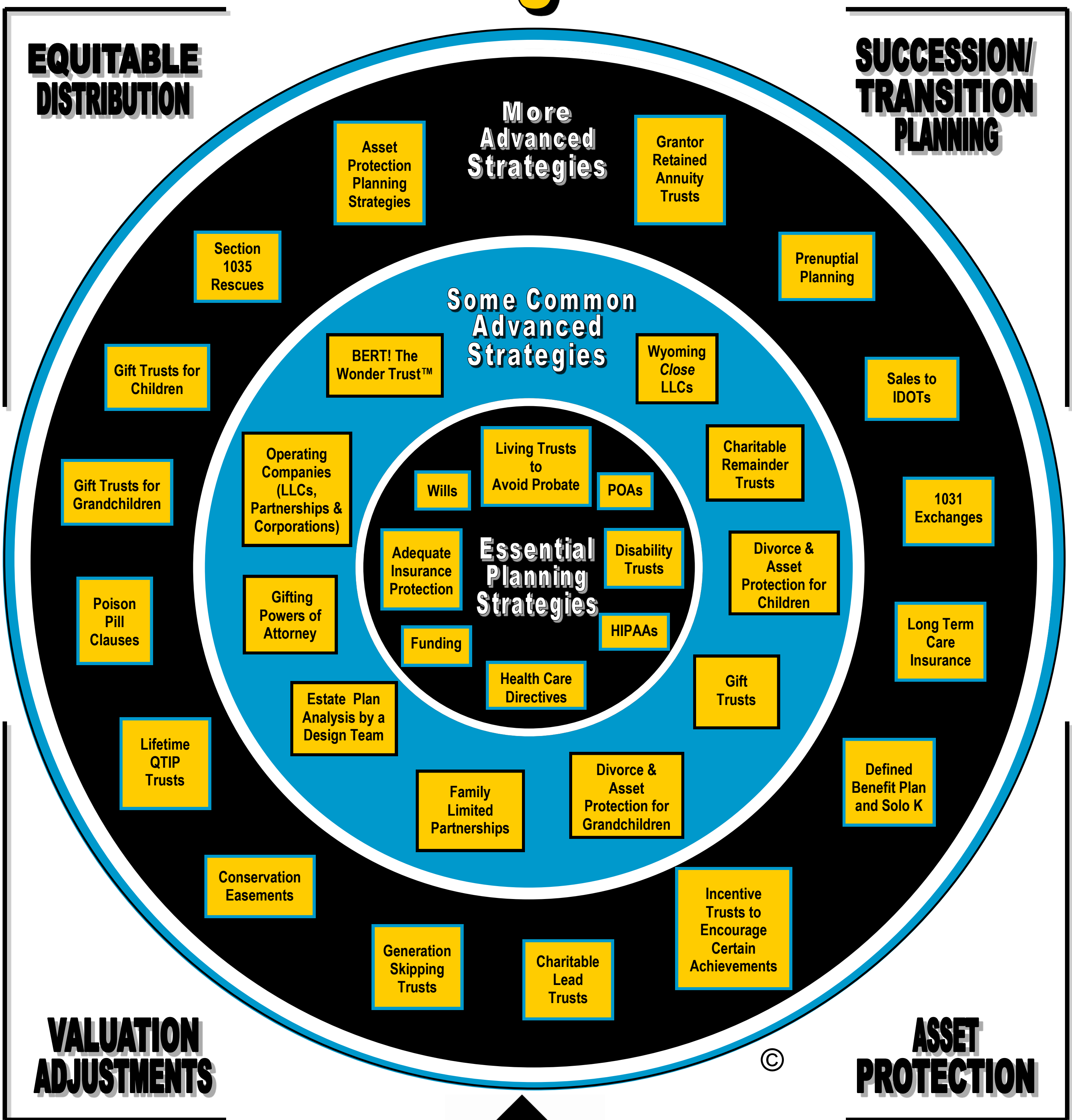
Farm Succession / Transition

PlanningWHEEL™



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Definitions to Farm Succession/Transition Planning Wheel

Revocable Living Trust (RLT) - Revocable Trusts hold assets to allow for maximum use of Federal and State Exemption Amounts (coupons); designed with MN GAP trust will allow for delaying MN Estate Tax to survivors death; designed with protective trusts shares to protect children's inheritance and farm from divorce or lawsuit; disability planning dealing with handling of farm equipment, farm land and farm buildings; final distribution documents and prenuptial planning will protect assets from the possible remarriage of the surviving spouse.

