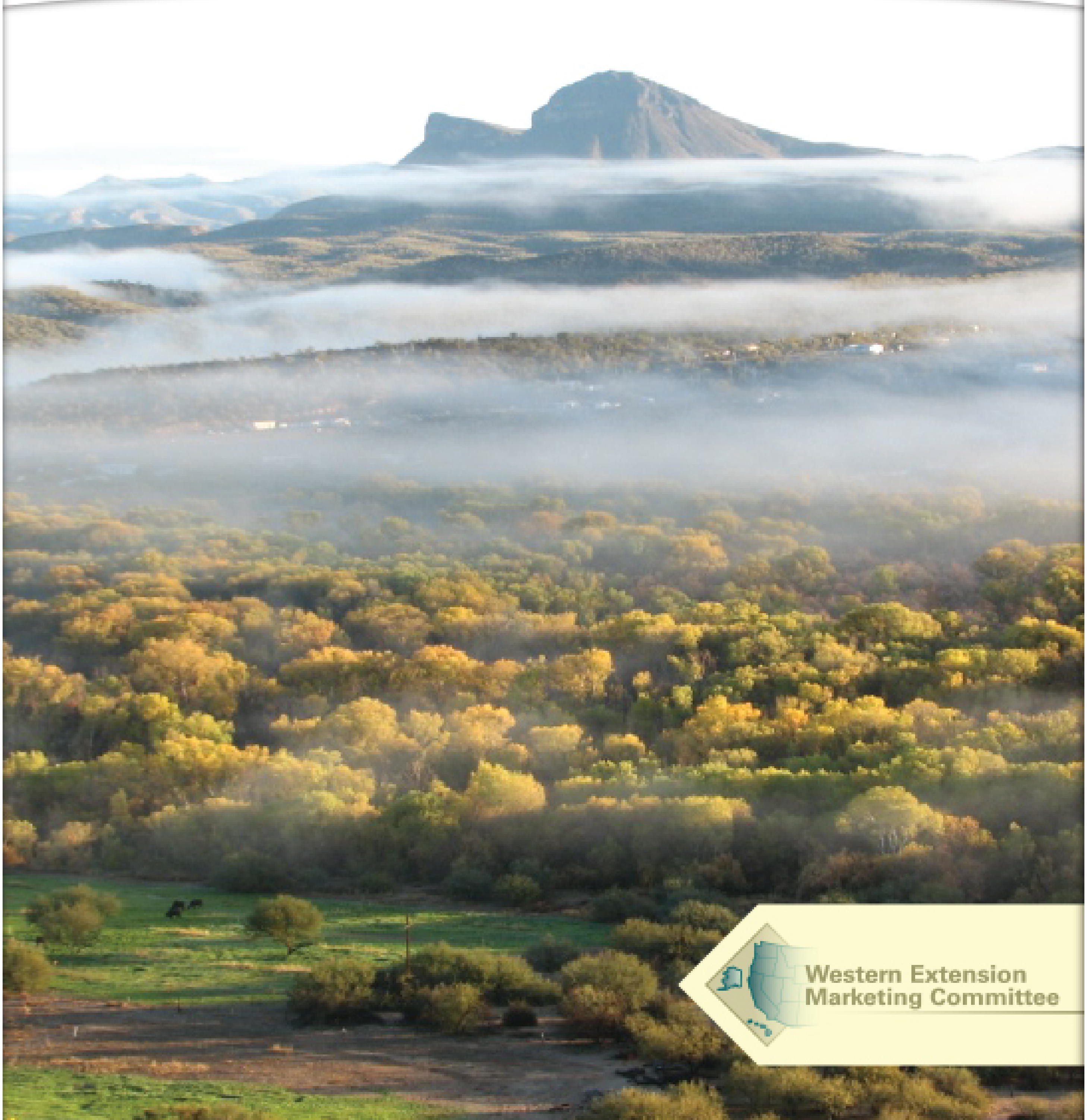
WESTERN FARM AND RANCH TRANSITION STRATEGIES



Western Extension Marketing Committee

Western Farm & Ranch Transition Strategies

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Table of Contents

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Colorado Ranch

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Early miners kept a canary in the mine to detect poisonous gases. Many farm and ranch families also have a canary—someone who first raises issues about estate planning and intergenerational transfer on the ranch or farm. In the current instance, the canary was a daughter-in-law with concerns about the family partnership's checkbook.

The operation, a cattle and small grains operation of approximately 10,000 acres of deeded range and dryland farm ground plus about 5,000 leased acres of rangeland in eastern Colorado, has a long history, starting with a homestead claim. The parents are descendants of the original settlers who settled in Colorado in the late 1880s. The operation is owned and operated as a family partnership that includes the parents (the managing partners) plus their two sons and their spouses. The operation produces primarily wheat, some spring crops such as millet or corn, and beef. In 2003, there were 1,000 mother cows and 6,000 acres of winter wheat and millet. The operation is debt free, and in 2003 the value of the total estate was nearly $9 million, based on an appraisal of the land, machinery, livestock, and farm improvements.

