

# Estate Planning

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- What is Estate Planning?



# Estate Planning

- The process of anticipating and arranging for the disposal of an estate.
- Estate planning typically maximizes the value of the estate by reducing taxes and other expenses.
- Guardians are often designated for minor children and beneficiaries in incapacity.

# My Simple Definition

- Helping clients achieve their objectives which always include minimizing taxes and being “fair” to their heirs.
- Equal vs Equitable

- *Gross Estate*

Your gross estate includes the value of all property in which you had an interest at the time of death including:

Life Insurance Proceeds

Certain property transferred w/in 3 yrs of death ( life insurance)

- ***Taxable Estate***

Gross estate minus allowable deductions include:

Funeral expenses

Debts

Marital Deduction

Charitable Deduction

State Death Tax Deduction

# Filing Estate Tax Return

- If gross estate plus taxable gifts exceeds \$5,000,000 in 2011 must file and pay within 9 months of DOD.
- Can extend filing date by 6 months but must pay tax in 9.

# Typical Documents

- Will
- Health Care Proxy/Living Will
- Durable Power of Attorney
- Trust Agreement
- Business Agreements



# Estate Planning Documents that Everyone Needs

## Will

Makes specific bequests, names executor, names guardians, testamentary trust, general provisions. Should be reviewed every five years.

Transfer document.

# What If No Will?

- Known as dying Intestate
- Assets then distributed according to State Intestacy Laws

# Intestacy Laws

## New Jersey Example

If have surviving spouse and children

- 25% to surviving spouse but minimum of \$50,000 and no more than \$200,000 plus 50% of the balance of the estate.
- Children split equally

## Health Care Proxy

Appoints someone to make health care decisions for you.

## Living Will

Outlines your wishes for extraordinary measures to be taken if there is no hope of recovery.

# Durable Power of Attorney

Provides someone the authority to act on your behalf in financial and legal affairs.

# Business Agreements

Limited Liability Company  
Operating Agreement

Partnership  
Partnership Agreement

Corporation  
Shareholder Agreement

# Life Triggering Events

Death

Disability

Divorce

Retirement

Disagreement

# Business Continuity

Buy/sell terms that promotes business continuity

First Right of Refusal

Valuation

Funding

Terms



# Estate Planning Basic Terminology

- Lifetime Exclusion
  - Value of assets that can pass to heirs free from estate tax.
- Lifetime Gift Exemption
  - Value of assets that one can gift while alive
- Annual Exclusion
  - Maximum amount that a person can gift without incurring federal gift tax. There is no limit on the number of recipients.
    - Must be “present interest”
- Unlimited Marital Deduction
  - Assets passing to a survivor spouse incurs no estate tax.

# Estate Planning Basic Terminology

- Trust
  - A legal title to property held by one party (trustee) for the benefit of another (beneficiary).
- Probate
  - **Probate** is the legal process of administering the estate of a deceased person by resolving all claims and distributing the deceased person's property under the valid will.

# Assets Subject to Probate

- All assets in your name, not owned jointly, not in trust and/or no beneficiary designation.

# General Transfer Rule

*The transfer of assets always occurs at Fair Market Value*

## **Sale**

Asset sold at FMV. It can be a cash sale or paid over time.

## **Gift**

A transfer for no consideration during your lifetime. FMV determined by appraisal.

## **Bargain sale**

A combination of sale and gift. Gift value determined by appraisal.

## **Bequest**

Transfer of assets via will. FMV determined by appraisal.

# Estate Planning Points

- Affects of Asset Ownership
- Estate & Gift Tax Rates and Exemptions
  - 2011 and beyond?
  - Estate Tax Considerations
- Gifts – Pros and Cons
- Trusts
  - Manage estate appreciation

# Types of Ownership of Assets

## **Joint Tenants With Right of Survivorship (JTWROS) or Tenants by the Entirety**

Property passes to the survivor regardless of the will terms.  
Typically 50% of asset value included in decedent's estate.

## **Tenants in Common**

Each owner owns an undivided interest. Can control disposition through will.

## **Individual**

Used to balance estates between spouses and can easily tied back to specific bequests to your will.

