ESTATE PLANNING BASICS

Agricultural Law Project, Legal Aid of Nebraska
and the
Risk Management Agency, USDA

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Need For Personal Legal Advice

The information in this presentation and accompanying material is provided for educational purposes only. It is not a substitute for individual legal consultation.
Estate Planning
Key Questions

- What do you own?
- What is it worth?
- How much do you owe?
- How are your assets titled?
- To whom will you give your assets?
- When will you give them away?
- How long do you want to exert control?
- What about long term care?
Key Notions to Keep in Mind

- **Probate**
  - What is probate?
  - Probate estate vs. taxable estate
  - Avoiding probate?

- **Minimize Tax**
- **Property Ownership**
- **Transferring Assets**
- **Long Term Care**
What is Probate?

- Legal process for proving the validity of a will
  - Someone has to start the process, not automatic
  - Petition court to probate will and grant letters testamentary (authority) to executor
  - Notice of hearing; Will contest would commence here
  - Grant letters testamentary
What is Probate?

- Legal process for proving the validity of a will
- Identify and inventory property of decedent
- Appraise property
- Pay debts and taxes
- Distribute property as the will directs
Probate Continued

- PR
  - Prepares inventory
  - Obtains appraisal
  - Gives notice to creditors to file claims
  - PR may reject claim, lawsuit on claim may result
  - If claims not filed, forever barred
Probate Continued

- PR
  - Collects and preserves property of estate
  - Pays debts, expenses and taxes
  - If any property left, PR distributes property as directed in Will or, if no Will, then by rules of intestacy

Probate can take time; ties up distributions; costs money – maybe more than alternatives
Remember –
Probate Estate v. Taxable Estate

- Assets may be part of one estate and not the other

- Anything a person has an interest in at the time of death goes into the taxable estate to the extent of that interest: this includes more than probate property, such as
  - Property transferred with strings attached
  - Value of an annuity
  - Joint tenancy property
  - Life insurance proceeds
  - Interests retained from previous inter vivos transfers
Avoiding Probate

- Reduce your probate estate to below $25,000
- How to accomplish and still control assets:
  - Joint tenancies
  - Payment on death bank accounts
  - Naming beneficiaries for retirement accounts
  - Register stock, bonds, brokerage accounts in “transfer on death” forms
  - Life estate deed
  - Living trust
  - Insurance
  - Gifting (you lose control with this option)
Avoiding Probate

- A word of caution: assets that pass to others outside of probate are generally not available to help pay costs of probate (if a probate is occurring at all), including taxes. This may mean that some heirs bear an unequal share of transfer costs.

- A spouse may generally reach assets that pass outside of probate with the spousal interest
Key Notions to Keep in Mind

- Probate
- Minimizing Taxes
  - Nebraska state inheritance tax
  - Federal estate and gift taxes
  - Unified credit
  - Marital deduction
- Property Ownership
- Transferring Assets
- Long Term Care
Minimizing Taxes

- Policy – at each generational level, assets will pass through a tax screen.....transfer taxes
- Nebraska State Inheritance tax
- Estate tax occurs on time-of-death transfers
- Gift tax occurs on inter vivos transfers
- Estate and gift taxes tied together in Unified Credit, as is generation-skipping tax
# Nebraska State Inheritance Tax

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<tr>
<th>Relationship</th>
<th>Rate</th>
<th>Exemption</th>
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<tr>
<td>Spouse</td>
<td>0%</td>
<td>Unlimited</td>
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<tr>
<td>Immediate</td>
<td>1%</td>
<td>$40,000</td>
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<tr>
<td>Remote</td>
<td>13%</td>
<td>$15,000</td>
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<tr>
<td>Other</td>
<td>18%</td>
<td>$10,000</td>
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# Federal Estate Tax

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<th>Tax Year</th>
<th>Tax Rate</th>
<th>Exclusion</th>
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<tr>
<td>2007</td>
<td>45%</td>
<td>$2,000,000</td>
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<tr>
<td>2008</td>
<td>45%</td>
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<tr>
<td>2009</td>
<td>45%</td>
<td>$3,500,000</td>
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<tr>
<td>2010</td>
<td>NA</td>
<td>Unlimited</td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td>$1,000,000</td>
</tr>
</tbody>
</table>
Estate Tax Marital Deduction

