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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
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
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
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
• **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
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
• 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)
• 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