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PLANNING FOR THE FUTURE- GET IN THE DRIVERS SEAT!

2024 NDSU TAX WORKSHOP

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The Importance of Planning

If your customers are not planning for the future of their farm or ranch--their retirement--or their estate plan, they are competing with other Ag producers who are planning.

Farming and ranching is now a "long game". To be ahead, you have to think ahead. The next 5 to 10 years will require a long game plan. If we just think short term we are event planning--no vision and no goals. Long Game planning needs vision, goals and **process planning**.

Today's discussion is about idea sharing to give you some options. We all know—each farm is different. So each plan is going to be different.

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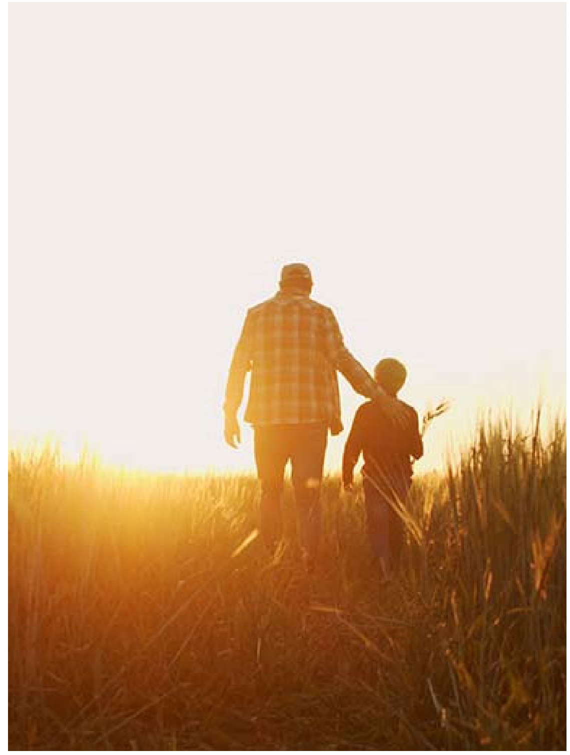
Today's Topics

1. Updates – What We Are Seeing
2. Review, Review, Review
3. Estate Planning and where a CRUT or CRAT may fit
4. Transition & Retirement Planning
5. Communication and Working with Family



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What we are seeing

High land values creating some family problems with buy outs of non-farming siblings financially stressing many operations.

Wills and trusts are not being reviewed often enough when there is a successor. Review every 3 to 5 years unless there is a change--then review right away (death, inheritance, marriage change, ownership changes, medical issues for parents and children, major life event, major financial change).

Consolidation continues. To be relevant in the future, most farms need to continue to grow.
Labor and capital are the challenging issues. Who does the work? Where does the money come from?

A recent EY (formerly Ernst and Young) study shows that 61% of farmers and ranchers do not have a fully documented and communicated plan for their transition, their estate or their retirement. The same study showed the following three reasons they farmers and ranchers take action and put a plan in place:

1. **They are aging**
2. **Desire for legacy preservation**
3. **Advice from someone**

What we are seeing (cont.)

The EY study asked who is the most trusted advisor?

1. Accountant
2. Lawyer
3. Tax Professional
4. Banker
5. Lender
6. Business Consultant
7. Wealth Manager
8. Education related (seminars, internet etc.)
9. Other (clergy, sibling, friend)
10. Insurance provider

What we are seeing (cont.)

EY's study asked what benefits are farmers and ranchers after in a succession, retirement and estate plan:

1. Peace of mind
2. Thoughtful long-term strategic planning
3. Long-term operational success (the term "success" being very subjective)
4. Tax efficiencies and ensuring estate taxes are eliminated or reduced
5. Preserve long term farm business and farm financial viability
6. Improved family cohesion and alignment
7. Reduced risk to the farm and a business continuity plan
8. Continued access to Ag based transition and estate planning specialists
9. Legacy preservation
10. Access to someone they trust to problem solve

What we are seeing (cont.)