- No estate or gift tax imposed on transfers between spouses
  - Treat spouses as one economic unit
  - Expose assets to estate tax at each generational level
- If all property owned jointly, no estate tax imposed on death of first spouse, but all assets will be taxed on death of surviving spouse
  - No tax problem, if assets are worth less than exclusion amount/unified credit
- For larger estates, may not want all assets to pass to surviving spouse under the marital deduction – take advantage of both spouse’s unified credits
Unified Credit

➢ A “credit” that exempts assets from gift, estate and GST taxation

➢ Estate and GST tax exemption amount
  ✓ $2 million per person for 2006-2008
  ✓ $3.5 million per person for 2009
  ✓ Unlimited for 2010
  ✓ In 2011, the Act sunsets: back to unified credit of $1 million per person

➢ No longer “unified” after 2003 – gift tax exemption amount stays at $1 million
Gift Tax

- 45% for 2007-2009; 35% for 2010
- Annual exclusion amount equal to $13,000
  - Does not reduce Unified Credit
  - No need to file return
  - Additional unlimited exclusion for education gifts and medical
  - Gift-splitting allows spouses to double annual exclusion to each donee
- $1 Million exclusion (tied to Unified Credit) – Call Them Transfer Taxes
- Gift tax return to be filed on annual basis and tax paid, if any
- Gift tax imposed only on completed gift – transfer of possession and enjoyment: life estate deed is not completed gift
Unified Credit II

- Each person has ONE unified credit
- Where an estate is large, take advantage of both spouses’ unified credit
  - Do not use joint tenancy
  - Use tenancy in common
  - Use credit shelter trust as part of will or living revocable trust
Credit Shelter Trust

- Also called by-pass or family trust
- Used to take full advantage of exclusion amount or unified credit
  - On death of first spouse, assets are transferred into trust for life-time benefit of surviving spouse
  - These assets are included in first-to-die’s taxable estate and are not later included in surviving spouse’s taxable estate
  - Value of assets transferred into trust equal an amount necessary to avoid federal estate tax
- Typically included in a will or living trust document
Very Large Estates

- If doubling of unified credit by spouses would still leave assets subject to federal estate tax, planning becomes more complicated.

- Reducing the size of the estate
  - Irrevocable trusts
  - Use of annual gift tax exclusion
  - Use of special valuation procedures
  - Discounting value for lack of liquidity or control
  - Installment sales
  - Insurance owned by someone else (three year look-back)
Special Use Valuation

- Real estate used in family farm or closely held business: Section 2032A
  - Land is valued on basis of value as a farm and not at fair market value (IRC formula)
  - Maximum reduction in value is $940,000
  - Decedent or family member farmed land for 5 of 8 years preceding death
  - Heirs must farm for 10 years
Discounted Value

- Interests in closely-held family corporations, family partnerships or LLCs
  - May be discounted for lack of marketability/liquidity
  - Also discounted for lack of controlling interests
- A useful tool for transferring assets within the exclusion amount
Key Notions to Keep in Mind

- Probate
- Minimizing Taxes
- Property Ownership
  - Joint tenancy
  - Tenants in common
  - Life estate deed
- Transferring Assets
- Long Term Care
Property Ownership Basics

- Ownership of property
  - Real property.....land and structures attached
  - Personal property.....everything else

- Title of property
  - Sole ownership – a single owner
  - Tenants in common – multiple owners with undivided interests
  - Joint tenancy – multiple owners with right of survivorship
  - Life estate – ownership for the period of the possessors life
Property Ownership Basics

- **Joint Tenancy**: typical land ownership for married couple
  - surviving spouse automatically inherits
- **Common Tenancy**: typical land ownership for siblings (e.g. inheriting from parents)
  - property passes to the deceased heirs
- No limited liability protection--so creditors (including judgment creditors--lawsuit winners) can go after all the property that is in your name
Joint Tenancy