Power of Attorney - Disability documents used for voting rights, rental rates and amounts, handling of all financial affairs of client in the event of their disability. Best if designed with springing powers so client is in control until their disability.

Disability Trust - Special Needs or Supplemental Needs Trusts are for beneficiaries that are collecting Title XIX benefits. They are specific trusts designed to provide for the supplemental needs of their beneficiaries without jeopardizing the governmental benefits currently being received by the beneficiary.

HIPAA - Allows for access to health information and complies with Health Insurance Portability and Accountability Act.

Health Care Directive - Appoints an agent to make health care decisions for the individual if they are not competent and deals with terminal illness and living will decisions.

Funding- Process that changes ownership of assets to appropriate trust, entity or beneficiary to insure that a plan works. This is probably one of the most overlooked and most important areas of estate planning.

Adequate Insurance Protection - Involves discussions of liability insurance, proper titling and naming of insured parties, looking into the possible use of Long Term Care Insurance and other important insurance needs.

Will - Pour Over Will used with Revocable Living Trust used as a safety net in the event that assets are not titled correctly. Will involve probate but insures the assets go thru the Trust.

Wyoming Close LLC - Used primarily for asset protection, discounting and transition planning (gifting or sales). This LLC used to own the land, building sites or occasionally farming operation. Allows for maximum discounting because of the statutory restriction within the Wyoming Close LLC Statute. Discounts up to 74% have been achieved. Traditional discounts up to 50%. Bulletproof assets protection by statute. The Wyoming Close LLC is one of our FAVORITE tools for larger farm cases.

Charitable Remainder Trust (CRT) - Works well as an exit strategy if there is no next generation or if client owns some land close to a developing city. Client gives highly

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appreciated property to the trust that sells the property without tax and pays an income stream to client and spouse for their joint lives. Trust goes to charity upon second death. Concept usually involves a Wealth Replacement Trust to replace assets going to charity. Sometimes used with equipment for exiting farm client.

Divorce & Lawsuit Protection for Children - Involves the creation of **Protective Trust Shares** (PTS) upon the distribution of assets to children or involves the creation of a Kid's Trust (Gift Trusts) if giving while alive. We recommend that inheritance is given to children in PTS which names child as sole beneficiary for their health, education and maintenance upon sole discretion of the Trustees. Trustees are recommended to be child plus a co-trustee usually limited to sibling, accountant, corporate, or attorney. Co-Trustee provides all the protection but child is in charge of investment decisions. Used in combination with Generation Skipping Tax (GST) you create.

Family Limited Partnership (FLP) - Primarily used for discounting, transitional planning, and asset protection. FLP will own the assets and will consist of General Partners and Limited Partners and usually try to have 1-2% of FLP represented by General Partnership (GP) interest with remainder in Limited Partnership (LP) interest. Parents give or sell the LP interests. Advantages would be that we use Minnesota Law so there is no need for registered agent, 100% control can remain with parents subject to some constraints, discounts range from 20-35% typically, and fairly good asset protection for Limited Partners. Disadvantages if FLP is to be used in multiple generations because it usually involves the use of corporation as General Partner and thus multiple book keeping, checkbooks and tax returns, smaller discounts than Wyoming Close LLC, and less asset protection than Wyoming Close LLC.

Estate Plan Analysis by a Design Team - Custom designed plans to help the client reach their HOPES, DREAMS, GOALS and ASPIRATIONS. Collaborative team set up to design and implement plan and then a formal maintenance plan is established.

Gifting Power of Attorney - Custom designed power of attorney that will allow for completion of plan. Example if plan involves the gifting of shares, creation of entities, creation of trusts the Power of Attorney must allow for the same under certain rules.

Operating Company - Choosing the correct operating Company based on client goals and circumstances.

C-Corp - Usually used in larger livestock operations, maximizes the use of deductions, and allows for possible deduction of housing, meals, etc.

S-Corp - Usually used in high profit operations because of the ability to pay both wages and distribution. Payment in distribution avoids the Self Employment Tax (SE Tax) that equals 15.3%.

Limited Liability Company (LLC) - LLC is primarily used in livestock operations or smaller cash crop operations where direct payment limits have not been exceeded. These work well for transition planning, allowing for rental income back to farmer land owners, and allows for most deductions. Good asset protection.