# Federal Schedule Gift and Estate Exemptions

Year	Gift Exemption	Lifetime Exclusion
	(during lifetime)	(at death)
2011	\$5,000,000	\$5,000,000
2012	\$5,000,000	\$5,000,000
2013	\$1,000,000	\$1,000,000

# New Jersey has a Separate Schedules

Lifetime Exclusion

New Jersey

\$675,000

No Gift Taxes



# New Jersey Lifetime Exclusion

- New Jersey \$675,000
  - NJ uses Federal rules that were in place in 2001 to calculate NJ estate tax due.

Example:

NJ estate value	State Estate Tax Due
\$1,000,000	\$33,200
\$1,500,000	\$64,400

# New Jersey Inheritance Tax

- Depends on your relationship to the decedent.
- Class A Beneficiary – lineal
- Class C Beneficiary – sibling, wife or widow of son or daughter of decedent
- Class D Beneficiary – everyone else
- Class E Beneficiary – Public charities, churches etc.

# New Jersey Inheritance Tax Schedule

- Class A Beneficiary – Exempt
- Class C Beneficiary –
  - First \$25,000 exempt
  - Next \$1,075,000 11%
  - Next \$300,000 13%
  - Next \$300,000 14%
  - Over \$1,700,000 16%

# New Jersey Inheritance Tax Schedule

- Class D Beneficiary
  - First \$700,000 15%
  - Over \$700,000 16%
- Class E Beneficiary Exempt

# Estate and Gift Tax Rates

2011 Taxable Gift Tax Rate 35%

2011 Federal Estate Tax Rate 35%

2013 Federal Estate & Gift Tax Top Rate  
60%

NJ Estate Tax Rate Up to 16%

# 2011 Example Estate Tax Calculation

## New Jersey Estate

Taxable Estate Value	\$3,500,000
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New Jersey Estate Tax	\$229,200
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Federal Estate Tax	\$-0-
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<b>Total Estate Tax</b>	<b><u>\$229,200</u></b>
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# 2013 Example Estate Tax Calculation

## New Jersey Estate

Taxable Estate Value	\$3,500,000
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New Jersey Estate Tax	\$229,200
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Federal Estate Tax – Initial Calc.	\$1,220,000
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Less: State Estate Tax Credit	(\$229,200)
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Net Federal Estate Tax	<u>\$ 990,800</u>
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<b>Total Estate Tax</b>	<b><u>\$1,220,000</u></b>
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# Estate Tax Considerations

- Property Valuation
  - Consider special use valuation
- Life Insurance
- Deductions
- Disclaimers
- Charitable Deduction



# Asset Valuation

Fair Market Value as of Date of Death (DOD)

Optional Valuation Method for Farm Real Estate  
– Special Use Valuation – Must Qualify!

# 2032A Special Use Valuation

Election required on estate tax return

50% and 25 % rules

- At least 50% of estate must be real farm property and other farm assets.
- At least 25% of value of the estate is qualified farmland.

Value the property as farm-use property.

Can make the election on agriculturally restricted property.

Value of property determined by capitalized rent approach.

Need actual market data in local market to support rental rates.

# 2032A Special Use Valuation

- Must meet certain rules to qualify:
  - Qualified Use – Productive farming use, passive use does not qualify
  - Ownership Test – 5 of 8 yrs prior to death owned by family
  - Qualified Heir – ancestor, spouse, lineal descendant
  - Material Participation – Family must have materially participated in farm business.

# 2032A Special Use Valuation

- Agreement must be filed with IRS
  - All heirs sign and are personally liable for estate tax in case of early disposition of property or cessation of qualified use.
- IRS has a lien on the property for 10 years
- If change use then subject to recapture of estate tax plus interest.
  - Be careful if property has all rights because the sale of development rights within 10 year period could be considered a change in use.

# 2032A Special Use Valuation

- Maximum deduction allowed:
  - 2011 - \$1,020,000
- States can have their own rules
  - e.g. State of New Jersey decoupled on 12/31/01.  
Maximum deduction in NJ: \$800,000.

# Special Use Valuation Example

- Farm Property FMV \$2,500,000
- Special Use Value \$ 500,000
- Difference \$2,000,000 (exceeds max.)
- Limitation of Reduced Value \$1,020,000 (changes annually)

Value for Estate Return

\$2,500,000 minus \$1,020,000 equals **\$1,480,000**

# Life Insurance

## Typical Purposes

Create or Preserve an Estate

Life Insurance Proceeds are Subject to Estate Tax  
if Owned by Decedent

# Life Insurance Estate Tax Mitigation Strategies

- Gift Insurance Policy to Trust or Individual

Value of Gift?