Cropland Appraisal Benchmarks for North Dakota*—percentage increase over time:

One-year	9.2%
Two-years	37.9%
Three-years	78.8%
Five-years	95.0%
Ten-years	61.0%

* NE ND showed the strongest increases in 2023 and first half of 2024
* Average cropland value in ND as of July 1, 2024 was $6588/acre and $1201 for pasture

Factors influencing some current land values:

1. Good 2023 crop yields. Strong cattle prices.
2. Strong cash reserves and good working capital positions for 2023. What does the 2024 balance sheet look like? Will this continue in 2024 and the near future?
3. Limited supply of land on the market—approximately 25% less land on the market YOY.
4. Stabilized interest rates. Is the "are the interest rates set" mentality sinking in? Buy now because rates ill not decrease any further. Not sure this one drives the market as much as other factors.
5. "I have farmed it for XX years and I need to keep it". Cost becomes an issue but loosing it is a bigger issue.
6. Weaker commodity prices and weather events may weaken future growth in land values.

Most farm related real estate is still being purchased by farmers and ranchers

Some Federal Stats (USDA Figures)

Average age of a U.S. Farmer is 58.1

Approximately 880 million acres of farm and ranch land in the U.S.

Approximately 60% owned by someone(s) age 65 or older.

Approximately 2 % of farmland owned by someone age 35 or younger.

It is estimated that over the next 15 to 20 years, 70% of U.S. farmland will transfer or change ownership.

These Stats Can Lead to……

Wealth transfer to a family sometimes happens without consideration to keeping the farmer that is farming/ranching the land financially viable and relevant.

Buyouts of non-farming siblings that do not cash flow for the farming sibling.

Feuds between siblings and their spouses or siblings who have not been associated with the farm other than growing up on the farm or being married to or, the child of, someone who grew up on the farm (there are also plenty of positive success stories with co-owned family land)

Financial stress for the family farm

Lawsuits

Recent Estate Buy-Out for Land *

A 72-year-old semi-retired farmer has a right to buy land from his family due to a 90 + year old mother's death. Land was purchased by the 72-year old's dad in the early 60's. Owned and farmed by the family for over 60 years. 72-year-old knew he could buy 200 acres of land from his parent's estate based on comments the parents made to him but, he never saw the Will. The 200 acres appraised at $8900/acre resulting in a value of $1,424,000. This land went to 2 of the 72-year-old's siblings at mother's passing. They want to sell. He has $600,000 to put down on the land (hesitant) resulting in a loan for $824,000. At 6.5% the payment for a 20-year note is $74,783/year. This equates to $374/acre in an area where land rents are between $125 and $200/acre.

Concerns:

1. The $600,000 down payment, for the most part, will drain 72-year old's savings accounts.
2. This debt may well pass to his farming son as this is who will someday inherit this land. Can son afford it? Right now, no.
3. Retirement lifestyle will change.
4. They rent some of their land to their son. Rent will have to go up for their farming son.
5. At the last meeting, they were considering letting the land go to the open market and bid there to see if they can retain the land at a price lower than $8900/acre.

* This situation is happening more and more and will cause financial stress for many farms.

Review, Review, Review—Can farms sustain buy-outs from the siblings/relatives?

Possible action steps to take with your will or trust because of high land prices when a successor needs to make a buy out from siblings or if an ownership interest in an entity needs to be bought out:

- Know your numbers. Run the balance sheet through each will, trust or entity buy sell to see how it functions if there is a death or buy-out—use current market values! Is the buy-out affordable? The numbers often surprise our customers. Not many farming families think about this.
- For entities, agree on a value each year or adjust valuation formulas in a buy sell agreement.
- Reduce the number of acres and/or the number of assets a successor must buy from siblings.
- Increase discounts or increase buy out duration.
- Buy life insurance to assist in payment of a buy-out or use life insurance as "equalization" tool for non-farmers.
- Have a family meeting to talk about how a farming sibling may buy out a sibling who does not farm.

Review, Review, Review (cont.) Ideas for consideration.

- Sell land to a successor now. The issue here is that the cost basis in the land is usually low, so this does not always work well from a tax standpoint. Sell higher basis land first?
- At the second passing of both parents, you could keep all or most of the land in a trust. The successor then rents the land from the trust for 5 to 10 years, with rental income going to the non-farmers. At the end of the 5-to-10-year time frame, land in the trust goes to the successor.
- Leave all or most of the non-farm related assets to non-farmers. All farm assets to the successor farmer. *Not always possible*. Fair vs. Equal approach conversation usually starts here.
- Land can go into a land entity that puts the farmer in control of the land. The entity should have a buy-sell agreement for a buy-out and a pricing formula to make a buy-out viable.

