AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
http://ageconsearch.umn.edu
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

Planning the Late-career, Retirement-mode Years

Part VI in the six-part part series:

Business Management for Farmers

Acknowledgments

This publication is a product of the North Central Regional (NCR) Cooperative Extension Services of:

Illinois	Nebraska
Indiana	North Dakota
Iowa	Ohio
Kansas	South Dakota
Michigan	Wisconsin
Minnesota	and
Missouri	the U.S. Department of Agriculture cooperating.

North Central Farm Management Extension Committee - February 2003

Arlin Brannstrom, Wisconsin
William Edwards, Iowa
George Flaskerud, North Dakota
Steve Halbrook, Farm Foundation
Greg Hanson, Pennsylvania
Mike Hardin, Oklahoma
Stephen Harsh, Michigan
Clarence Haverson, Ontario
Joe Horner, Missouri
Steve Isaacs, Kentucky
Rodney Jones, Kansas
Rick Klemme, Wisconsin
Bill Lazarus, Minnesota
Warren F. Lee, Ohio
Robert Milligan, New York
George Patrick, Indiana
Burton Pflueger, South Dakota
Brian Roe, Ohio
Gary Schnitkey, Illinois
Roger Selley, Nebraska
Don West, CSREES, USDA

MWPS Headquarters

Jack Moore, Manager
C J Huffman, Editor
Bill Koenig, Engineer
Letitia Wetterauer, Graphic Designer
Kathy J. Walker, Graphic Designer

NCR-610F
February, 2003

Copyright © 2003,
MidWest Plan Service,
Iowa State University,
Ames, Iowa 50011-3080
(515-294-4337)

...And Justice for All.
MidWest Plan Service publications are available to all potential clientele without regard to race, color, sex, or national origin. Anyone who feels discriminated against should send a complaint within 180 days to the Secretary of Agriculture, Washington, DC 20250. We are an equal opportunity employer.

For additional copies of this publication and a FREE Catalog of other agricultural publications contact:
MidWest Plan Service (MWPS), 122 Davidson Hall, Iowa State University, Ames, Iowa, 50011-3080
or CALL: **1-800-562-3618**

NCR-610F

Planning the Late-career, Retirement-mode Years

Part VI in the six-part part series:

Business Management for Farmers

Kenneth H. Thomas
Professor Emeritus and former Extension Economist, Farm Management
University of Minnesota

About the author

Kenneth H. Thomas was an extension economist in Farm Management at the University of Minnesota from 1959 to 1992. That this was a very dynamic period in U.S. agriculture is reflected in the wide range of management issues he worked on and wrote about.

During the 1960s and early 1970s he was very involved in helping farm families develop longer range plans for their businesses. In 1973, he coauthored a North Central Region publication that integrated profitability and financial soundness aspects into business planning and analysis.

Beginning in the mid-1970s he began working in, and writing about, land rental arrangements and the buying and selling of farmland. He also began working in the areas of getting started in farming, business arrangements, and farm estate planning and transfers, coauthoring four regional bulletins on these topics.

As businesses became larger, he began working on personnel management issues and coauthored a regional bulletin on farm personnel management. He also team-taught an agricultural law course at the University of Minnesota, which led to the inclusion of a number of the legal aspects in this series.

As a capstone of his career and as a transition into retirement, he began writing this six-part series, *Business Management for Farmers*. It is his hope that this six year "labor of love" will prove helpful to present and future generations of farmers.

Table of contents

Preface v

1 Pre-retirement planning: An Overview 1

Pre-retirement planning—A complex, interactive process 2

Major factors impacting retirement plans 3

- Pre-retirement lifestyle 3
- Present health and financial situation 3
- Future of the farm business 4
- Goals and desires of spouse and other affected parties 4
- Outside forces 4

Communication and conflict management: Two keys to successful retirement 5

Brief overview of remaining chapters 6

2 Developing and testing a retirement lifestyle 7

Developing a satisfying retirement lifestyle: An overview 7

- Typical progression through early retirement 7
- Steps to develop a satisfying retirement lifestyle 9

Step 1. Sketching out a desired lifestyle 9

- Reallocating "farming time": Major activity categories to consider 9
- Sketching out a desired retirement lifestyle/plan 11

Step 2. Comparing proposed lifestyles; making needed adjustments 12

Steps 3 & 4. Making detailed plans for time use; testing plan 12

Retirement lifestyle: "Where to hang your hat" 13

Where to from here? 14

3 Managing financial security; developing/updating estate plans 19

Road map of the farm estate and transfer planning process 20

Completing a financial profile and estate planning questionnaire 20

Question 1. Will there be sufficient income to meet lifestyle needs and desires? 21

- Situation 1. Inadequate retirement income 21
- Situation 2. Relatively adequate retirement income 22
- Situation 3. More than adequate retirement income 23

Question 2. Is financial situation adequately protected? 23

- Protecting against unnecessary business-related risks 23
- Protecting against unnecessary investment risks and income taxes 23
- Protecting the financial situation from health-related costs 26

Question 3. Does the present estate plan adequately protect the spouse and treat heirs fairly? 28

- Does the present estate plan provide adequate financial security for the spouse? 28
- Does the present estate plan treat heirs fairly? 30

Question 4. Does the present estate plan avoid excessive estate settlement costs? 30

- Having affairs in good order 30
- Reducing the amount of property that is subject to probate 31

Table of contents (continued)

Question 4b. Does the present estate plan avoid excessive estate taxes? 31
Review of Tax Act of 2001 31
Tax management strategies for estates larger than unified credit limits 35
Providing sufficient liquidity to make an estate plan operable 37

Application: Selected financial situations; business to be discontinued 39
Situation 1. The marginally adequate to inadequate financial situation 39
Situation 2. The adequate to very adequate financial situation 40

4 Farm business continuation and transfer planning 55

Considerations when planning asset transfers 56
Personal and financial considerations 56
The fair treatment of heirs 57
Tax considerations when transferring farm assets 60

Methods/strategies when transferring current assets 62
Transferring grain and market livestock by sale 62
Making gifts of grain and market livestock 63

Methods/strategies when transferring breeding stock and machinery 64
Tax consequences of selling breeding livestock and machinery 64
Other transfer methods and their tax effects 64

Methods/strategies when transferring real estate 65
General methods used in transferring control and ownership of real property 65
Transferring larger land holdings—the land partnership/entity route 67
Transferring farm buildings and residence 69

Some additional tools to aid the transfer process 70
The buy-sell agreement/life insurance funding 70
Trusts funded during one's lifetime 70
The corporation 71

Firming up retirement and asset transfer plans 72
Firming up retirement plans and financial security aspects 72
Firming up an asset transfer plan 73

Implementing and adjusting estate and transfer plans 74
Implementing an estate/asset transfer plan 74
Adjusting the plan over time 75

List of Worksheets

2-1. Sketching out selected personal aspects of a retirement lifestyle plan. 15
2-2. Planning the use of your time—the early retirement years. 17
2-3. Summarizing your retirement lifestyle plan; related expenses; health considerations. 18

3-1. Financial profile and estate planning questionnaire. 42

4-1. Roughing out an estate/asset transfer plan. 76

Preface

> *Retirement today can be the most enjoyable and productive time of your life—a time of fresh opportunities, expanded interests, new friendships, and a deeper understanding of yourself—**if you plan for it**.*
>
> –AARP Booklet on Retirement Planning

About the series

This publication is the sixth in a six-part series written for, and dedicated to, farm operators and managers in the U.S. Parts I, II, III and IV deal with managing an established farm business. Part V focuses on the issue of getting established in farming, while Part VI deals with planning the late career/retirement years. The series should prove useful not only to managers, but to educators, lenders, consultants and others, including persons considering farming as a career. **A list of chapter titles for the other parts in the series is on the inside back cover of this publication.**

Part I, *Developing a Longer Range Strategic Farm Business Plan*, first provides an introduction to the planning process. It then covers evaluating a present business situation and setting tentative life-style and business goals. This is followed by a discussion of the development of a longer range business plan. Information is then provided on how to develop, gain acceptance of, and implement a workable transition plan. Restructuring and/or liquidation of a financially stressed farm business are also addressed.

Part II, *Business Management for Farmers*, is divided into three sections. Section I focuses on people skills and legal aspects. Section II discusses financial management including financial planning, security agreements, income tax management, and the use of insurance. Section III discusses the development and/or updating of business arrangements and retirement and estate plans.

Part III, *Managing Production and Marketing Systems*, discusses production and marketing, and the use of production contracts.

Part IV, *Acquiring and Managing Resources for the Farm Business*, focuses on the acquisition of land via lease and purchase; the management of machinery systems; and personnel planning and management.

Part V, *Getting Established In Farming*, discusses whether one should consider farming as a career, whether to farm together; starting farming via multi-owner/operator route or partly or mostly on one's own.

About Part VI

There are numerous unknowns: how long a life one will have, one's health, income level, and living costs, to name a few.

This publication is divided into four chapters. Chapter 1 provides an overview of the pre-retirement planning process. The complexity of this process is discussed first. Then a series of factors that will likely have a major impact on retirement plans are delineated. Then the role of communication and conflict management in a successful retirement is covered.

Chapter 2 focuses on the process of developing and testing a meaningful, satisfying retirement lifestyle. An overview of this process is provided first. Then, a four step process designed to aid the development of a retirement lifestyle is given.

Chapter 3 focuses on managing financial security issues and the development or up-dating of estate plans. First, a road map of the farm estate and transfer planning process is presented. Then, the process for completing a financial profile and estate planning worksheet is given. Four key questions that help analyze, revise, and finalize a plan are discussed. Finally, there is a brief discussion of the process of firming up retirement-related financial and estate plans under two different scenarios wherein the business is discontinued.

Chapter 4 focuses on asset transfers where the business is to be continued by the next generation. First, several important considerations or issues involved in planning asset transfers in the farm family setting are discussed. Various methods and strategies involved in transferring current assets, breeding stock and machinery, and real estate are discussed. There is also a discussion of firming up retirement and asset transfer plans, their implementation, and their possible adjustment as times and situations change.

