



Estate Planning for the Family Farm

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From commodity prices to the weather, uncertainty is a fact of life in agriculture. There is one essential factor for long term success, however, that a family farm can control – careful estate and succession planning. Let's start with the basics, and then concentrate on how transfer taxes affect estate plans.

Estate planning is simply the process of creating a plan to transfer assets from one generation to another. No two estate plans are identical, but each properly structured estate plan will allow a family to transfer its assets from generation to generation and in the way the family chooses, while minimizing transfer taxes so more assets can be kept.

Generally speaking, federal transfer taxes apply when a person transfers an asset by gift or inheritance to another who does not give equal value in return. There are three federal transfer taxes. First, the well-known estate tax applies to transfers at death. Second, the generation-skipping transfer tax (GST) applies to certain lifetime or after-death transfers. Third, the gift-tax applies to lifetime transfers. Some states impose inheritance taxes, but Michigan does not do so at this time.

The law permits an individual to transfer certain assets without triggering the federal transfer taxes. There are generally two "exclusions" or "exemptions" from the federal gift tax: an annual amount and a lifetime amount. The gift tax annual exclusion permits any person to give up to \$14,000 to any other person during a calendar year, without gift tax. In addition, there are lifetime exclusion amounts for the various federal transfer taxes. The gift tax lifetime exemption amount is basically an aggregate amount that any person may give to any other person during life (over and above the annual exclusion), without incurring an immediate tax liability. Lifetime exemption amounts also apply to transfers that are subject to estate tax and GST laws.

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Over the past decade, the lifetime exemption amounts and transfer tax rates have been in constant flux. Fortunately, the American Taxpayer Relief Act was enacted on January 2, 2013, and it provides certainty. Now, the lifetime exemptions and tax rates for all three federal transfer taxes are the same. In 2014, the exemption for each is \$5,340,000, and is indexed for inflation. With proper planning, any unused exemption amount remaining after the death of one spouse may be transferred to and used by the surviving spouse. As a result, an individual can transfer up to \$5,340,000 in the aggregate during life or after death without incurring transfer taxes (\$10,680,000 for married couples). A 40% tax rate applies to transfers in excess of \$5,340,000 (\$10,680,000 million for married couples). The gift tax annual exclusion of \$14,000 still applies.

These rules create many planning opportunities for families who have worked hard to build successful farm businesses. For example, members of older generations may choose to make large present gifts to younger generations free of transfer tax. While basis issues need to be carefully analyzed, this could permit transfers of significant portions of many farm business, avoiding the risk of future changes in the estate tax laws and transferring future growth in the value of the business to younger generations.

With additional planning, farm assets could be transferred in a manner that takes advantage of GST exemptions, such as through a long term trust for the benefit of children, grandchildren, and future generations. These transfers could be structured so that they will never be subject to transfer tax, even upon the death of members of the next generation.

The new transfer tax exclusion amounts and tax rates ease a portion of the tax burden, while estate tax planning has become as important as ever. Getting the maximum tax benefits and reducing the federal transfer taxes are not automatic. Careful estate planning is required to create a strategy that reduces future tax burdens and meshes with your overall succession plan.

Note: This article was originally written in September 2011 and has been updated to include the latest information as of March 2014.