Review, Review, Review

- All wills and trusts should be reviewed every 3 to 5 years if there is a successor.
- If there is no successor, review every 5 to 7 years.
- Buy-sell agreements for an entity need to be looked at every 3 to 5 years or if someone new joins the entity.

Buy Outs in Wills, Trusts and Buy Sell Agreements

The message:

Review your documents regularly if they have buy-out provisions in a will or trust for a successor with siblings to buy land from them or if you have an entity buy out plan with business partners.

Know your numbers!

Transition and Retirement Ideas—Grain Inventory

- Defer
- Fill the 22% & 24% tax bracket 2/3 years ahead of retirement. Maybe sooner.
- Income Average
- Buy new machinery and lease it back to successor (not so sure on this idea?)
- Defined Benefit Pension—allows a good-sized tax deduction. Where are tax rates going to be in the future when the pension money is taxed at age 73 or older?
- CRUT or CRAT
- Pay down debt
- Or, just pay the tax and be done with it.

Transition Tools

Machinery, Bins, Buildings, and Infrastructure

1. Sell
2. Leasing for new assets at the farm (Bins, Buildings, the second Combine, the extra Planter…..)
3. Operating Lease for machinery and buildings between parents and successor(s).
4. Gift piece by piece or just move the building site to successor.
5. Gift and increase cash rent.
6. How about a combination of some or all of these?

How does the estate plan fit in for machinery, bins/buildings and other infrastructure?

Transition-Land

Usually, the last asset to transfer---if at all. The step-up rules are paramount in this part of the planning.

- How much of the farm is rented vs. owned? What is the risk level for a successor to have to buy non-family land?
- Is protection a priority? What are we protecting from (nursing home, divorce, unstable child/grandchild)?
- How is the land going to be transitioned?
  - **Sell on a contract, sell to pay down parent's debt, sell the farm site to buy the house in town…….**
  - **Trust-owned** so terms can be set up for renting or buying land for a successor.
  - **Entity-owned** to keep the land base together and offer some level of protection—and a "rule book".
  - **Life Estate** to transfer equity/protect from a nursing home but provide lifetime income to parents.
  - **Estate plan** (will or trust)? What language is in place to assure the next generation of farmers that the land base is stable and available? Use of Rights of Refusal and Options for land and machinery.

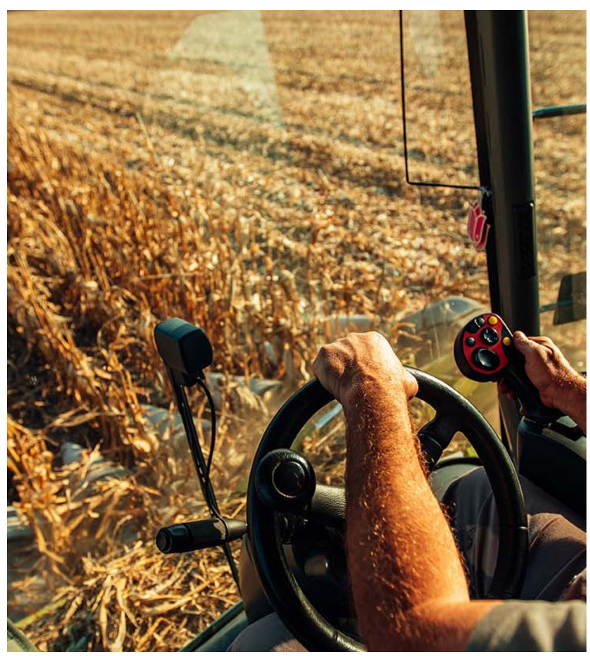
Note: if possible, avoid leaving land equally to all children in your will or trust—a major source of disagreement and raises the risk of litigation.

Retirement Planning –No Successor

Many producers say getting out of farming is more difficult than getting in. No doubt!