General Partnership - These are used in larger cash crop operations. A general partnership allows for a direct payment limit per general partner and ability to create multiple general partners for direct payment limits. Still allows for rental of real estate but slightly greyer area. There is little to no asset protection available.

Bert the Wonder Trust - Also known as a Spousal Gift Trust. Irrevocable gift trust naming the spouse as the beneficiary for their health, education and maintenance whereby the spouse can benefit without the assets of trust being included in their estate. Perfect for client that wants to save taxes but is not comfortable with gifting to children.

Grantor Retained Annuity Trust (GRAT) - An Irrevocable Trust used to transfer wealth from generation to generation. We will typically use a Walton GRAT which is a Zero Gifting GRAT for tax purposes. Trust is set up to pay out an annuity stream over a fixed period of time dependent on the Federal 7520 rate to the Grantors of the trust with the remainder passing to the beneficiary gift and estate tax free. GRAT's are typically used in combination with a discounting tool such as a Wyoming Close LLC or FLP. Only negative is that it becomes more difficult when used with land and if grantor does not survive the term of the GRAT the full value of GRAT assets will be included in the estate of the grantor.

Prenuptial Planning - The most common type of prenuptial planning involves actually getting a prenuptial agreement before a marriage, but this is not the only thing that can be done. The vast majority of our clients design into their RLT prenuptial planning that would require the surviving spouse to sign a prenuptial agreement in the event of a remarriage. This gives the surviving spouse someone to blame and relieves much of the stress of asking for the prenuptial because they have no choice and can blame others. This same language can also be required of children before a marriage but very few clients take this step and most prefer to use PTS to protect against this risk. We have also used this technique when gifting interest in the family farm to a child whom is married by having that spouse sign off waiving their rights to that gifted asset. Planning for a potential divorce is to us one of the single most important steps to protecting the family farm.

Sales to IDOT's or IDIT's (Intentionally Defective Irrevocable Trusts) - Involves the sale of the farm business or land to an IDIT with a promissory note being used for the sale of the assets. An IDIT is an irrevocable trust that is structured such that transfers to it are complete for transfer tax purposes (estate taxes) but incomplete for income tax purposes. The grantor will achieve non-recognition of capital gain on the sale of appreciated assets to the IDIT. Advantages will be a freeze on the value of the assets subject to the sale. A steady income stream from the IDIT to the grantors and the only thing included in the estate of the grantor would be the outstanding balance of the promissory note. Disadvantages would be that the grantor is responsible for all income taxes from the trust except for the sale of appreciated assets. Again, these are typically used with some sort of discount planning.

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1031 Exchange - Like-in-kind exchanges. Sell this land and reinvest the proceeds into the next property. Options for 1031 are land to land, building to building, landlord to landlord, land to TIC (tenants in common property). Key to remember is if any funds are retained by seller for cash or payment of debt there will be a gain recognized on that amount. The Boot (gain) is recognized first.

Long Term Care Insurance Planning - Planning should be made for how to deal with a long term care stay or nursing home stay. Either an asset protection plan needs to be established, insurance taken out, or adequate income should be available to pay the bill without jeopardizing the farm assets. Key item to remember is the new look-back period of 5 years for Medical Assistance purposes.

Defined Benefit Plan and Solo K - A defined benefit plan and Sole K is an advanced income tax strategy that may be used to deal with highly profitable farming operations, grain in storage or as part of an exit strategy for a retiring farmer. Both plans allow the farm to sell their grain and then contribute to their defined benefit plan or solo K while getting a tax deduction for their contributions to the plan.

Incentive Trust - These are specifically designed trusts, protective trust shares with designed terms or gift trusts that reward certain behavior. Incentive Trusts are ideal for a client that does not want a child or grandchild to become a trust baby or wants to reward certain behavior or not reward certain bad behavior. This is a very common planning tool in our practice.

Charitable Lead Trust - These are charitable trusts, generally formed on a testamentary basis (which means after death), that pay income to the charity or private foundation for a period of time, generally 18-21 years, then the balance of the trust assets pass to the children tax free. Testamentary Charitable Lead Annuity Trusts (TCLAT) are used both to zero out estate taxes and also as a poison pill to take away the IRS's incentive to challenge a discount. Using a TCLAT with a family business can be very effective but puts an emphasis on GOOD PLANNING.