Acknowledgments

Special thanks to Dr. Sharon Danes, Extension Specialist, Family Social Science, University of Minnesota, for her help in developing Chapter 2 on retirement lifestyle planning. Erlin J. Weness, Area Extension Educator, Farm Management, retired, of Worthington, Minnesota for use of portions of his excellent *Transferring the Farm* series in Chapter 4. Paul Brutlag, attorney/farm operator of Elbow Lake, Minnesota for his helpful review of Chapters 3 and 4, particularly the section on transferring large land holdings, pages 67 and 68. Richard O. Hawkins, Professor Emeritus, University of Minnesota, for his helpful review and suggestions for all parts of the series. Thanks also to the Center for Farm Financial Management at the University of Minnesota for providing secretarial support for this project.

Finally, the author wishes to thank the North Central Farm Management Extension Committee for their support of this series. Thanks also to the staff at MidWest Plan Service for their expertise in editing and designing this series.

Pre-retirement planning: An Overview

1

- **Pre-retirement planning—A complex, interactive process**
- **Major factors impacting retirement plans**
- **Communication and conflict management: Two keys to successful retirement**
- **Brief overview of remaining chapters**

Pre-retirement planning should take into account many factors in order to determine when to retire, "how retired" one should be, where to live, etc. But most books and articles on the subject tend to paint an idyllic picture of retirement, and then go directly to a discussion of a set of financial factors that they deem critical to retirement *timing*. Witness the following:

> "When it gets a little tougher to climb down off the tractor and morning chores start taking twice as long as they used to, farmers start thinking about cutting back a bit. They start dreaming about retirement...when they can work if and when they want; when they can take some time off for travel and family; when they can start receiving money from social security and other retirement plans rather than paying in money. As an aging farm population nears retirement age, factors such as social security payments, $50,000 government payment caps, and estate taxes make proper timing of retirement critical."[1]

Though such financially-related factors need to be considered, a meaningful, satisfying retirement lifestyle, the adequacy of one's financial situation, and one's health, are likely to be of much greater importance in the decision-making process. The following quotation offers a much more balanced view.

> "Retirement today can be the most enjoyable and productive time of your life—a time of fresh opportunities, expanded interests, new friendships, and a deeper understanding of yourself—**if you plan for it**. You have more options than ever before for designing and achieving a retirement lifestyle that's right for you. . .The key to creating and experiencing (such) a satisfying retirement is planning—preparing yourself psychologically, physically and financially. Such planning will give you a sense of control, raise your expectations, and turn you toward the future with enthusiasm."[2]

[1] Elizabeth C. Williams, *When It Makes Sense To Retire*, Landowner, Vol 12, No. 10, June 25, 1990, pp. 3-6.

[2] *How to Plan Your Successful Retirement*,-an AARP Book, Scott, Foresman and Company, Glenview, IL, p. 4.

This chapter first describes the complex, interactive nature of the retirement planning process in some detail. Factors that will likely influence or constrain the resultant nature of an ultimate retirement plan are discussed. A brief overview of the importance of communication and mediation skills in arriving at a satisfying retirement is also provided. The chapter closes with a brief overview of the remaining chapters in this sixth and final part of the series.

Pre-retirement planning—A complex, interactive process

The way in which farmers and their families decide whether or not to retire and when is often a complicated, very individualized matter. For many non-farm workers, there is usually a very narrow window of choice as to whether or when they will retire. But, farmers, like many other small business owners, generally can choose their own retirement date. They may even have a choice as to "how retired" to become, and/or can retire at their own pace, and, hopefully, do it gracefully.

With this much freedom of choice, however, farmers and their families often give too *little* thought to retirement until they are ready to retire. By then it is often too late to affect their situation in a positive way. As a result, many never retire: some because they do not want to; some because they can't afford to; and still others because they do not know what they would do with all of that free time. They know what they would be *retiring from*, with little idea as to what they would be *retiring to*. And, of course, there are those who may well retire, but then find themselves with too much time allocated to doing nothing. They often end up making their spouse exclaim: "Retirement can best be characterized as "*out of the barn, into my hair!*"

As can be seen in Figure 1.1, pre-retirement planning is a very complex, interactive process. Just the **planning aspects** themselves (center of diagram) are very interactive. For example, retirement lifestyle is likely to be influenced by one's financial situation, and personal desires will be linked to the future of one's farm business. Similarly, a desired lifestyle may influence whether one continues to farm or seeks other sources of income or enjoyment.

When planning, one also must consider such **influences** or **constraints** (left side of diagram) as pre-retirement lifestyle, present health and financial situation, the future of the farm business, and various outside forces, such as economic conditions and government programs and regulations. And, obviously, personal goals and desires, as well as those of one's spouse (if any), one's family, and/or other affected parties, must be factored in (right side of diagram).

Major factors impacting retirement plans

Several factors will likely affect one's retirement. Here, five such factors are discussed briefly: 1) pre-retirement lifestyle, 2) present health and financial situation, 3) future of the farm business, 4) goals and desires of one's spouse and/or other affected parties, and 5) outside forces. (See left-hand column of Figure 1-1.)

Pre-retirement lifestyle

Continuity is an important concept in retirement planning, particularly for the early years of retirement. Thus, the nature of one's pre-retirement lifestyle should be considered carefully when developing retirement plans. The more drastic the level of change one attempts to bring into the early years of retirement, the more likely there will be marked periods of stress, and the more chance one will become disenchanted with retirement as it is lived out. Of course, people vary as to how much change they can handle; each has his/her own limit.

Therefore, generally one should not introduce too many *major* changes when transitioning into retirement. For example, a person who has been dedicated to business and community, will likely need challenges or activities which will still offer a sense of usefulness. Similarly, a couple that has worked closely together on the farm, without much time for socializing will need to explore new things to do together. But, remember, one is not likely to become a gadabout overnight. Many changes, both small and large, individually and in relationships, will occur during the transition into retirement. The relationship aspect is especially important to work through.

Present health and financial situation

The present health of both retiree and spouse can affect the timing and degree of retirement, as well as the nature of one's retirement lifestyle and

Figure 1-1. Pre-retirement planning–a complex, interactive process.

Influences/constraints	Dimensions of retirement planning	Your retirement goals/desires
▪ **Your pre-retirement lifestyle** ▪ **Your health and financial situation** ▪ **Future of your farm business** ▪ **Goals and desires of others** -Your spouse (if any) -Family members -Other affected parties	▪ **Lifestyle aspects** -When/how retired to get -Reallocating your former "work" time -Relationships with others -Where to live	▪ **Develop a retirement lifestyle that:** -Is meaningful and satisfying to you as an individual -Has been discussed and agreed upon with your spouse and other affected parties
▪ **Outside forces** -Economic conditions -Government programs -Other ________	▪ **Financial aspects** -Can we afford our desired lifestyle? -Is our financial position adequately protected?	▪ **Develop a financial plan that:** -Is compatible with your desired lifestyle -Protects your financial situation from undue risks and costs
	▪ **Estate management/transfer aspects** -Providing for management in case of incapacity, etc. -Transfer plan consistent with your financial needs and the future of your business	▪ **Develop an estate management and transfer plan that:** -Provides for the management of your estate in case of disability, incapacity or sudden death -Provides for the transfer of your assets whether your business is to continue or be discontinued

sense of economic security. Therefore, when developing retirement plans, determine if there are health factors which would necessitate an early retirement.

Current health status should be reflected in retirement lifestyle plans. But it is necessary to also keep retirement plans flexible since the aging process increases the risk of the onset of other health problems. A health problem could develop quite gradually or happen very suddenly. The retiree and spouse should also talk over both health situations carefully, particularly in regards to the future of the business, should disability or death occur to one or the other. The health situation of other family members may also dictate the nature of one's retirement lifestyle. In fact, because people are living longer, the health of the retiring generation's own parents may impact transition into retirement even more than their own health might.

The financial situation must also be considered when planning retirement. One thing is certain: just as in the past, there probably won't be enough income in retirement to do all the things one would like to do. In fact, many retirees find that they may never be able to quit working entirely, in order to just make ends meet. One's present financial situation must also be looked at carefully to determine whether steps need to be taken to better protect your present holdings. Because of its critical importance, Chapter 3 focuses on the financial security aspects of retirement planning.

Future of the farm business

Slowing down in a farming career but never really quitting provides a gradual transition into retirement. However, if all a farmer wants to do is stay home and farm, a spouse may get upset when he/she wants to travel, or to go south for the winter. If, on the other hand, one plans to sell or rent out the farm at retirement, plans for using up farming time in other ways must receive careful attention.

The best of both worlds situation may well be where one or more children will be taking over the farming operation. But even this approach has its inherent problems if the retiree still insists on being in charge. The future of the farm business must also be considered when addressing the financial and estate transfer aspects of a retirement plan. A careful analysis of the situation may indicate that one's business should be liquidated or rented out, rather than take undue financial risks in trying to bring a family member into the business.

Goals and desires of spouse and other affected parties

It is important to consider how one's goals and desires might mesh with those of one's spouse and other affected parties. A spouse will certainly be concerned as to how retirement might invade his/her space. The issue of how retired to become can also affect a spouse. The more important concerns may be those of a farming son or daughter. Their goals and desires must also be considered when making financial, estate, and business transfer decisions.

Outside forces

Outside forces such as changing/uncertain economic conditions and possible changes in government programs and regulations need to be considered as well. They will likely have the greatest impact on the financial aspects of one's retirement plans. In turn, the financial impacts may affect retirement lifestyle and estate transfer plans.

Communication and conflict management: Two keys to successful retirement

As noted at the beginning of this chapter, pre-retirement planning is a very complex, interactive process. This may be true even in the simplest situation—a retiree who is single, with no immediate family or related responsibilities. He or she still has to balance lifestyle desires with the realities of his/her own financial situation. It becomes somewhat more complex when the retiree has a spouse and/or other family members or parties to consider (note the interlocking of the top two circles of Figure 1-2).

But, in most farm situations, families are typically involved in a virtual "three ring circus," with all three "rings" or "circles"—self, spouse/others, and the farm business—overlapping each other to varying degrees, depending on the particular set of circumstances.