Must be more than 3 years prior to DOD



# Life Insurance Strategies

- Gift Value is equal to:
  - Permanent Policy - Cash Value
  - Term Policy - One Year's Premium
- New owner must pay premium going forward
- Ensure there are no “incidents of ownership” of insured
  - i.e. cannot retain the authority to change beneficiaries, cancel policy or borrow against policy

# Typical Deductions from Gross Estate

- Debts of Decedent
- Funeral Costs
- Administration Costs
- Medical Expenses
- Bills due as of DOD
- Accounting fees
- Appraisal fees
- Attorney fees
- Etc

# Marital Deduction

- Unlimited value of assets may pass to spouse and not be subject to estate taxation
- Marital deduction portable in 2011 and 2012

# Post Mortem Technique

## Disclaimers

- Must be in writing
- Must occur within nine months of DOD
- Person did not accept property or any of its benefits before making disclaimer
- The interest passes to someone besides the disclaimant

# Charitable Deduction

- Value of assets left to qualified charities are a deduction against the gross estate value.

# Gifts

## Pros and Cons

- In general all gifts are valued at fair market value
- Pros
  - Can reduce estate taxes
  - Reduce estate settlement costs
  - Transfer a going business to successors
  - Benefit family members and charitable organizations

# Gifts Pros and Cons

- Cons
    - Assets no longer available to provide income
    - Control over gift property is given up
    - Tax basis of gift transfers to recipient
- vs
- Holding asset through estate then heirs receive a stepped up basis equal to FMV

# Gift Tax Issues

- 2011 – Taxable gift tax rate is 35%
- 2013 – Follows estate tax rate schedule  
37% up to 60%
- What is a taxable gift?



# Taxable Gift Defined

- Any gift made to a recipient that exceeds the value of the Annual Exclusion in a calendar year.

# Transfers Excluded from Gift Tax

- Any gift that is not more than the Annual Gift Exclusion for the calendar year
  - 2011 Limit - \$13,000
- Tuition
- Medical expenses
- Charitable gifts
- Gifts to a political organization
- Gifts to your spouse

# Trusts

- An arrangement where one party (trustee) holds legal title to property and manages it for the benefit of another (beneficiary).
- The trust agreement is a legal instrument that directs the trustee to do certain things with the property (corpus) and income generated by that property and determines ultimate disposition of the corpus.

# Why Use a Trust

## Save on Estate Taxes

Must find assets to fund the trust.

Non-farm assets are preferred. “Estate freeze” affect.

## Allows for Outside Help from professionals

Help survivor manage the business and/or estate.

Watch the fees!

# Why Use a Trust

Hold life insurance policies out of your estate. Good tool

Directs assets in a more definite manner than through the will, if the trust is created during the grantor's lifetime. This avoids probate.

# Types of Trusts

- Irrevocable Trust
  - Cannot be changed
  - Assets of trust not included in estate
  - Trust typically funded by gift of assets
- Revocable Trust
  - Can be changed
  - Assets of trust are included in estate
  - Assets not subject to probate

# Credit Shelter Trust

- Maximizes use of lifetime exclusion for each spouse
  - 2011 - \$5,000,000 – federal
  - 2011 - \$675,000 - state
- Trust typically established via Will.
- Surviving spouse receives income from trust and principal for health, education and maintenance expenses.
- Beneficiaries are typically children.

# Living (Inter Vivos) Trust

usually revocable

- Grantor creates the trust during his lifetime.
- Retain the use of income for grantor and grantor's family.
- Trustee provides professional investment management.
- Saves probate costs at death.
- Does not eliminate assets from taxable estate



# Irrevocable Life Insurance Trust (ILIT)

- Owns life insurance policy and receives the insurance proceeds upon the death of the insured.
- If irrevocable & the transfer into trust is made more than 3 years before death, then out of grantor's estate.
- Gifting of premiums may be part of this plan. Requires careful planning...

# Installment Payment of Estate Tax

- To Qualify: Minimum of 35% of estate value attributable to business interest
- Terms:
  - Tax attributable to business interest qualifies for 2% interest rate up to ceiling established annually.
    - 2011- \$1,360,000
  - Tax deferred for five years – paid over subsequent 10 years at low interest rate (interest paid during deferment period.)
- Must post a bond or allow a lien for tax due.
- Special Rules apply.

# Thank You

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