Private Lands Summit

Pressure of Estate Taxes on Texas Farms and Ranches

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- **Today's Agenda**

- Transfer Tax System
  - Where We've Been
  - Where We Are
  - Relief Provisions
- A Word About Income Taxes
- Basic/Advanced Planning Opportunities
- A Word About Conservation Easements
- Washington Update
- Summary

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- **Transfer Tax System**
  - Where We've Been
    - 2001 – 2009
      - $675,000 - $3.5 MM exemption
      - 55% - 45% rate (35% for gifts)
      - Estate, gift and GST gradually, partially, reunified
    - 2010
      - Repeal estate tax ($1 MM exemption and 35% rate for gifts)
    - 2011 – 2012
      - $5 MM exemption indexed
      - 35% rate

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- **Transfer Tax System**
  - Where We've Been
    - 2013
      - Scheduled to go back to 2001
  - Where We Are Today
    - $5 MM exemption, indexed ($5,340,000 in 2014)
    - Estate, gift and GST unified
    - 40% rate
  - From "Permanently Temporary" to "Temporarily Permanent"

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- **Transfer Tax System**

  - Where We Are Today
    - Portability, introduced temporarily in 2011, made permanent in 2013, significantly changes planning options

    - Estimated that only 0.14% of estates will be subject to estate tax (that's less than 2 people out of 1,000)

    - For farmers/ranchers, remember that tax is assessed based on value of all assets, not just farm or ranch

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- **Transfer Tax System**
  - Where We Are Today
    - Not many will be subject to estate tax, but when it applies, it is 40% of the value of the assets above exemption amount
    - Tax is due 9 months after date of death (although return itself may be extended)
    - Particularly onerous when estate includes an illiquid asset such as farm or ranch

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- **Transfer Tax System**

  - Where We Are Today

    - Relief Provisions
      - Valuation election under IRC Section 2032A
      - Deferral and extension of tax payments under IRC Section 6166
      - Deferral and extension of tax payments under IRC Section 6161

      - Relief provisions are "after the fact," and not as effective as proactive lifetime planning

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- A Word About Income Taxes

  - 2012
    - Top income tax rate of 35%
    - Top dividend rate of 15%
    - Top capital gain rate of 15%
  - Now
    - Top income tax rate of 39.6%
    - Top dividend rate of 20%
    - Top capital gain rate of 20%
    - Health Care Taxes

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Income Taxes – Other Considerations

- Sales tax deduction
- Itemized deduction phase-out
- IRA charitable rollover
- Conservation easement deduction limits

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- **Basic Planning Options**

- Wills/Revocable Trust
  - A/B Planning
  - Portability

- Powers of Attorney
  - Business
  - Healthcare

- Living Will

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- **Basic Planning Options (continued)**

- Gifting using the $14,000 annual gift tax exclusion
  - Outright
  - In trust
  - Liquid assets
  - Illiquid assets

- Life Insurance Trusts

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- **Advanced Planning Options**

- This list is by no means exhaustive, nor are the options mutually exclusive

- We will cover four:
  - Family Limited Partnership/Limited Liability Company
  - Grantor Retained Annuity Trust
  - Sale to Intentionally Defective Grantor Trust
  - Conservation Easements

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Advanced Planning Options (continued)

- Family Limited Partnership/Limited Liability Company (FLP)
  - Limited partnership under state law with 2 classes of partners
  - General partners "control" management; limited partners usually own most of the partnership's profits, losses, and capital
  - Senior generation contributes assets to the FLP, and receives all partnership interests in return, in a tax-free transaction
  - Senior generation then gifts limited partner interests to next generation(s), outright or in trust, but retains practical control over the partnership activities
  - Over time, a substantial amount of wealth can be transferred

- **Advanced Planning Options (continued)**

- FLP (continued)
  - Lack of marketability, and the lack of control, attributable to the limited partner interests means that they are worth less than their proportionate share of underlying value
  - Increases the effectiveness of annual gifts and taxable gifts
  - May be combined with other techniques to increase the efficiency of this technique

- **Advanced Planning Options (continued)**

- Grantor Retained Annuity Trust (GRAT)
  - Irrevocable trust into which the senior generation contributes assets, and retains an annuity (set income interest) for a period of time, with whatever is left at the end (the remainder) going to the next generation
  - The present value of the remainder is a taxable gift at time of formation
  - To minimize the taxable value of the gift, the income interest can be made larger, or longer, which will reduce the value of the remainder
  - If the grantor dies during the income term, everything comes back into the grantor's estate (the mortality risk)
  - To reduce mortality risk, it is customary to make the income interest only 2 years
  - The end result is that appreciation in the asset above an assumed interest rate is a tax free gift

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- **Advanced Planning Options (continued)**

- Sale to Intentionally Defective Grantor Trust (SIDGT)
  - Irrevocable trust, structured so that assets in trust are outside of senior generation's estate, but at the same time the trust is disregarded for income tax purposes
  - Senior generation sells assets to the trust for a note
  - Freezes the value of the estate at the value of the note, with any income or appreciation above the interest rate on the note being a tax free gift to the next generation
  - Trust can generation skip as well, removing assets and appreciation from generation 2 estates as well

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- **Advanced Planning Options (continued)**

- Conservation Easements
  - Voluntary restriction on future development or other uses of property
  - Difference in the value before and after the restriction is deductible for income tax purposes
  - Estate tax reduction for a portion or all of the value of the easement
  - Landowner (individual, corporation, partnership and certain trusts) contributes a restriction (which is the easement), in perpetuity, to a qualified organization (a charity, likely a land trust)

Advanced Planning Options (continued)

- Conservation Easements (continued)
  - The purpose of the easement must be to preserve or protect open space, habitat (fish, wildlife, plants, ecosystem), scenery, etc., for the public benefit
    - Does **not** mean the public has to have access to your land!
  - Strict substantiation and appraisal requirements
  - Income tax deduction:
    - Up to 30% of adjusted gross income, 5 year carryforward
    - Hopefully will return to 50% AGI limit, 15 year carryforward, and 100% AGI for farmers and ranchers

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- **Washington Update**

- Democrats' Proposals
- Republicans' Proposals
- Simpson-Bowles' Proposals
- Extenders Legislation

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- **Take Aways**
  - Plan!
    - For taxes
    - For liquidity
    - For family discord
  - Monitor your plan:
    - Tax changes
    - Financial circumstances change
    - Family and life events
  - Use competent advisors

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