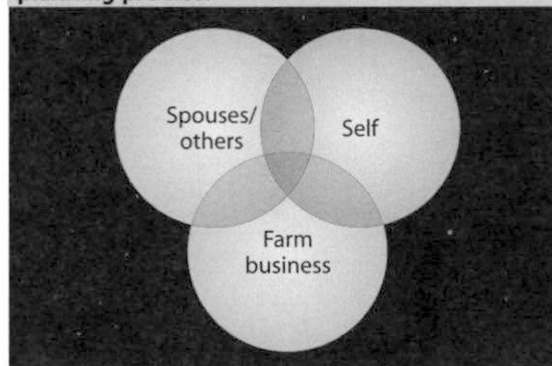
Because of its complex, interactive nature, the retirement planning process for farm families requires that family members possess good communication skills and that they have or develop the ability to manage conflict effectively. Therefore, before beginning your pre-retirement planning, review Chapter 1, Part II of this series, which deals with communications and negotiating skills. It will help with communication problems and managing conflict within the family, whether it is in the lifestyle, financial, or estate planning phases of the retirement planning process.

It is important to recognize that retirement is a new phase of life, one often involving much closer ties with one's spouse or other family members. For example, if the retirees are married, retirement is a time when spouses find themselves needing to interact more. Thus, they need to communicate about their respective retirement desires and expectations. If that communication does not take place prior to retirement, retiree and spouse could be thinking about retirement in ways that will not mesh well at all. The transition to retirement can be much smoother if a couple takes time to talk about it before it happens, or better yet, tries out some possible retirement activities together before retirement.

The first thing to recognize is that men and women tend to have different perspectives. Generally, the main perspective of *women* is that of *connectedness*. They have been socialized to take care of the desires of others ahead of their own. After years of practice doing so, it is often very hard for them to figure out exactly what they would like to do for themselves. They have never experienced such choice making! So, they often go along with their spouse's retirement expectations at first, only to experience considerable dissatisfaction and even resentment with the situation later on. Therefore, it is critical that the female spouse figure out for herself what is likely to be important to her in retirement, and what needs to be done to move in that direction.

Men, on the other hand, are generally *task oriented* and communicate accordingly. Doing what needs to be done to put the finances in order for retirement seems like the most logical thing to do. They are accustomed to operating a major business enterprise, so that is the same attitude with which they approach retirement. Since many couples start their retirement years together, it is important to address each others' needs and expectations in planning what could be a major part of their lives together. So, for the man, it is important to consider the retirement expectations of his spouse and to take time to talk about plans for retirement and the changes that maybe needed.

Figure 1-2. Interrelationships in the pre-retirement planning process.



Brief overview of remaining chapters

Thus, it is important to carefully evaluate the present situation and lay plans for a satisfying, financially secure retirement. The remaining three chapters are designed to aid this process.

Chapter 2 focuses on the process of developing a meaningful, satisfying retirement lifestyle. There, the typical progression that many people go through in their retirement years, which is often fraught with unfulfilled expectations, time on their hands, etc. is discussed first. Then a series of steps designed to aid the development of meaningful, satisfying retirement lifestyle and the testing of selected aspects is laid out. This analysis should help decide when to retire and/or "how retired" to become.

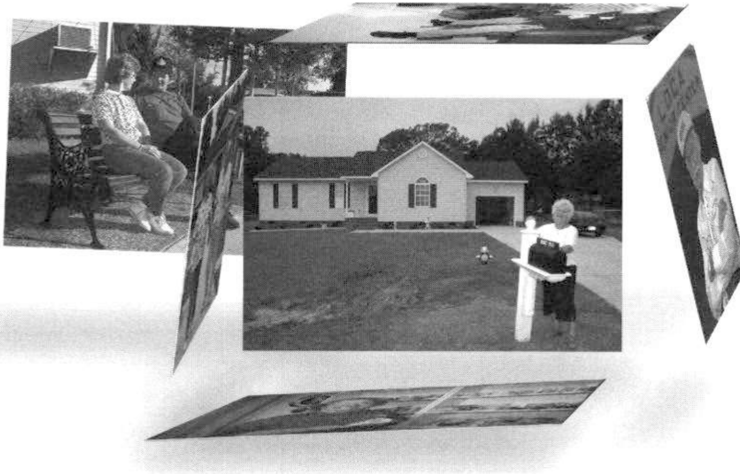
In Chapter 3, the focus is on financial security and death-time plans. The filling out of a financial profile and estate planning worksheet is discussed first. An approach for determining the affordability of a desired lifestyle (developed in Chapter 2) is then presented. Four key questions are asked and discussed. The chapter closes with the application of the planning process to two common financial situations: (1) where income is likely to be marginally adequate to inadequate; and (2) where the income may be quite adequate but the business is not to be continued.

Chapter 4 focuses on business continuation and the asset transfer process. First, focus is directed toward issues and considerations involved in transferring a business. Then several ways to transfer various farm assets, as well as various tools that can aid the transfer process, are discussed. The chapter closes with a brief discussion of the process of firming up retirement, estate management and asset transfer plans, as well as the implementation and updating of these plans.

Developing and testing a retirement lifestyle[1]

2

- Developing a satisfying retirement lifestyle: An overview
- Step 1. Sketching out a desired lifestyle
- Step 2. Comparing proposed lifestyles; making needed adjustments
- Steps 3 & 4. Making detailed plans for time use; testing plan
- Retirement lifestyle: "Where to hang your hat"
- Where to from here?



This chapter focuses on developing a meaningful, satisfying lifestyle for the early years of retirement. Through this process, it is hoped that the resultant retirement experience will be as rewarding as the quote in Chapter 1 predicts.

First, an overview of the process of developing a meaningful, satisfying retirement lifestyle is provided. Then a series of steps designed to help develop an individualized retirement lifestyle is given. The importance of testing various aspects of one's plan is also stressed.

Developing a satisfying retirement lifestyle: An overview

In this section, the typical progression that people often go through in their early retirement years is described. Then a series of suggested steps to be used in developing a more meaningful, satisfying retirement lifestyle for early retirement years is outlined.

Typical progression through early retirement

Atchley[2] suggests that most retirees go through several phases while living out their early retirement years. Five phases are:

1. Looking ahead.
2. Honeymoon.
3. Disenchantment/re-orientation.
4. Stability.
5. Dependency and death.

Phase 1: Looking ahead

As people reach their fifties and early sixties, they are reminded in various ways that some major changes in their lives are about to happen. Some shudder at the thought of retirement; others fantasize about playing golf and traveling

[1] Special thanks to Dr. Sharon Danes, Extension Specialist, Family Social Science, University of Minnesota, for her help in developing this chapter.

[2] Robert C. Atchley, *The Sociology of Retirement*, John Wiley and Sons, 1976

all the time. To further complicate matters, they may or may not have come to the realization that their perception of retirement may be quite different from that of their spouse or other family members.

Phase 2: Honeymoon

The retirement event is often followed by a rather euphoric period in which the individual "wallows" in his/her new found freedom of time and space. It is in this phase that people try to "do all the things I never had time to do before." The person in this honeymoon period of retirement is often like a child in a room full of new toys: he/she flits from one activity to the next, trying to experience everything at once.

People vary as to the nature and extent of such a honeymoon phase. It may be a very short period or extend for years, depending on the resources available and the involved person's flexibility and resourcefulness. Others may never experience such a honeymoon phase in their retirement. For others, the choices are severely limited by their financial, health and/or extended family situations.

But most people find they cannot keep up this frantic pace and thus try to settle into some sort of routine. The nature of this routine is important. Many people whose off-the-job lives were full prior to retirement will likely be able to settle into a retirement routine fairly easily. For them, choices among activities and persons to do them with were made earlier. All that remains is for them to reallocate their former work time in relation to these easier choices. They are often able to by-pass Phase 3, and go directly to the highly prized Phase 4 of retirement living.

Phase 3: Disenchantment and reorientation

Many people, however, find that it is not easy to adjust to retirement. After the honeymoon phase is over, retirement life begins to slow down and often becomes downright boring. They experience a period of let down: *disenchantment*, and even *depression*. People with few alternatives, little money, poor health, previous over-involvement in their jobs, and/or those who immediately move from the communities where they have lived for many years, are particularly susceptible to this *disenchantment*. Unrealistic expectations, during Phase 1 can bring about a resultant feeling of emptiness that may include a depressive episode.

Having hit bottom, *reorientation* is usually necessary. It involves developing a more realistic view of one's choices and use of time and talents. Counseling may be necessary to bring one out of this phase. Most people eventually graduate from disenchantment to *stability* (Phase 4). However, some never quite make it; for them, retirement is "for the birds."

Phase 4: Stability

This is the ultimate, prized phase of retirement. By now, the individual has a well-developed set of criteria for making choices, and these allow him/her to deal with retirement life in a reasonable, comfortable, orderly fashion. Life may be busy and exciting, but it is largely predictable and satisfying. The individual knows what is expected of him/her and knows his/her capabilities and limitations. He/she is a self-sufficient adult, going his/her own way, managing his/her own affairs, a bother to no one. For them, being retired is a serious responsibility, seriously carried out—and quite satisfying.

Sometime during this stability phase, an individual inevitably encounters physical and/or mental declines that change the level of functioning. Sometimes such changes can be readily incorporated into one's on-going, independent lifestyle. But in some cases the situation may well call for a return to *reorientation* (Phase 3), or passage to *dependency* (Phase 5).

Phase 5: Dependency and death

The dependency phase of retirement is usually brought on by sickness, disability, or lack of money. When an individual is no longer capable of engaging in routine retirement activities because of health or financial reasons, he/she ceases to be independent and thus becomes dependent on others. This change may come on very gradually or very quickly. In any case, since at least some retirees will experience this phase, there is need to plan for it, both psychologically and financially. This dependency phase is followed by death.

Steps to develop a satisfying retirement lifestyle

A more *ideal progression* through retirement would mean a *fairly extended honeymoon phase*, during which one would enjoy relief from previous responsibilities, and anticipate new opportunities and different activities. Communicating with one's spouse and others about retirement expectations can extend the honeymoon phase as well as reduce the impact or length of a possible disenchantment phase. One would then move directly to the stability phase where retirement lifestyle is under control. One looks forward to the future, feels challenged by the satisfaction it can bring and the world of accomplishments it can hold—and, of course, ideally one would prefer to die on the golf course, or out doing some other favorite activity, rather than face the prospect of living through an extended dependency phase, with whatever that might entail.

