicaid
- Combination of Private Payment, LTC Insurance/Products, and Medicaid

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When are the Medicaid Rules Implicated in a Typical Estate Planning Context?

- Farmers
- Ranchers
- Small Business Owners
- Clients using trusts as part of their estate planning
- Clients with known potential long term care issues
- Elderly clients with assets of less than $500,000
- Clients with disability issues of their own
- Clients whose beneficiaries may become disabled
- Clients with an active gifting plan who may need long term care assistance
- Petitions for Elective Share
- Disclaimers
- Estate distributions to disabled beneficiaries
- Medicaid as an estate creditor

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The Basic Medicaid Rules

- Residency (Note: The rules included in your materials apply <u>only</u> to Nebraska residents.)
- Medical or Physical Criteria
  - Age 65 and older, *<u>or</u>*
  - Younger than 65 and blind or disabled
- Financial Criteria

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Financial Criteria - Income

- Income Test
  - Gain or recurrent benefit received in money or in-kind from employment, business, property, investments, gifts, benefits, or annuities, at regular or irregular intervals of time
  - Includes earned or unearned income if the income is received and currently available for the use of the individual

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Financial Criteria - Resources

- Resource Test
  - Medicaid considers only available or countable resources
  - Countable resources include cash or other liquid assets or any type of real or personal property or interest in property that the individual owns or may convert to cash to be used for support and maintenance
  - Available or countable assets include any assets that Medicaid does not deem excluded

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Available/Countable Resources (Complete List in Regs)

- Cash (savings or checking accounts)
- Certificates of Deposit
- Investments, stocks, and bonds
- Certain promissory notes
- Certain land contracts
- Collectable unpaid notes or loans
- Interests in LLCs, corporations, or similar entities **(Liquidation value)**
- Certain land leases
- Certain life estates
- Excess motor vehicles

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Available/Countable Resources (Complete List in Regs)

- Combined face value of insurance policies > $1500
- Certain trusts
- Guardianship and conservatorship funds
- Elective share of a spouse's augmented estate
- Revocable, assignable, or saleable annuity

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Excluded Resources (Complete List in Regs)

- Real property applicant or spouse owns and occupies as resident with equity value of less than $636,000
- Tangible personal property of a moderate value used in the home
- Certain types of burial funds and related assets (Irrevocable Burial Trust = $5654)
- Combined face value of life insurance policies < $1500
- One motor vehicle that is actually used for transport or as a home (by applicant or spouse)
- Retirement accounts inaccessible to applicant or spouse

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Excluded Resources (Complete List in Regs)

- Resources used in applicant's trade or business *if* applicant, spouse, or applicant's parents are *actively involved* in day-to-day operation of business as primary source of income
- Certain life estates in real property
- Certain trusts

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Two Common Financial Scenarios

- Single person entering a nursing facility
  - $4000 in countable assets
  - All income (less small income disregard) will be contributed to the nursing home and Medicaid's budget will pay for the difference at the Medicaid rate

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Two Common Financial Scenarios

- Married couple (one needing Medicaid/one living at home without Medicaid)
  - Apply under the spousal impoverishment program
  - Assessment of Resources (one time only)
  - Divide resources
    - Community spouse retains one-half of countable assets up to $137,400 (retains all assets if countable assets total $27,480 or less)
    - Medicaid spouse retains up to $4000 in countable assets
  - Designate resources
  - No income limitations
    - Each spouse takes own income unless community spouse's income < $2289
    - NH spouse's income then shared with community spouse to bring up to the $2289
  - Spend down the excess according to Medicaid rules

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Gifting = Deprivation of Assets

- Medicaid is a needs based program.
- Applicants cannot deprive themselves of resources in order to meet the applicable financial criteria.
- A deprivation of resources is any action taken by the applicant or another party on the applicant's behalf that reduces or eliminates the applicant's or his/her spouse's recorded ownership or control of an asset for less than fair market value.

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Penalty for Improper Transfers (Gifts)

- If the applicant or applicant's agent transfers assets for less than fair market value within 60 months of application for Medicaid, that transfer will be deemed a deprivation of resources.
- Benefits will be withheld for the period of time the transferred asset(s) would have paid for the applicant's care.
- The penalty period will begin running once the financial criteria for Medicaid qualification are otherwise met.

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Questions?

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- PLEASE NOTE: The purpose of these materials is to generally inform and not to specifically advise. You should not make legally significant decisions without advice from competent legal counsel. Estate and generational transition counseling is based upon the application of state and federal laws to unique facts. Presentations and materials cannot consider all factors that impact counseling in individual cases. Materials prepared applying Nebraska law.

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