- Distinguished by WROS With Right Of Survivorship: on death of one owner, other owner(s) automatically succeeds to entire property
  - Not part of probate estate – avoids probate
  - Included in taxable estate
  - After death, not subject to decedent’s creditors’ claims
- All joint tenants own property together
  - Joint tenancy can be destroyed by any owner; also destroys right of survivorship.
  - If mortgage given by one tenant, joint tenancy destroyed; parties become tenants-in-common
  - Joint tenant’s creditor can attach interest in joint tenancy property during life; creditor and other tenant(s) become tenants-in-common
Taxation of Joint Tenancies

- Joint tenancy between spouses
  - One-half of value of property included in estate of first-to-die; survivor gets step-up in basis
  - No estate tax payable because property passes under unlimited marital deduction, depending on value
    - No doubling of unified credit
- Joint tenancy between non-spouses
  - All of value of property included in decedent’s estate
  - Except to extent survivor contributed to acquisition
Tenancy in Common

- Owners have distinct and separate interests
- No right of survivorship
- Right of possession is undivided
- Each owner may transfer interest, including by will
- Value of interest is included in taxable and probate estates
Life Estate Deed

- Property owner (grantor) deeds property to heir but reserves a life estate
  - Owns property for duration of life but cannot transfer/will
  - No changing mind without heir’s consent
  - Avoids probate
  - Value of property is included in taxable estate
  - Inexpensive tools for estate planning

- Heir acquires legal interest
  - Heir becomes “remainderman”
  - Remainder interest can be pledged, transferred or attached
  - Heir acquires stepped-up basis on death of life tenant
Life Estate Deed continued

- Restrictions may be imposed on the remainder interest
  - No encumbrances
  - Judgment v. remainderman results in reversion to life tenant or in transfer to a third party
- BUT restraints on alienation limit controls
  - Careful language, don’t give a fee simple
Joint Accounts, POD, Beneficiary Designations

- **Payable-on-death bank accounts**
  - Simple form available at bank
  - During your life, person named to inherit has no right to money; you can change beneficiary, spend money, close account
  - At death, beneficiary shows death certificate and ID and takes funds
  - If account owned jointly with spouse, POD beneficiary takes only after death of both owners

- **Retirement accounts**
  - On account-opening forms designate beneficiary
  - Surviving spouse may have right to funds, if not named
  - Roth IRA has no withdrawal deadlines, gain is tax-free, and with named beneficiary it is simple to pass on funds

- **Transfer-on-death registrations**
  - Register ownership of stocks, bonds, brokerage accounts with beneficiary designation
  - Beneficiary has no rights until your death
Key Notions to Keep in Mind

- Probate
- Minimizing Taxes
- Property Ownership
- Transferring Assets
  - Give it to them now with no strings attached
    - Gift
  - Give it to them now with strings attached
    - Trusts
    - Deed with life estate
    - Contract sales
  - Give it to them when you die
    - Intestate
    - Wills
    - Trusts
  - Basis adjustment
- Long Term Care
Give it to them now with no Strings attached

- Gifts
  - Elements of a gift
    - Must have a donor
    - Must have a donee (recipient) of the gift
    - Must have actual or constructive receipt of the gift
  - Gifts must be given free of any restrictions
  - Gifts in any amount are not income to the recipient
  - Gifts in excess of $13,000 per year to any one recipient will effect the unified credit of the giver
  - Basis considerations
Capital Gains Tax

Capital gain, put simply, is the difference between the value of an asset when you acquired it and what it is presently worth.

- Basis equals your “cost” in the asset – what you paid for it and the cost of improvements to it.

If you sell the asset, you pay capital gains tax (current maximum rate is about 22% combined federal and Nebraska state).