The steps needed to develop a retirement lifestyle that more nearly approximates the ideal progression include:

1. Sketch out a desired lifestyle for one's early retirement years.
2. Share this concept of desired lifestyle with spouse, and make needed adjustments.
3. Plan the use of time in the early retirement years with great detail.
4. Test parts of the desired retirement lifestyle.

It is strongly recommended that one focus lifestyle planning efforts on the *early years of retirement*. The reasons are two-fold. First, this early retirement period can be a very volatile one if not planned. As noted earlier, without careful planning, a euphoric honeymoon phase may be followed by considerable disenchantment and even depression. It may also turn into a less-than-desirable period for one's spouse, and/or other affected parties. Second, unforeseen changes in health and/or other factors may necessitate marked changes in lifestyle later on. But such changes cannot be anticipated with any degree of certainty at this time. All one can do is be flexible in order to adapt to unforeseen changes.

Step 1. Sketching out a desired lifestyle

Describe the type of lifestyle that is desired. **Both retiree and spouse (and/or other directly affected parties) should participate in this process.** First, do this on an individual basis and then compare notes.

When sketching out a desired retirement lifestyle, it is important to recognize that the major upcoming change is the reallocation of the time spent running the farm business, the "farming time." Therefore, the major activity categories to consider for this reallocation are discussed first. A worksheet for sketching out a desired retirement lifestyle begins on page 15.

Reallocating "farming time": Major activity categories to consider

Consider three major activity categories to in this planning process:

1. Time feeling useful
2. Time indulging self
3. Time with spouse, family, and friends

1. Time feeling useful

After retirement, most people will need to keep usefully active, at least some of the time, in order to feel they still have a place in the scheme of things. Feeling unneeded can cast advancing age as a burden instead of a pleasure. And, as a result, one will likely pass this burden on to others—always complaining, finding fault, and being hypercritical of the people and the world.

As Parker,[3] a British gerontologist, suggests, a person's work/non-work lifestyle prior to retirement can have a major impact on the retirement lifestyle, at least in the early years. He identifies three broad patterns: extension, opposition, and neutrality. Extension means people have had lifestyles in which non-work activities, if any,

[3] Cited without footnote in *Planning Your Retirement, The Complete Canadian Self- Help Guide*, Blossom T. Wigdor, Editor, Grosvenor House Press, Inc., Toronto/Montreal, 1985.

were often similar in nature to their work. The people's lifestyles have centered around work (or being useful). For example, they may have been accountants who helped senior citizens prepare their income tax returns on weekends. Dairy farmers often fall into this classification, as they "just can't leave those cows to someone else's care."

Persons of this type should not burn too many bridges, early on, but rather focus on easing themselves into retirement by finding new ways of feeling useful, or learning to bring other interests into their life. In the farm setting, helping out with chores or with livestock or cropping operations may provide such a bridge into retirement. However, for health and family reasons, new non-farm interests should be developed for later retirement.

At the other extreme is the **opposition** pattern. This means that people have, over time, deliberately chosen leisure or non-work activities that were markedly different from their work. Crop farmers who spend winters in Texas, or potato farmers who fly to Kalispell, Montana to golf and fish, are examples. Persons in this group tend to adjust to retirement quite readily. They welcome it with open arms; they now can do more of what they *really* enjoyed doing before.

The third pattern, **neutrality**, fits in between extension and opposition. In neutrality, people tended to balance work and non-work activities during their working years. They will likely find it relatively easy to shift into a retirement lifestyle involving less work, though they will likely need to find some useful activities that replace their previous work time.

Thus, in beginning to plan, it is important to know which of the these patterns describe the retiree and spouse. How important is "doing something useful in life"? Generally, persons who fit into the extension category will need to spend considerable time developing a retirement plan that gives them sufficient opportunity to feel useful. The amount of "other" useful activity needed will depend, in part, on one's retirement status relative to the farm business. Will it be "just slow down a bit" by getting rid of the cows or sows and wintering in Florida or Arizona? Or will it be continued time on the farm, helping a farming son or daughter when needed? One could quit farming, rent out the land, and run for mayor or county commissioner. If one remains fairly active in the farm business, another "useful" activity in retirement—at least in the early years may not be needed.

But, if one desires new, different challenges, then consider a part-time job, a second career and/or involvement in community, state, or even the world. Not all the useful work that retired people do is done for pay. In every community, there are civic activities and organizations that depend on time, talent, and energy of volunteers. For satisfaction and self-respect, consider community/volunteer work. As a dividend, one gains a ready-made source of useful activity and new acquaintances in the process.

2. Time indulging self

Feeling useful activities should not totally dominate retirement days. While spending some time in useful activity is likely to be necessary, it is equally important to plan ample time for other things, or even nothing at all.

Many retired people get great satisfaction out of hobbies and various recreational and educational activities. For many, seeing the world via travel or study is an important, enjoyable, and educational retirement endeavor. When possible, these interests should be developed prior to retirement and should not be too expensive or too strenuous for one's financial and health situation in retirement. Becoming involved in various educational endeavors such as book clubs and Elderhostel programs may spark new interests and provide a chance to meet new, interesting people. **Selecting activities that involve both retiree and spouse should be given special consideration.**

And, of course, there is no statement in the retirees' code of ethics that says one can't spend some time just "sittin', rockin' and whittlin'." In fact, solitude and relaxation can do wonders for the soul—providing it doesn't become the sole use of former work time.

3. Time with spouse, family, and friends

Having a satisfying home environment and social life in retirement requires several things. First, retiree and spouse (if there is one) must agree on how much togetherness is acceptable to each. Also, maintain and possibly improve, relations with extended families and friends, as well

as make new friends. Past and present relationships with one's spouse and others need to be considered as a plan is developed.

Retiree and spouse: Togetherness—how much?

Robert Browning once wrote:
"*Grow old along with me*
The best is yet to be . ."

Retirement will likely provide the opportunity to spend more time together. If done in appropriate amounts and ways, it can bring a new and exciting dimension to one's marriage—the best may well be "yet to be!" The question is how much togetherness is right for each person? It is important that both husband and wife agree to respect each other's space.

Apart from the big things each can do for the other, remember that it is often the little things—small courtesies, thoughtful acts—that make the day. But, it should also be recognized that little irritations can pile up and turn what might be a happy time of life into an armed truce—with war likely to break out at any time. Therefore, it is important to realize that, while it is unlikely to transform one's spouse, each person can at least try to set an example. And when conflicts do arise, try to resolve them in a win-win fashion, rather than letting the conflict poison the relationship.

Relations with extended family and friends—a social life

Retirement will also provide more time to spend enjoying family and friends, time to really get to know grandchildren, and to be a part of the changes taking place in children's lives. But, just as with one's spouse, respect children's need for space. Too much togetherness can cause real strains within the extended family. On the other hand, if family is or could be scattered geographically, plan to have funds available to visit them periodically.

One reason many older people lose their interest in living is because of a lack of friends. They had friends once, but they may have died or moved away. In other cases, it is not so much a lack of friends but a lack of friendliness. To avoid being hemmed in by life, one must keep up interest in other people, and not get upset by their shortcomings. Continuing to have contact with younger people will also help to keep one's thinking young and more flexible. Upon retirement, true friends are especially needed. Friendships do not just happen. So plan to continue to seek out and cultivate new friends, without forgetting old ones, as time marches on.

Sketching out a desired retirement lifestyle/plan

Worksheet 2-1, which begins on page 15, is designed to focus individual thoughts about what is personally important for various aspects of retirement living. It will also help assess how expectations differ between spouses. The worksheet also includes aspects that might affect others, such as a farming son or daughter, aging parents, etc.

The best way to complete this exercise is to first make several copies of the worksheet. Each spouse should first complete the worksheet individually without discussing it. Then after both have completed it, take a look at how expectations about retirement are similar or different. Remember the purpose of this worksheet is two-fold. First, it sparks thinking about various aspects of retirement and what **each individual** wants to do! Secondly, it will help spouses come to some consensus regarding the lifestyle that will provide a meaningful, satisfying experience for both.

The first page focuses on the various uses of time. The next page focuses on health, financial, and living arrangement aspects. These latter items will affect not only a lifestyle, but also the financial and estate management (Chapter 3), and business transfer aspects (Chapter 4) of a retirement plan.

Step 2. Comparing proposed lifestyles; making needed adjustments

Retirement years will be truly prime time years if spouses and other affected parties can agree on a plan that meets as many of the respective lifestyle needs and desires as possible. Don't be surprised if, after doing Step 1 individually, there are some marked differences in expectations. Thus, there will need to be time spent in resolving differences so that each has a lifestyle that is largely complementary to the other's, and not too competitive or divisive. The desired result should be a win-win situation, not an I win; you lose situation. If a problem arises when trying to resolve differences, revisit the earlier discussion of communications and conflict management in Chapter 1, Part II of this series.

Steps 3 & 4. Making detailed plans for time use; testing plan

In steps 1 and 2, a desired retirement lifestyle was sketched out in general terms and shared with the spouse and/or other affected parties. This process is taken one step further by focusing on more detailed plans for the use of time in retirement. Also, consider testing out selected aspects of the resultant plan.

Step 3a. Listing planned activities; ranking relative importance

Using worksheet 2-2, on page 17, list potential activities for the early retirement years. To begin, list the activities identified in steps 1 and 2. Add other activities and possibilities. Then rank or prioritize these various activities as to their relative importance in the desired retirement lifestyle.

Step 3b. Allocating time; checking for peaks and valleys

Once key retirement activities are identified indicate the amount of time to spend on each activity during various periods of the year. To do this, first estimate the amount of time spent on each activity during the early retirement years. Do this on a weekly or monthly basis or by periods of the year. Change the calendar quarters listed in worksheet 2-2 if they do not apply to the situation.

Add up the hours for each period and compare the total to the time available. Take note of any potential peaks (too busy) or valleys (too inactive). If important "valleys" do appear, explore activities that would more fully use available time. Failure to respond to these gaps may well bring on a period of disenchantment in the early retirement years. Of course, there are many people and organizations that would be glad to keep retirees busier than they want to be. *So be forewarned.*

Worksheet 2-3 (on page 18) provides a means of:

1. Summarizing one's retirement lifestyle plan.
2. Estimating expenses relating to the various activities.
3. Evaluating health limitations that may affect the desired lifestyle.