Although it is a traditional ranch/farm operation, the younger generation is well educated and has been directly involved in the operation since graduating from college. Both sons and their spouses have four-year college degrees in agriculture. The two sons split the day-to-day work responsibilities of the operation: One son runs the cattle operation while the other heads up farming operations. Their father is currently in his early 70s and assists the sons as needed. Their mother is the bookkeeper/accountant for the businesses. She is three years younger than her husband. Mother typically writes all of the checks for the business, keeps the accounting records, and assists with tax preparations for the family partnership. In the past, when the parents left to spend the winter in a warmer climate, the checkbook also made the trip; bills and invoices were forwarded to them for payment. Their concerned daughter-in-law raised a very important question: “What do we do if something were to happen to Mom and Dad?”

At a family meeting based on this question, several issues surfaced: neither parent had a will, neither parent had granted power of attorney to any of the family partners, and there was no estate succession plan. Follow-up meetings were scheduled to discuss transfer, control, and fairness issues. One very important step the family pursued early in the process was to select a qualified estate attorney, who outlined a process to help solve the transfer issues. Based on the parents’ ages, time was of the essence.

When the initial estate plan was developed in the early 2000s, the tax exclusion was less than the $5 million available today. The original estate plan used many of options the then available: A marital trust was used to establish the use of the $2 million exemption for each parent available in 2004. This exemption increased to $5 million from 2010 through 2012. The $5 million exemption indexed for inflation ($5.25 million in 2013) became permanent with the American Taxpayer Relief Act passed in January 2013. With the unused portion of the federal estate tax exclusion ($5.25 million per parent), the portability option added by Congress could be transferred to the surviving spouse, allowing the parents to utilize a $10-million-plus exclusion.

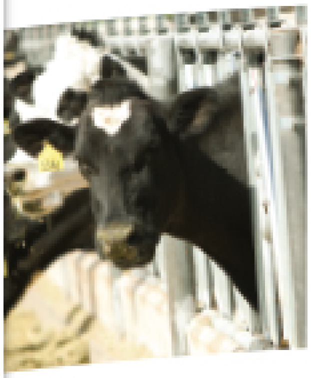
Using the individual exemption in 2004, $4 million of the estate was excluded from estate taxes. The parents gifted partnership assets—which included the machinery, livestock, and a portion of the real estate shares—to their children and grandchildren annually, but there was concern about whether this gifting would be sufficient to counter rapidly increasing land values. The family decided that machinery and livestock replacement would become the responsibility of the two sons, shifting those asset values away from the parents.

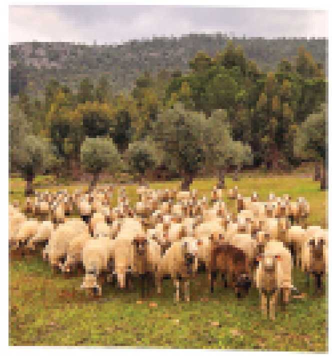
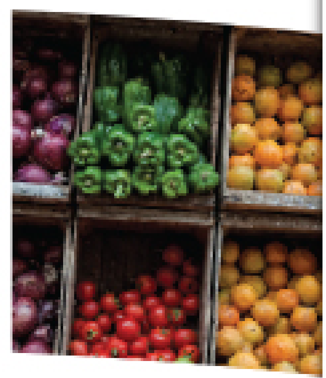
Many farmers and ranchers must find ways to counteract rapidly escalating farm and ranch land values and the impact this has on their estates. Based on information published by the Kansas City Reserve Bank, land values in Colorado appreciated significantly in 2012. Assuming the values of this $9 million estate appreciated at a modest 2% per year from 2004 through 2008, the value would be nearly $10 million by 2009. Land values increased on average 11.5% per year for nonirrigated farmland, 11.3% per year for irrigated land, and 10.1% per year for rangeland from the beginning of 2008 through the third quarter of 2012. With a 10% average increase from 2008 through 2012, the value of the estate increased by nearly 50%, to $14.5 million, in only five years.

Under current law (American Taxpayer Relief Act, January 2013), the estate would incur a large estate tax liability (40%) of $1.8 million. The family has realized that rapidly increasing land values make an annual evaluation of their estate plan necessary. The 2004 estate plan initiated a transfer of shares in the partnership to the two sons and their families to ensure a succession plan that provides for the continuity of the business. The parents remain the controlling managers of the operation, and rapidly appreciating land values in their area have not kept pace with the gifting partnership strategy.

The special-use provision, which exempts approximately $1.3 million from the estate, may be necessary at the time of the last parent’s passing, but significant requirements must be met if this option is to be exercised. Another option that farm and ranch families have utilized is a conservation easement. However, given the location of this operation, it is doubtful that such an easement would be of much benefit. Currently, potential easements are scrutinized relative to the appraised value of the land and the percentage of land to be placed in the easement. Another issue often overlooked is the salability of the land once an easement is granted.

Since the two daughters were not involved in the operation, there was a need to provide them with part of the estate. The parents chose to pursue two options. One was procure a “last to die” term-life insurance policy. The daughters own the policy and are its designated beneficiaries. The parents gift cash to them annually to pay for the majority of the policy’s premium. Secondly, the parents willed the daughters their certificates of deposit (their retirement account) and personal assets such as vehicles, motor home, and household goods. The daughters were somewhat satisfied with this arrangement. Since both parents are alive today, they have revised their estate plan. With the $5 million exemption, together they have a more than $10 million exemption. Even with rapidly increasing land values, the family feels comfortable that their current estate plan has significantly reduced the financial risk associated with the operation. Now the two sons are developing their own individual estate plan to transition the operations to their own children. This is a good ending for this family.



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