There are financial, tax, and emotional challenges as you wind down

- **How much debt is the farm servicing?**
  - Debt can stop most retirement plans
- **What's your time frame?**
  - When to start Social Security? For most it is FRA.
  - What is the plan to pay for health insurance?
- **How are taxes controlled in the final years—especially the last year?**



Transition and Retirement Planning With a Successor

- Time is important—farmers and ranchers, give *yourself* time.
- Transition often takes **5 to 10 years**. A plan needs to be in place for all aspects of the transition, such as land access and now maybe a new expense for the farm (cash rent), machinery (lease, sell, gift?), bins/buildings (lease, sell, gift?) the estate plan for a successor needs to keep the business going, tax planning with a successor much different than no successor and what about living location—is it important that the successor reside in the home where headquarters is located—how will successor's spouse feel about moving to the in-laws house?
- *Shifting power can be much more difficult than shifting asset ownership.* Need to take a "blood test" of the successor and his/her spouse. Is this what they really want to do—regardless of the economics of farming and ranching year in and year out?
- They key to successful transition is good communication, seeking advise, being patient, thinking about keeping the business together in all areas of planning (estate, retirement, transition) being flexible to changing economics and crop conditions as well as land-lord "surprises".

Nursing Home and Asset Protection

If no or little nursing home insurance, not enough income or existing liquid assets to pay for care, many people will need to apply for Medical Assistance (MA). Now you function under Medicaid and Department of Human Services (DHS) rules.

Planning options:

Gift land to children and reserve a Life Estate to the parents. Children now own land. This means land is transferred to children and after 5 years the land is no longer available to pay for care. Caution—if rent is not at market rental rates, this is considered a gift as well and may disqualify the confined parent from MA.

Three questions and concerns need to be asked whenever parents are considering transferring land to a child(ren) with a life estate interest:

Are children maritally stable?
Are children financially stable?
Are children emotionally stable?

If one of these is a no—then the Life Estate is not recommended (hard to predict the future of our children).

Life Estate Land is stepped up at death.

Nursing Home and Asset Protection Planning (cont.)

Transfer land ownership to an income only Irrevocable Trust where parents give up ownership of the land and move ownership to the Irrevocable Trust. The parents get the rental income each year but can no longer control the land and only have a right to the income each year. This type of trust is usually deployed when one of the three questions above is a yes. After five years of irrevocable trust ownership the land is protected.

Some catches:

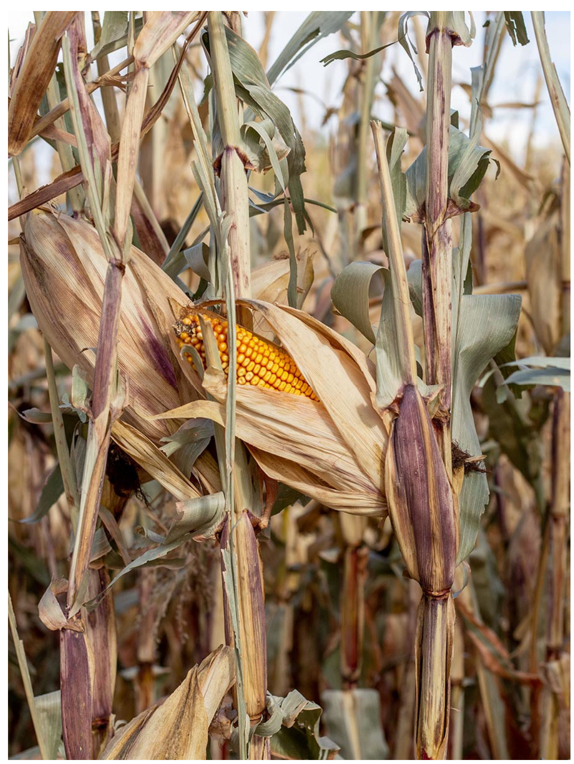
- The trust cannot be changed.
- If trust owned land is subject to a mortgage the land in the trust is not protected.
- The trust must file its own tax return.
- Land can be sold by an irrevocable trust but the sale proceeds need to stay in the trust.
- Land is stepped up at death.

State Estate Taxes

North Dakota, South Dakota, and Wisconsin are coupled with Federal law.

- No specific or separate state estate tax.

Minnesota is decoupled from Federal law.