Step 4. Testing parts of desired lifestyle

It is likely that the desired retirement lifestyle plan will contain certain activities that will be new or foreign to one's current lifestyle. Therefore, if it is at all possible, test out some of these activities before retirement. This will provide a better feel of whether certain aspects of the proposed retirement lifestyle are workable and/or will likely be satisfying. It will also reduce the amount of change in lifestyle during the early phases of retirement.

Retirement lifestyle: "Where to hang your hat"

Several factors influence plans for retirement living arrangements, not the least of which is the desired lifestyle. For example, if one continues working the farm, but it will be disbanded upon incapacity or death, one will likely need to reside on the farm or at some nearby location. If a family member is taking over the business, then recognize that it is usually not desirable to have two families living on the same farmstead, particularly if one family unit is retired. Mom may not like the way the daughter-in-law is bringing up her grandchildren; Dad may think the son should get up earlier, get home earlier on a night out, or that he just seems to take too much time off. To avoid this, the son should live on another farmstead, or Mom and Dad should plan to move to town or to another home in the country, letting their own children live out their own desired lifestyle on the home place.

If the business is to be rented or sold, or a farming son or daughter will be taking complete charge of the business, then one's choice of living arrangements can involve several possibilities. It may involve moving to a smaller house in town or to a country home near town. Such a move would likely involve fewer housekeeping chores as well as shorten the distance to stores, senior activities, church, and friends.

Each year, however, thousands of retired people move from localities with severe winters to places with warm, attractive winter climates. There are pros and cons to such a plan. On the plus side, apart from enjoying pleasant weather, one has a chance to meet others of comparable age and interests. Also, with lower housing and clothing costs, one might be able to reduce living costs. On the other hand, once-familiar scenes and faces will be gone. Loneliness or even homesickness may become issues. One might tire of hearing about the aches and pains of other retirees, and yearn to hear a baby cry!

If interested in moving from the home area, probably the best plan would be to start exploring various retirement areas during vacations before retirement. Does a northern Minnesota lake beckon? Try living there during January, February, and March. If Arizona is appealing in winter, try living there June through August. Renting a place for a while rather than buying immediately is generally a good strategy for checking out an area. These experiences will help identify the best plan. A compromise approach often works well: spend winters in the south and the remainder of the year in the home area, thus becoming a so-called Snowbird.

In any case, unless circumstances are exceptional, plan on living in separate housing from the children during retirement. They welcome visits, but when two generations are together day in and day out, life can become uncomfortable. Some day, an independent lifestyle may not be possible. Here again, it would be desirable to have the where-with-all to provide for one's own care, whether it be in one's own home, an extended care facility, or a nursing home.

This issue should be discussed thoroughly with family members while health is still good. Make wishes known. This will relieve children of the decision as to where and how care should be provided and from any guilt feelings that they aren't doing enough if a nursing home is required. Similarly, if family members are scattered geographically, care might well fall on just one of the children, and thus heap undue work on just one or two family members.

Where to from here?

Having completed this thought process and the worksheets, potential retirees should be in a good position to decide, from a lifestyle perspective, when they will likely be ready to retire, and how retired to become. However, one's projected financial situation may have a marked impact on the nature of retirement lifestyle and/or the extent to which one can retire. The financial aspects of one's retirement situation will be addressed in the next chapter.

References

Atchley, Robert C., *The Sociology of Retirement,* John Wiley and Sons, 1976.

Danes, S.M. and Cavanagh, M., *Retirement: More Than Money Decisions*. Minnesota Extension Service Publication HE-FO-3794, St. Paul, MN, University of Minnesota, 1990.

Danes, S.M. and Rettig, K.D., *Solving Family Problems Involves Social Decision Making,* Minnesota Extension Service Publication HE-FS-3104, St. Paul, MN, University of Minnesota, 1986.

Lingren, H.G., *Managing Conflict Successfully,* North Central Regional Extension Publication 365, Lincoln, NE, University of Nebraska-Lincoln, 1990.

Rettig, K.D., *Social Decision Making,* Minnesota Extension Service Publication, St. Paul, MN, University of Minnesota, 1986.

Robinson, J.W., Jr. and Silvis, A.H, *Interpersonal Communications in the Family and Farm Business,* Urbana-Champaign, IL, University of Illinois, 1989.

Wigdor, Blossom T., Editor, *Planning Your Retirement: The Complete Canadian Self-Help Guide* Grosvenor House Press, Inc., Toronto/Montreal, Canada, 1985.

Worksheet 2-1. Sketching out selected personal aspects of a retirement lifestyle plan.

First, think about each of these questions as you personally view them. Then, place a check mark next to those areas you think you and your spouse/other parties should discuss. It is important to think only about your own ideas first, and then discuss them with your spouse/others.

Working/volunteering

- How much time should I (we) spend working: On the farm: ______________________;
  Off the farm: ______________________
- How much will I (we) continue to be involved with the daily activities of the farming operation? ______________________
- When will I (we) discuss how my (our) retirement plans will affect those involved in the daily operation of the farm? ______________________
- What types of volunteer/community activities do I (we) plan to be involved in? ______________________

Leisure/personal development

- What types of recreational activities or hobbies do I (we) plan to get involved in? ______________________
- What types of self-improvement activities do I (we) plan to get involved in? ______________________
- I (we) have the following travel plans: ______________________

Relationships with spouse/others:

- How much time should we (spouse and I) spend together? When? Doing what? ______________________
- How much time do I (my spouse) need alone? Doing what? ______________________
- How should I (we) relate to our children? Aging parents? Grandchildren? ______________________
- Should we each have our own friends as well as friends in common? ______________________
- How should I (we) go about making new friends? ______________________

Health

- What plans should I (we) have for maintaining health through diet, exercise, etc.? ______________________

Worksheet 2-1 (continued). Sketching out selected personal aspects of a retirement lifestyle plan.

Health (continued)

- How will retirement affect our health insurance coverage? ____________________
- How will I (we) deal with the effects of a long-term or serious illness if: my (our) aging parent(s) becomes come(s) ill? ____________________
  If I (one of us) or my (our) children become ill? ____________________
- How will I (we) handle questions of terminating life support systems if that becomes necessary? ____________________

Finances

- What yet needs to be done to transfer our farm assets and how will this affect our sources of income? ____________________
- How will we determine how the money should be spent? ____________________
- How much money should each of us have to spend as we choose, without having to consult each other? ____________________
- How will we reduce living expenses in retirement, if needed? ____________________
- How will we increase income if we need to do that? ____________________
- How much of our income will come from using up our assets, and how much will come from other sources? ____________________
- If I (we) continue to work, how will that affect my (our) retirement benefits? ____________________

Living arrangements

- Does my (our) current home meet my (our) goals, needs? ____________________
- What changes need to be considered to make our home a safe, user-friendly place as I (we) age? ____________________
- Shall I (we) remain in my (our) present community or move to a different one? Where? ____________________

Worksheet 2-2. Planning the use of your time—the early retirement years.

First, develop a list of possible retirement activities and indicate whether they have a high, medium, low priority in your proposed lifestyle. In Sections I and II, check (✔) those activities that will likely involve your spouse. Then indicate the amount of time you expect to spend with each activity by periods of the year. Finally, check the balance between the time you have allocated and the time available.

Possible retirement activities	Relative importance (low, med., high)	Time to be spent: per week/month Dec-Mar	Apr-June	Jul-Aug	Sept-Nov
I. Time feeling useful					
A. Time working (farm/other)					
______	______	______	______	______	______
______	______	______	______	______	______
B. Time serving others (volunteering, etc.)					
______	______	______	______	______	______
______	______	______	______	______	______
C. Being creative, etc.					
______	______	______	______	______	______
______	______	______	______	______	______
II. Time indulging yourself					
A. Time for self improvement (education, health, etc.)					
______	______	______	______	______	______
______	______	______	______	______	______
B. Time for special interests/other (hobbies, recreation, etc.)					
______	______	______	______	______	______
______	______	______	______	______	______
C. Time for travel/other					
______	______	______	______	______	______
______	______	______	______	______	______
III. Time with your spouse/others					
A. Time with your spouse					
______	______	______	______	______	______
______	______	______	______	______	______
B. Time with family/affected parties					
______	______	______	______	______	______
______	______	______	______	______	______
C. Time with friends/socializing					
______	______	______	______	______	______
______	______	______	______	______	______
IV. Summary					
Total time allocated					
Total time available					
Balance					

Worksheet 2-3. Summarizing your retirement lifestyle plan; related expenses; health considerations.

Our lives are filled with many types of activities. In retirement you may find that some activities that were not important while farming full time become more significant during your retirement years. What will you do? When? Will it involve additional expenses? Will your health limit your involvement?

Activities	What will you do and where will you do it?	How much time per week? (or which months)	Related expenses (dues, clothing, travel, material)	Will health limitations affect involvement?
1. Farm work				
2. Involvement in organizations				
3. New job, second career				
4. Special interests (hobbies)				
5. Travel				
6. Visiting, walks, time				

Managing financial security; developing/updating estate plans

3

- **Road map of the farm estate and transfer planning process**
- **Completing a financial profile and estate planning questionnaire**
- **Question 1. Will there be sufficient income to meet lifestyle needs and desires?**
- **Question 2. Is financial situation adequately protected?**
- **Question 3. Does the present estate plan adequately protect the spouse and treat heirs fairly?**
- **Question 4. Does the present estate plan avoid excessive estate settlement costs?**
- **Question 4b. Does the present estate plan avoid excessive estate taxes?**
- **Application: Selected financial situations; business to be discontinued**

A second major area of concern when planning retirement is financial security and death-time plans. Such a focus underscores the fact that one has probably spent an entire farming career to develop the present financial wherewithal. **Thus, it is only fitting that one first decide what to do for oneself, before thinking about children and others.**

To facilitate this process, a road map of the financial and estate planning process is presented first. Next, the steps involved in completing a worksheet designed to gather information needed relative to one's situation are discussed briefly.