If you give away an asset, the recipient of the gift receives a basis in the asset equal to your own.
Capital Gains Tax Example

- Selling Price: $480,000
- Basis: $160,000
- Capital Gain = $320,000 @ 22%
- Tax Due = $70,400
Basis Adjustment

- Only a time-of-death transfer wipes out locked-in capital gain tax liability
- Heir receives the asset with a basis equal to FMV at time of death
- Time of death transfers only occurs in
  - Wills – probate transfers
  - Living revocable trusts
  - Life estate deeds
Give it to them now with Strings Attached

- Trusts
- My brother’s lunch
  ✓ My younger brother and I are going to the carnival and our mom gives me $10. She says: $5 is for you and with the other $5 make sure your brother eats lunch. The first $5 is mine; the second $5 I hold as trustee. I possess the second $5 and I have the right to spend it, but only as I have been told. My brother is the beneficiary, he does not possess the money but has the right to have it spent on his lunch. In legal terms, I have legal ownership and my brother has equitable or beneficial ownership.
  ✓ If I were to spend part of that $5 on myself, I would have violated my fiduciary duties to my brother. My brother would then.....
Elements of a Trust

- **Settlor**
  - Creator of the trust (My Mother)
- **Trustee**
  - Holds title to and manages trust property (Me)
- **Fiduciary**
  - The relationship between trustee and beneficiaries. Position of trust and confidence
- **Beneficiary**
  - Person for whose benefit trustee owns and manages the trust property (Brother)
- **Corpus**
  - The property that is held in trust (also called trust res, trust assets, principal, or trust estate) ($5)
- **Trust instrument**
  - Document that embodies the terms of the trust
Transferring Assets

- Trusts
  - Elements of a trust
    - Settlor or donor
    - Trust document
    - Trustee
    - Known or discernable beneficiary
  - Revocable or Irrevocable
  - Inter vivos or living trusts are established during the settlor’s life
  - All trusts become irrevocable at the death of the settlor
  - Testamentary, credit shelter or pour over trusts are established by a will
  - A living trust has no greater effect on Tax than a will
Uses of Trusts

- Protect assets from beneficiaries: separate management from enjoyment
- Manage property or investments
- Avoid probate or minimize probate costs
- Avoid guardianship requirements of transfers to minors or incapacitated persons
- Protect privacy in property transfers
- Guard against will contests
- May help to save estate tax, Irrevocable trust
Irrevocable Inter Vivos Trust

- Can reduce value of taxable estate
- If grantor/settlor does not retain interest in income or corpus of trust
  - Trust must benefit others
  - No retention of life estate in income
  - Enjoyment by beneficiaries cannot be contingent on death of settlor – must be present interest (some room to plan for minors)
  - Cannot retain power to change the transfer of property

✓ Use of trust to reduce value of estate runs against desire to control enjoyment or management of assets
✓ Planning for retention of some non-fiduciary powers can be risky

- Transfers still subject to Gift Tax: over $13,000 per person reduces unified credit but appreciation occurs outside of estate
Inter Vivos Revocable Trust
“Living Trusts”

- Avoids probate of trust assets
  - Assets can be quickly transferred after death
  - Costs more to create than a will, but avoids probate costs
  - Particularly useful to avoid probate in another state where property is held

- Property remains part of taxable estate
  - Not useful for reducing value of estate for estate tax planning
  - Heirs do receive step-up in basis
  - Spouses can use to double unified credit

- May be less susceptible to attack than will
  - Not subject to rules of testamentary proof (contract not a will)
  - “Seasoned” or in existence for some time before death

- Can be fully funded at creation or subject to pour-over provisions of will
- Can be used to manage assets
Life Estate Deed

- Property owner (grantor) deeds property to heir but reserves a life estate
  - Owns property for duration of life but cannot transfer/will
  - No changing mind without heir’s consent
  - Avoids probate
  - Value of property is included in taxable estate
  - Inexpensive tools for estate planning

- Heir acquires legal interest
  - Heir becomes “remainderman”
  - Remainder interest can be pledged, transferred or attached
  - Heir acquires stepped-up basis on death of life tenant
Transferring Assets

WILLS

- Competency required to make a will
  - Know the nature and extent of your estate
  - Be able to formulate a plan of distribution
  - Know the natural objects of your bounty
  - Understand the relationship of the above
- Must be witnessed by two witnesses in the presence of the testator and each other
- Must be revoked and/or amended with the same formality with which they are made
Living Will

- Medical directive or “living will”
  - Permanent vegetative state – what are your wishes with respect to life support
  - May ease difficult decisions for survivors
  - Should be part of estate planning documents
Durable Power of Attorney