Minnesota Estate Taxes

Minnesota Estate Tax Exemption:

2024/2025 - $3,000,000/person but not an automatic $3,000,000/person

- If you have a farming heir, an extra $2,000,000 for ***qualified*** farmland & small business entity/assets for a total of $5,000,000/person (again, not automatic).
- NO PORTABILITY **between spouses – need to use disclaimer/bypass trusts**
- For estates that exceed the exemptions, there is a graduated tax scale
  - Current rates range from 13% to 16%
- Real Estate owned by non-MN residents may be exempt from Federal estate tax but **not** exempt from MN estate tax

Federal Estate Taxes & the Tax Cuts and Job Act (TCJA)

- ✓ A collective "Whewooo!!!" on November 5th from most of the Ag community.
- ✓ Nothing is permanent, is it? Design estate and transition plans for flexibility. Remember, every 3 to 5 years review the estate plan to align with any new federal (or state) estate tax rules. Estate tax legislation is very "political".
- ✓ Current Federal Exemption is $13,610,000/person or $27,220,000 for a married couple.
  - ✓ For 2025 the exemption will move to $13,990,000/person or $27,980,000 for a married couple.
  - ✓ Annual gift exclusion rises from $18,000/year to $19,000/year.
- ✓ In all probability TCJA will remain in place after 2025 or perhaps be enhanced however, is taking the "wait and see" approach an OK plan? The majority in the House and Senate is pretty thin!
- ✓ Larger estates ($15,000,000 plus in equity) should still take a proactive approach and at least have documents in place with a plan for estate taxes, especially MN residents or ND residents with real estate in MN.
- ✓ *Reacting to the government is never a good plan.*

Estate Plan Focus

Is the goal to:

1. Transfer your farm or ranch as an ongoing business **to a successor** or:

2. Transfer to family members as a group of assets **with no successor**.

A will or trust for situation number one should look different than situation number two. Fair or Equal—they are very different.

Estate Plan Focus **(some hard questions to ponder)**

Events that occur at death.

Who represents you and what are the powers you have given them. Usually a spouse. But who succeeds the spouse?

A plan for the land. This is by far one of the most divisive issues with estate planning.

Is an equitable distribution of land a priority or is keeping the farm/ranch going a priority. At some point either children, their children or maybe their spouse will sell. Over time, land rent returns will not be as appealing as a large cash payment. The hard question here is what do you do about it:

What is your priority for your land? What does keeping the farm together look like for you?

If each child gets their own piece(s) of land, will those that farm have a right to rent and buy land if someday a non-farming child/sibling wants to sell? At what price? Can they rent too?

How is headquarters set up in your will or trust?

What is the game plan for machinery ,tiled ground and the irrigation system that your farming child maybe helped to pay for? Should they have to pay a higher rate of rent on land they improved that was not paid for by a sibling that did not farm? What about tiled land? Who gets it and if a non-farmer inherits, how is rent determined.

Maybe consider a right of refusal to rent land so the faming child keeps farming this land. In your Right of Refusal, do not set rents an “fair market value”. Use ND Trust Lands Survey or MN or SD Extension.

Estate Planning—Events That Occur During Life

What about disability planning?

- Durable Power of Attorney. Consider updating. Older POAs leave many things missing like power over digital assets. Try to avoid dual successors.
- Health care directive. Try to avoid dual successors.

What is your approach to planning for the nursing home?

1. Insure.
2. Self-pay.
3. Protect by transferring assets out of your name (**five-year look back on gifted assets or low rent**)
   - Life estates for land (some limitations in MN).
   - Irrevocable trusts (will not work if land going into trust is mortgaged).

Maybe a combination of two or all three. Please do not wait on this important planning.

Charitable Remainder Trusts (CRTs)

A possible tax saving tool for machinery and equipment and possibly land and grain inventory sales when sold under the ownership of the trust. We just do not see many of these tools used in agriculture. Donors need to be charitably inclined.

Work with a CRT professional (CRTs receive a higher level of scrutiny from the IRS).

Income to the beneficiary is reported on a K-1 each year

The CRT must report an informational filing on Form 5527 each year.

It is recommended the beneficiaries receive an annul report of trust income, expenses and distributions from the trustee.

Some CRT basic rules:

1. One advantage to selling in a CRT is the assets are sold tax free and thus will generate more investable income. $1,000,000 of machinery sold in a CRT will have about $900,000/850,000 to invest where machinery sold outside of trust will have about $650,000 to invest.

2. Assets must be in the trust before being sold in order to escape the assets being sold as personal income. If there is no basis in the asset being sold by the trust such as fully depreciated machinery or grain inventory there is little if any income tax deduction for the contribution to the CRT. Contributions may be partially tax deductible if there is carryover basis in the assets.