Generation Skipping Trust (GST) - These are trusts specifically designed to create a generation skip for estate tax purposes using a client's generation skipping transfer tax exclusion amount. This can be designed as either a direct skip to the next generation (ex. skipping directly to the grandchildren) or more popularly a trust that creates a skip because the next generation has no general power of appointment (Protective Trust Share that does not allow the child to appoint the assets but at their death creates a skip and thus the PTS would not be included in their estate for estate tax purposes).

Conservation Easement - Conservation Easements are an income tax strategy whereby a farmer or rancher can take marginal land out of production and place a permanent easement on the property and receive a tax deduction for that action while maintaining 100% ownership and control of the property subject to the easement.

Lifetime QTIP Trust - Used to control the ultimate distribution of the assets while still qualifying for the unlimited marital deduction. Used extensively in second marriage planning and for delaying the MN Estate Tax.

Poison Pill Clause - Involves putting a TCLAT into an RLT to zero out all federal estate taxes and taking away the IRS's incentive to audit a discount thus resulting in larger discounts.

Gift Trusts for Grandchildren - Irrevocable Trusts designed to qualify for the Generation Skipping Tax Exclusion amount. A key item is to file a 709 gift tax return applying GST to all gifts to the trust including those using the annual gifting exclusion amount.

Gift Trust for Children - Irrevocable Trust designed to receive gifts from parents to the children either by using their annual gifting exclusion amount (remember if they do not have control over the distribution of these gifts a Crummy Notice must be given to them for it to qualify under the annual gifting exclusion) or by filing a 709 gift tax return for the gifts to the trust. Again these can be designed to protect the child from creditor/predator risks.

Section 1035 Rescues and the use of Irrevocable Life Insurance Trusts (ILIT) - Section 1035 is the like-in-kind exchange section of the IRS code for insurance products. This strategy keys in on the importance of making sure your client's insurance needs are adequately funded, are healthy, and owned properly. An ILIT is a trust designed to own and be the beneficiary of life insurance while keeping the death benefit out of the estate of your client. ILITs are generally funded using the annual gifting exclusion amounts in combination with Crummy letters; however larger cases may require the use of a Split Dollar Agreement to reach the necessary funding requirement of the life insurance policy. One key for how a policy should be owned is where the premium is coming from. If the premium is coming from income produced by the farm we generally will always use an ILIT for asset protection purposes (protecting the cash value in the contract from the risk of divorce of a farming child or a child quitting the farming operation).

Asset Protection Planning Strategy - Includes all plans to insure that the farm is not lost to the risks of a lawsuit, creditor risks, risks of the farming partners and other risks. It involves the concept of divide and conquer, hot assets/cold assets, entity selections, jurisdiction planning, and maintenance.

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A Note from...

Miller Legal Founder & Attorney, Scott P. Miller

There are a thousand ways to do your Estate and Farm Transition Planning. You come to us to pick the best solution to your problem. With 90% of our clients being farmers we work with farm families on a daily basis developing farm succession and transition plans specifically to generate the results that they want. We want you to have the best experience possible and our number one priority is that the plan we create and implement for you works.

We understand that each family is unique and has different challenges, values, and goals. We custom design every plan to have each client's assets produce their desired result and individual goals.

Here are some of the most frequently asked questions that we help our clients solve.

1. How do I get my children involved in the family business?

2. How do I save Estate and Income taxes?

3. How do I protect my children's inheritance?

4. How do I keep family harmony?

5. What are the methods to provide fairly between my children?

6. How do I make sure any future farming child can be successful (generational planning)?

Miller Legal Strategic Planning Centers, P.A. has been in business since 1996. We have the experience, the highly trained staff, and the tools to help you. We have offices throughout Minnesota to serve you, as well as our network of Farm Business Managers, Ag Lenders, CPAs, and Financial Advisors that we work with and can schedule meetings at any of their locations too.

If you don't have next generation planning done, do it! If you don't it is a mess for your loved ones. Simply put, failing to plan is planning to fail. Finally, I would like to share with you our mission statement.

Mission & Vision Statement

Miller Legal's mission is to guide farmers, business owners, and committed clients to identify and reach their family goals by creating a customized wealth preservation, business, and transition plan that incorporates complex estate planning and tax saving strategies, while protecting relationships and minimizing conflict.

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