The four key questions then addressed are:

1. Will there be sufficient income to meet your retirement lifestyle needs and desires?
2. Is the financial situation adequately protected from associated risks and costs?
3. Does the present estate plan adequately protect spouse and still treat other heirs fairly?
4. Does the present estate plan avoid excessive estate settlement costs and estate taxes?

Finally, a brief discussion of the process of firming up retirement-related financial and estate plans for two very different financial situations is presented, namely; (1) a marginally adequate to inadequate situation, and (2) an adequate to very adequate financial situation. In both instances it is assumed that the farm business **will not** be taken over by a related or unrelated party. (Issues relating to a situation where the business is to be continued by a family member(s) are discussed in Chapter 4.)

Road map of the farm estate and transfer planning process

The top of Figure 3-1, shows the first step in the farm estate and transfer planning process involves gathering and analyzing financial and other information regarding the current situation. Also, set some goals relative to the estate and family situation. Worksheet 3-1, which begins on page 42, will be used in this process.

The first priority in this planning process should be financial security in retirement. Focus on the projected retirement income/expense situation. As indicated in Figure 3-1, situations can range from an inadequate income situation to a more than adequate financial situation.

If retirement income is projected to be inadequate, explore ways of balancing income and expenses. If retirement income is projected to be relatively adequate, any transfers of assets will likely have to be delayed until the death of the retiree and/or surviving spouse. Of course, if projected retirement income is likely to be more than adequate, one should be able to live as one pleases, yet be in a position to begin transferring at least some assets while both retiree and spouse are living. If the estate is quite large, potential estate taxes may even *necessitate* these lifetime transfers.

Once a likely retirement income situation is determined, consider what would be fair treatment of heirs (priority 2 in center of Figure 3-1). This treatment will vary according to whether the farm business is to be discontinued at retirement (or later on), or be continued in operation by one or more of the heirs. If the business is to be discontinued there is no worry about transferring the business. The heirs can be treated in a more or less equal fashion, taking into consideration their past treatment and their present situation. Considerations and possible strategies for this situation will be discussed later in this chapter.

If the business is to be continued by one or more of the heirs, the parents face a much more dynamic and delicate situation. They will be walking a tightrope between their own financial well-being, the farming heir's desire to eventually gain control of the business, and trying to be fair to the nonfarm heirs. This whole process is discussed in greater detail in Chapter 4.

Of course, various tax aspects and settlement costs must also be considered (priority 3 in Figure 3-1). Estate settlement costs and estate tax aspects are discussed later in this chapter. Chapter 4 is devoted to a discussion of various tax aspects and strategies involved in transferring assets, either while living or at time of death, where the business is to be continued.

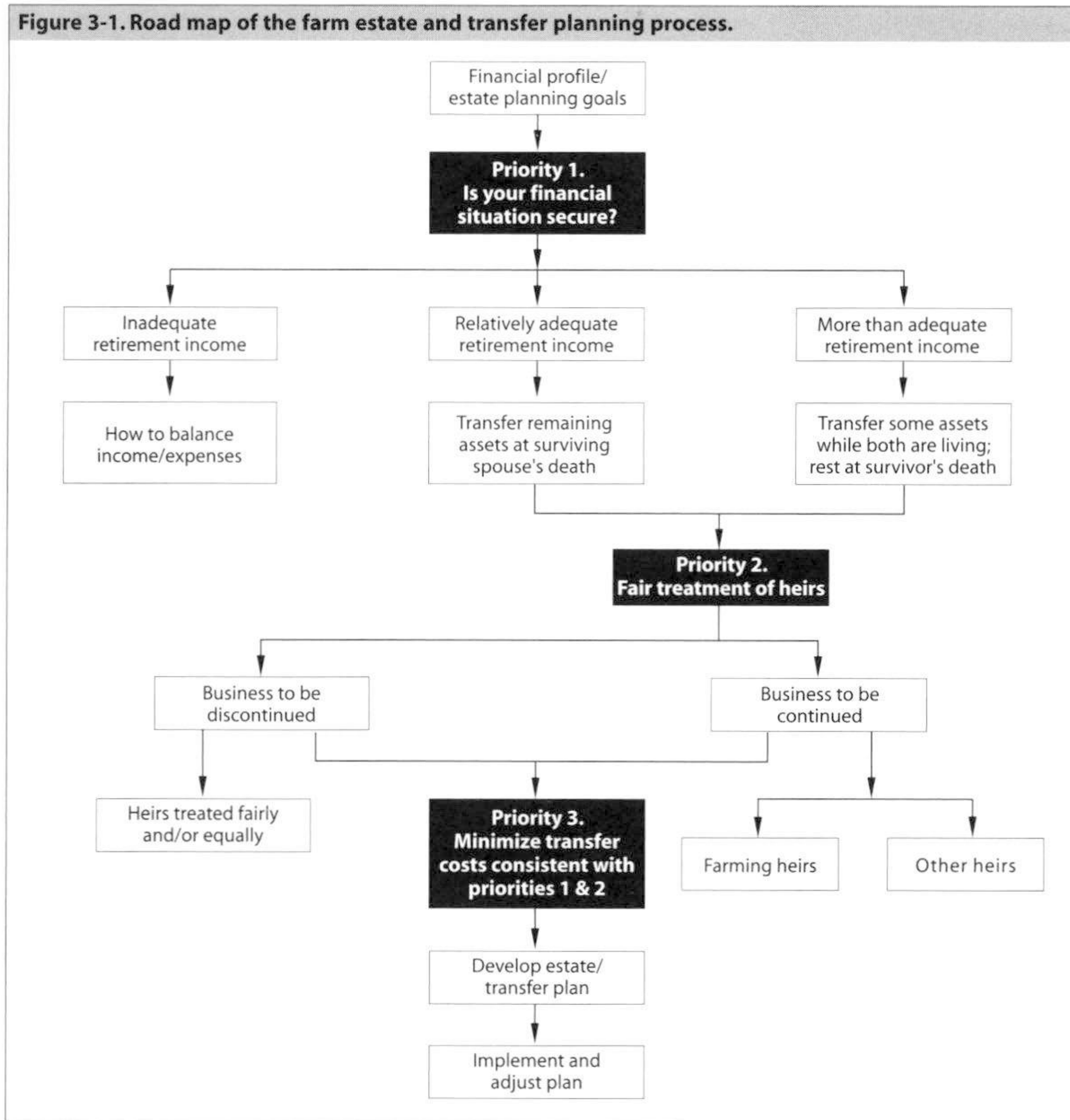
Eventually, one must develop an estate/asset transfer plan and prepare to implement it. Also review the situation periodically, and make adjustments as needed (bottom portion of Figure 3-1).

Completing a financial profile and estate planning questionnaire

Complete Worksheet 3-1, Financial profile and estate planning questionnaire, page 43. Worksheet instructions begin on page 42.

Once the worksheet is completed, address the following four key questions.

Figure 3-1. Road map of the farm estate and transfer planning process.



Question 1. Will there be sufficient income to meet lifestyle needs and desires?

Having completed Worksheet 3-1 *Financial Profile and Estate Planning Questionnaire*, the process of analyzing the situation begins. As indicated in Figure 3-1, there are three possible broad income situations:

1. An **inadequate** retirement income situation.
2. A **relatively adequate** retirement income situation.
3. A **more than adequate retirement** income situation.

Refer to the bottom portion of Step 7 Worksheet 3-1. Which of the three income situations best describes the situation?

Situation 1. Inadequate retirement income

If the projected income/expense balance shows there will be barely enough income to meet committed expenses (needs), to say nothing of discretionary expenses (desires), there is likely to

be future financial trouble. In this case, first study alternative ways of bringing income and expenses into better balance. There are four ways to do this.

Option 1. Increase income

There are three ways to increase retirement income:

- Save more money before planned retirement. This might involve cutting current living expenses, increasing business income, and/or managing income taxes better.
- Delay retirement; keep farming if it is still possible and profitable.
- Work part-time during retirement, either on the farm or in town.

Option 2. Reduce living expenses

This might include cutting back on discretionary spending and, if possible, reducing the committed expenses part of budget. This may involve:

- Changing one's lifestyle.
- Improving money management.
- Moving to a place where living and associated overhead costs might be lower.

This latter adjustment should be thought through carefully (see the discussion "Where to Hang Your Hat" in Chapter 2). Solving an income problem is a short-sighted solution, while becoming very unhappy with living arrangements.

Option 3. Liquidate assets

The big unknowns in this period of life are: (1) how long will one live, and (2) what might happen to future living costs. For example, the average life expectancy of a 55-year old male is about 20 years, though 16 percent can expect to live for 30 years. For 55-year old women, the average life expectancy is about 24 years, with 29 percent living 30 more years. At age 65, the average life expectancy of males is 13 years and for women 16 years. Very few 65-year olds will live 30 years more, but 20 percent of males and 32 percent of females will live for 20 years. Add to this the fact that an inflation rate of 4 percent per year will more than double costs in 18 years, while a 6 percent inflation rate would double costs in just 12 years. (The rule of 72: divide expected inflation rate into 72, to determine the years required to double costs or income.)

Thus, **asset liquidation** is a questionable way to meet income needs, *particularly during the early years of retirement*. This is a time when one would likely be able to supplement income with part-time work. If, on the other hand, one sells the farm on a contract for deed, payments received will not change with inflation, and outliving the associated payment stream is a possibility. By that time, one may not be able to work to cover income needs. If considering asset liquidation, then work closely with a financial consultant.

Option 4. Combine strategies.

In this situation, the main concern should be trying to make ends meet during one's lifetime. In terms of estate plans, have a simple will directing all remaining assets to the surviving spouse. If there is no spouse, or upon the death of the surviving spouse, the will(s) should also direct how remaining assets should be distributed to heirs and others. Typically, the farm business would be discontinued or absorbed into another business. Any distribution of assets would be divided equitably, often equally, among the heirs. More on this situation appears at the end of this chapter.

Situation 2. Relatively adequate retirement income

If it appears that projected income will be more or less sufficient to meet projected early retirement living expenses (including discretionary expenses), then one has an essentially workable retirement income situation. But, there is not likely to be a lot of room for any excesses. Therefore, keep good income and expense records and be ready to adjust living expenses if things don't balance out as well as earlier projections would suggest.