3. Must take income of at least 5% of previous year's, year end balance. Can go as high as 50% of previous year end balance of the trust as income. We see between 5% and 8% as a normal income distribution each year.

4 . The trust, for the most part, cannot exceed 20 years.

5. The trust must distribute at least 10% of the initial value of the trust Corpus to the charity at the end of the trust.

CRTs (cont.) Charitable Remainder Annuity Trust (CRAT)

A lot of different types of Charitable Trusts serve in various capacities to cut tax bills and help charities.
There is the Charitable Remainder Annuity Trust (CRAT) and a Charitable Remainder Uni-Trust (CRUT).

They are different.

CRAT (Charitable Remainder Annuity Trust)—What it does. This trust's payment to an income beneficiary each year will be the same regardless of the value of the trust each year. Thus, if at the inception, the trust is valued at $500,000 and the trust directs the trustee to pay out 7% of $500,000 each year, $35,000/year is paid out each year until the trust terminates. The percentage of payment each year is the same percentage elected at the inception of the trust regardless of the value of the CRAT each year. If the CRAT goes up or down in value, the payment remains the same. An appraisal of trust assets needs to be done at inception of the trust. The trust cannot be set up for a term of years that exceeds 20 years (it can be for a shorter duration). Ultimately, it pays out to a charity or charities at the termination of the trust. No new assets can be added to this trust during the term of the trust.

The benefits here are that assets placed in this trust when sold are not taxed to the income beneficiary (the individual who set up the trust). Depending on the carry-over basis in the property there may or may not be a charitable deduction when the asset is sold.

CRTs (cont.) Charitable Remainder Uni-Trust (CRUT)

CRUT (Charitable Remainder Uni Trust)—What it does. This trusts payment to an income beneficiary is based on the trusts value each year. Unlike the CRAT which has a fixed payment each year, the CRUT's payment will vary each year depending on the trust's value at year end each year.

The pay out percentage is the same each year but the payment will vary because payments to the income beneficiary each year are tied to the previous year end value of the trust and so annual payments will go up and down each year. One of the big differences with the CRAT is that additional assets can be added to a CRUT.

The rules related to a CRAT (Charitable Remainder Annuity Trust) on the previous slide are very similar to a CRUT in terms of how long the trust must be in place and ultimately how much of the trusts original value must be distributed to the charity. The trust cannot be set up for a term of years that exceeds 20 years (it can be for a shorter duration). Ultimately, it pays out to a charity or charities at the termination of the trust. Unlike the CRAT, the CRUT allows new assets such as land, investments and other assets to be added to the CRUT after its inception. It has to pay out at least 5% of the trusts value each year. It must give the charity 10 % of the original balance of the value of the property when the trust was established. Thus, an appraisal is required at inception or if assets are added.

Like the CRAT, the benefits here are that assets placed in this trust when sold are not taxed to the income beneficiary. Depending on the carry-over basis in the property there may or may not be a charitable deduction when the asset is contributed to the trust.

Importance of Communication

Communication is the glue that binds you and your family or the gun powder that blows you up!

- Who ***understands*** your plan?
- Is your shop or the yard your "***Las Vegas***"? What happens there—stays there?!
- ***Expectations*** need to be clearly communicated to each other by both the Sr. farmers and successors—perceptions will become reality. Uncommunicated expectations is where assumptions grow and thrive. Talk to your non-farming children and hear their expectations, too.
- Litigation is on the rise between family members. Communication problems can morph into legal issues.
- Family meetings are important. Your family both wants and needs to know your plan.
    - Communicating **why** you've set up your plan the way you have is every bit as important as **how** you've set it up. Who should attend? Just children? Children and their spouses? Yes spouses should be there, too.
        - But---Spouses in family meetings not always recommended because of ongoing dynamics. Tough decision sometimes.

Some Rules That Never Change!

- Good communication is vital regardless of your planning goals. Talk regularly to both your family and your professionals.
- **If it is not in writing, then it does not exist.**
- Don't assume anything—especially the fact that someone understands what you are thinking. There are technical terms that are often misused between family members.
- Proper succession and retirement planning adds emotional and financial value to your farm or ranch legacy.
- Time is your friend.

Thank you for Attending!

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