- Grant of power to another to look after assets and manage affairs
- Anticipates possibility of incompetence: avoids need for incompetency hearing or approval of guardian
- Statute defines powers
  - Should also include express powers for tax returns, life insurance matters, making gifts, transferring property into trust, accessing safe deposit box, dealing with retirement plans and Social Security
- May be *contingent* or *present*
  - Contingent – effective only upon incompetence
  - Present – effective when executed and continues in spite of incompetence
Powers of Appointment

- Useful tool for postponing decision as to ultimate disposition of an asset; allows post-mortem modification of plan
  - Circumstances may change
  - Unforeseen events occur
  - Power of Appointment survives death, unlike power of attorney
- Used in trusts and wills
- Example: Ted gives farm to Kathy, his wife, for her lifetime, with the power to direct in her will how the farm should be divided among their children after her death
  - E.g. They want it to go to the “farming” child, but do not yet know who that is
Key Notions to Keep in Mind

- Probate
- Minimizing Taxes
- Property Ownership
- Transferring Assets
- Long Term Care
  - Statistics
  - Income from earnings and assets liquidation
  - Long term care insurance
  - Medicaid = safety net
Long-Term Care

- Cost of Nursing Homes
  - Assisted Living
  - Adult Day Care

- $3,000/month to $6,000/month
  - Inflation faster than general economy

- Wipe out a lifetime of work and savings
Long-Term Care

- Limited ability for Activities of Daily Living
  - Eating Meals
  - Personal Hygiene

- Aging Population
  - 36 Million over age 65
  - 72 Million over age 65 in 25 years
Odds of needing Long-Term Care

- 6.4 Million (18%) over 65 need some type of Long-Term Care
  - Nursing Homes
  - Assisted Living
  - Adult Day Care

- 1.5 Million over 65 reside in a Nursing Home
  - 65-74 1.1% 210,159
  - 75-84 4.7% 574,909
  - 85+ 18.2% 772,733
  - Over 65 4.5% 1,553,800

Cooperative Extension
Long-Term Care Statistics

- 2/3 of all men over 65 and 1/3 of all women over 65 will not spend 1 single day in a nursing home
- 50% of all nursing home facility stays will last less than 6 months
- 25% of all women over age 65 and 10% of all men over age 65 will stay more than one year in a nursing home facility
Long-Term Care Statistics

- 10% of those over 65 will stay more than 3 years in a nursing home facility

- The average length of stay in a nursing home facility is between 18 months and 20 months

- Vast majority of people will not need an extended period of Long-Term Care
Strategies to Provide for Long-Term Care

- Adequate income or reduction of assets
  - After tax available income
  - Earnings and asset sales

- Long-Term Care Insurance

- Medicaid safety net
Estate Planning

Key Questions

➢ What do you own?
➢ What is it worth?
➢ How much do you owe?
➢ How are your assets titled?
➢ To whom will you give your assets?
➢ When will you give them away?
➢ How long do you want to exert control?
➢ What about long term care?
# Time Management Matrix

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<tr>
<th>Important</th>
<th>Urgent</th>
<th>Not Urgent</th>
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<tbody>
<tr>
<td>I. Activities</td>
<td>Crisis Management</td>
<td>Deadline Projects</td>
</tr>
<tr>
<td>II. Activities</td>
<td>Planning</td>
<td>Relationship Building</td>
</tr>
<tr>
<td>III. Activities</td>
<td>Some Calls, Mail, Popular Activities</td>
<td>IV. Activities</td>
</tr>
</tbody>
</table>
Resources

- David Goeller, UNL Farm Transition Specialist
  - Phone: 402-472-0661
  - Email: dgoeller@unl.edu

- Joe M. Hawbaker, Attorney at Law
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- **Roger A. McEowen, Attorney at Law**
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Need For Personal Legal Advice

The information in this presentation and accompanying material is provided for educational purposes only. It is not a substitute for competent legal advice. Farmers and ranchers need professional legal and financial counsel in evaluating alternatives for legally structuring the farm business. This information is provided to help you better communicate with your professional advisors in analyzing your specific situation.