Again, place high priority on one's own financial security. Therefore, be conservative relative to transferring assets to heirs while living. If the business is likely to be discontinued, definitely delay asset transfers until the death of the surviving spouse, unless there is some special family or tax circumstance that would dictate otherwise.

If one of the children will be taking over the farm business, then have provisions in the will or trust relative to how assets are to be transferred to

the farming heir compared with the nonfarming heirs. This might include some transfers before the death of a surviving spouse. But in most cases, such transfers should involve a sale or life estate arrangement, as opposed to a gifting approach. **Remember: the gifting approach precludes the retiree/spouse from receiving any future earnings or income from the property that was gifted.** If considering any lifetime transfers, see the discussion of various transfer tools in Chapter 4.

Situation 3. More than adequate retirement income

If it appears that projected living expenses (committed and discretionary expenses) can be met with plenty of room to spare, one should feel very fortunate.

But, like other retirees, one needs to: (1) adequately protect one's financial situation from various financially-related risks and costs; and (2) have death-time plans in place that adequately protect one's spouse and the estate. These two issues will be discussed in the next two segments of this chapter.

Another issue to consider is that of transferring assets to heirs—both while alive and at time of death. If the business is to be continued by a family member, the process is so important and complex that the next chapter, Chapter 4, is devoted to this business transfer process. The process is much simpler if the business is not being continued by a family member. A portion of the last segment of this chapter is devoted to this latter situation.

Question 2. Is financial situation adequately protected?

As indicated earlier, financial planning for this stage of life is a difficult task because of all the uncertainties associated with it. The best one can do is recognize the associated risks and costs and try to moderate them, thus eliminating as many big surprises as possible. When beginning this process, first review answers in Step 8 of Worksheet 3-1, which involved sorting financial concerns, goals, and priorities. What are the most important aspects of the financial situation to achieve or protect against? What is the overall risk tolerance of both retiree and spouse at this point? That is, how much risk can be assumed and still allow for sleep at night? And finally, how are the various factors associated with one's financial future ranked?

In this section, the attention focuses on managing business, investment, and health-related risks and costs.

Protecting against unnecessary business-related risks

If it appears the retiree will continue to operate the farm business for at least a few more years, consider making changes in the farming operation, such as:

- Resorting to less risky enterprises or farming practices.
- Making use of crop insurance programs.
- Utilizing marketing strategies such as forward contracting and hedging to reduce market risks.

Other business-related risks to be avoided include: (1) being involved in any unwarranted or unnecessary business expansion program; and (2) personally co-signing sizable notes for children.

If the financial position is stressed by a lot of debt, determine if principal and interest payments can be rescheduled on more favorable terms, or whether one should go through a mediation process to determine if the lender(s) would grant some debt forgiveness. In some situations, declaring bankruptcy may be necessary to more adequately protect one's retirement years. See Chapter 5, Part I of this series for a discussion of these issues.

Protecting against unnecessary investment risks and income taxes

Generally, the closer to retirement one gets, the more conservative and income-oriented one should become. This is because if one incurs

substantial losses in income, and/or reductions in asset values, there is less principal for future use and less time to recover from any such losses. Of course, the present financial situation must be factored in as well.

But, there may be another bit of irony: In a strong financial position, one can take more risks, but one certainly doesn't need to do so at this stage of life. On the other hand, if the present financial position is marginal at best, one should be assuming even less risk, but inflation and other factors may dictate continued risk-taking to provide for retirement needs.

Therefore, it is important to work with a financial consultant who understands the farm business, to first evaluate one's present investment portfolio, and to then explore the likely impact of other types of investments on the income and risk characteristics of an alternative investment portfolio. Also explore investment strategies that will reduce, defer, and/or eliminate associated income taxes. To aid this process, the risk/return characteristics of the major investment groups and the effects of diversification on risks and returns are discussed next. The process of evaluating one's present investment portfolio is also discussed.

The risk/return characteristics of the major investment groups

Investment options tend to fall into five broad groupings:

1. Money market funds.
2. Income-related investments (bonds, tax-deferred fixed annuities).
3. Growth-oriented investments (stocks and variable annuities).
4. Real estate.
5. Gold, gems, commodities, etc.

The pyramid in Figure 3-2 illustrates the risk/return characteristics of these various investment alternatives. As indicated on the left-hand side of the diagram, if one selects investments that increase potential rewards through appreciation in the value of the investment, one also increases the potential risk of loss of principal. On the right-hand side, the trade-off is between increasing the safety of principal against an increasing risk of loss of purchasing power due to inflation.

Investment alternatives in the bottom part of the pyramid tend to be quite liquid and conservative, risk-wise. They include insured savings accounts, cash value of life insurance, fixed annuities, CDs, and savings bonds. They provide a high degree of safety of principal and low income variability. However, they do exhibit a relatively high degree of risk of loss of purchasing power, particularly during inflationary times. At the other extreme, such investments as gold, speculative common stocks and bonds, and real estate are found in the top portion of the diagram. In general, these investments have a greater potential for rewards through capital appreciation. However, these alternatives also have a greater potential for loss of principal.

In between these extremes are various types and combinations of stocks, bonds, and debt securities. Bonds tend to be income-oriented and exhibit less variability of earnings and loss of principal, while stocks tend to be more risky, both in terms of earnings and asset value changes.

There is no riskless investment. It is a matter of combining investments that fit one's present financial situation and personal comfort level.

The risk/return characteristics of selected investments; correlation with farm real estate

As shown in Table 3-1, the average rate of return from treasury bonds and long-term corporate debt during the 1947-84 period was slightly below 4 percent, which is below the consumer price index change for the period studied. The average risk associated with these investments was about the same as for farm real estate. On the other hand, the average return on residential real estate was about 8 percent, and exhibited a very low risk factor. Farm real estate and corporate stocks showed high average returns. The risk on stocks was quite high, while farm real estate exhibited a more moderate degree of risk. (The farm crisis of the 1980s, with its accompanying marked changes in farm real estate prices, probably changed these relationships somewhat.)

When considering changes in an investment portfolio, one should also be concerned about the

Figure 3-2. The investment risk/return pyramid.

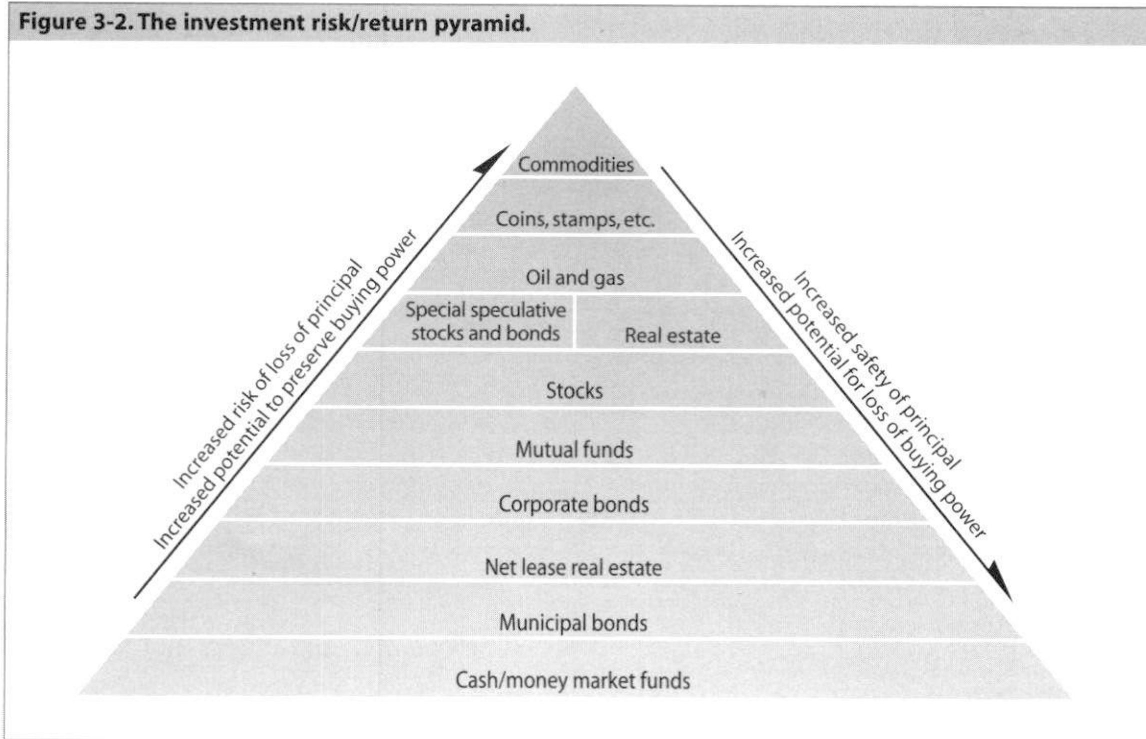


Table 3-1. Average rates of return and risk for various investments; correlation with farm real estate, 1947-1984.[a]

Asset	Average return	Average risk[b]	Correlation with farm real estate[c]
	percent per year		
Treasury Bonds	3.56	8.58	-0.34
Long-Term Corporate Debt	3.90	9.75	-0.30
Residential Real Estate	7.73	3.80	+0.47
Farm Real Estate	10.63	7.90	—
Corporate Stock	12.49	17.17	+0.04
Consumer Price Index	4.58	3.87	+0.36

[a] Source: *Farmland As An Investment Alternative*, by Sherrick, Foster and Irwin, Ohio's Challenge, Summer 1990, Vol. 3, Issue 2, Tables 1 and 2.
[b] Average risk = The average yearly percentage variability in returns from that type of investment.
[c] Correlation With Farm R.E. = A number between 0 and +1 indicates that the assets' returns tend to move in the same direction; a 0 to -1 indicates that the assets' returns move in opposite direction.

degree of correlation among investment alternatives in terms of changes in returns—both cash and appreciation. As noted in the right-hand column of Table 3-1, returns from farm real estate investments tend to move in the same direction as the consumer price index (0.36) and residential real estate (0.47). That is why farm real estate is often thought of as a good hedge against inflation. But it is also why investment in residential real estate generally is not a good way to diversify a portfolio if one also has large holdings of farmland.

By the same token, corporate stocks are relatively neutral as far as their returns being correlated with farm real estate earning patterns. Treasury bonds and long-term corporate debt are negatively corre-

lated with farm real estate, and thus would spread risks better than other options noted.

Evaluating present investment portfolio

With the above as background, there are three broad questions to be answered regarding one's present investment portfolio:

1. **Is the overall risk/return character of the investment portfolio appropriate?**

   As one approaches retirement, it is important that the investment portfolio be a relatively conservative risk, yet be aggressive enough to keep up with inflation. Table 3-2 shows the commonly recommended distribution of assets along risk and return lines for the early retirement years.

   Review the portfolio and determine the percentage of total investments that fall into each of these asset categories. If a fairly high proportion of assets fall into the bottom two categories, consider ways of shifting toward assets that exhibit less risk of loss of principal.

2. **How concentrated and/or highly correlated are the investments?**

   In farming, a large share of a farm family's investment portfolio is often in farmland. If this is the situation, then one probably should not invest in more farmland. In fact, one may want to consider disposing of some of what is currently owned. But exchanging farmland for commercial real estate may not help the situation much, since the risk/return is highly correlated.

3. **Can income taxes be deferred or reduced?**

   Income taxes are another important factor to consider when analyzing an investment portfolio. The question is, can income taxes be deferred or reduced? Increases in the value of farmland is an example of tax deferral. Tax on this appreciation in value is not due until the property is sold. Investments in pension plans and annuities are examples of other tax deferral tools. Investments in municipal bonds and certain government notes are examples of tools that can be used to eliminate income taxes; their income stream is non-taxable.

   With this information and analysis, one should then work with a financial consultant to bring about the desired changes in the asset mix.

Table 3-2. Commonly recommended distribution of assets.

Desired % of Assets	One's Present % Distribution	
40-60%	______	Should go into investments that provide a relatively safe return of 5-7%, with 0% risk of loss of principal.
20-35%	______	Should go into investments that provide a moderate return of 8-9%, with 10-12% risk of loss of principal.
10-20%	______	Should go into investments that provide an average return of 10-12%, with a 15-20% risk of loss of principal.

Protecting the financial situation from health-related costs

One of the major concerns of persons nearing or in their retirement years is that of health-related costs. For example, recent projections[1] suggest that the number of persons reaching 100 years of age will increase rapidly over the next half century: from 72,000 in the year 2000 to 834,000 in 2050. Studies also show that only 1 percent of persons ages 65 to 74 are in nursing homes, while 47 percent of those 95 and over are in nursing homes. As one writer noted: "I'm all for living to 100 or 110. But, if we are going to get 10 more years of life, and eight of them are dependent, then I consider that prolonging dying rather than prolonging living."

One may not live to be 100, but planning as though it's possible is wise. With the ever-increasing ability to treat various life-threatening illnesses and their resultant effect on one's life span comes the reality that health costs and associated home care or nursing home care costs can devastate a retiree's financial situation. It will likely continue to be important to maintain, along with Medicare and Medicaid programs, a good supplemental health insurance program. But the $64 question is what to do about long-term care!

[1] *St. Paul Pioneer Press*, June 22, 1998, pp IA and 4A.

The nursing home/long-term care issue—a brief look

At the present time, about 50 percent of nursing home patients pay their own way; 1-2 percent rely on long-term care insurance, while the remaining patients' costs are paid for by the government through the Medicaid or Medical Assistance program.

The group impacted the most by long-term care costs are persons with moderate-sized estates. Persons with very small estates will likely be covered by Medicaid, while at the same time the community spouse (the spouse residing outside the nursing home) is allowed set amounts of income and the retention of a specified amount of assets for his/her own use. At the other extreme, persons with large estates will likely be in a position to cover nursing home care costs out of investment earnings, without having to invade their asset base to any marked degree.

However, persons with net assets in the $200,000 to $800,000 range are faced with three choices:

- Invade the asset base to meet nursing home care costs in excess of investment earnings.

- Buy long-term care insurance to cover costs. The present status of long-term care insurance is experiencing the normal growing pains associated with a new product. But, there are several good products on the market now. Over time, there will likely be improvements in this type of insurance, and/or a government health care program may provide for at least part of this cost. In the meantime, explore other ways of protecting holdings.

  One approach that has considerable merit is to buy additional second-to-die life insurance with the funds that might have been spent on long-term care insurance. This insurance coverage would be used to offset at least part of the asset erosion that might have occurred while the committed spouse was in the nursing home. This would benefit the surviving spouse and/or the heirs.

- Consider ways of avoiding paying one's own way. As with other government-related stopgap programs, there are a number of options available to protect or dispose of one's assets so that the government will end up paying most of the longer-term health care costs. Possible tools that might be employed include:
  - Selling or gifting of assets to persons other than spouse.
  - Placing assets in an irrevocable trust.
  - Deeding a remainder interest in a property while retaining a life estate.
  - Placing property in a charitable trust.
  - Purchasing selected annuities.

The Federal rule now says that sales and gifts of property must have been made at least 60 months (5 years) prior to a person's entrance into a nursing home or required home health care. Sales and gifts occurring within this 60-month window are subject to a formula that will determine what care cost payments must be made by the individual before Medicaid begins. The other tools for shielding assets are not sure things at this point, as they will need to be tested on a case-by-case basis in the courts. (State law may apply, which may involve a shorter period of eligibility for Medical Assistance. For example, at present Minnesota has a three-year eligibility requirement.)

The nursing home care issue will continue to be in a state of flux for the foreseeable future as the government attempts to provide adequate income and assets to the community spouse, while trying to invalidate care cost avoidance techniques of those persons who are able and should pay for their own care. But the most important bit of advice is: **Don't be so bent on avoiding nursing home care costs as to end up penniless while still in good health.** Remember, it's possible to be lucky enough to die on the golf course, rather than in a nursing home. Or, as Bob Luening, Professor Emeritus of the University of Wisconsin suggests in jest, "Get shot by a jealous husband!"

Advance directives: The living will and/or durable power of attorney for health care

There are two possible legal tools to consider when protecting a financial situation from excessive long-term health care costs. The first is the **living will.** This is a statement prepared and signed by an individual expressing wishes for medical treatment in the event of a **terminal**

condition. Several states have developed special forms and instructions for developing a living will. However, it is important to review a proposed living will with one's doctor to make sure it is worded properly and to be sure that it gives the doctor(s) adequate guidance should such a situation develop.

Another legal tool that is receiving increased use is the **Durable Power of Attorney for Health Care**. This document appoints a person (or institution) as the agent to make any health care decisions for an individual when, in the judgment of the attending physician, the individual is not able to make decisions or communicate them. The durable power approach provides *greater flexibility* than the living will in that it can also be used in non-terminally ill situations. It also provides a designated person to ensure that one's health care wishes are followed, *instead of depending on a piece of paper and a doctor.*

Providing management of affairs in case of incapacity

Another potential health-related cost is a situation in which one becomes incapacitated and is not able to manage affairs. In such a case, one will likely incur what is often termed living probate costs. Such a situation requires the courts to provide for the management of affairs—thus the term living probate.

This situation can be avoided by having in place a **durable power of attorney**. This document provides that a specified person or institution be given the power to manage an individual's affairs if he/she were to become incapacitated and unable to make decisions. Another planning tool that is used more commonly is the **revocable trust**. The revocable trust (commonly referred to as the living trust) provides for a co-trustee who would manage the affairs if necessary. This tool can also be useful when/if one reaches the stage of not wanting to be bothered with managing affairs, even though one is still healthy and competent. The revocable trust is not for everyone. However, the revocable trust is a very flexible tool. Assets can be taken out of the trust, as it is revocable. It also provides necessary management help, if the situation warrants such help

Question 3. Does the present estate plan adequately protect the spouse and treat heirs fairly?

As indicated at the beginning of this chapter, the retirement years are difficult ones to plan. One thing is certain, however: no one lives forever. Therefore, it is important to review any existing estate plan and make needed adjustments periodically.

The focus in this segment is whether the present estate plan: (1) adequately protects the spouse's financial security; and (2) treats the heirs fairly. (The next segment deals with the issue of whether the present estate plan adequately protects the estate from unnecessary estate settlement costs and estate taxes.)

Does the present estate plan provide adequate financial security for the spouse?

The overriding concern when developing or updating estate plans should be that of protecting the spouse's financial security. Certain items of property pass directly to the surviving spouse upon one's death. These include:

- Joint tenancy property, which passes directly to the surviving joint tenant—usually the surviving spouse.
- Life insurance proceeds, which pass to the

designated beneficiary of your policy.

- Property held in a revocable or irrevocable trust or a retained life estate. **Any remaining property will be distributed according to the written will or the so-called State's Will.**

Dying intestate–without a will

If there is no will at the time of death, property will pass according to the intestate statutes of the state of residence. These statutes keep changing, generally in the direction of providing more financial security for the surviving spouse. If one has no will at present, compare the state's will with intentions for the property. If the state's will is unsatisfactory or incompatible with the situation, create a personal will.

Developing/changing one's own will

There are several **requirements** that must be met in order for a will to be valid:

1. One must be at least 18 years.
2. One must be of sound mind and not unduly influenced by any person mentioned in the will.
3. The will must be in writing, and the signing must be witnessed by two disinterested parties.

To make a will self-proving, and to allow the will to be recognized in other states, it is highly recommended that one's signature and those of the witnesses to the signing be notarized.

- **The simple, "I love you" will**

The vast majority of wills drafted in the United States are **simple wills**. If there is a surviving spouse involved, and with the unlimited marital deduction provision of the present estate tax law, one can pass all property to the spouse, tax-free. One can also pass part of the estate to heirs, providing the spouse is not disinherited in the process. That is, a surviving spouse cannot be put in a position where he/she would be worse off financially than under the provisions of a state's will.

A will, of course, indicates the desired property distribution in case one precedes the spouse in death. With the simple will, one can also designate a **personal representative**—the person who will take responsibility for settling one's affairs upon death. Wills can also provide a **guardianship arrangement** for a minor or special needs child.

The simple will also can be made more complex, but yet more flexible. It can contain provisions for providing management assistance for a surviving spouse. It also can contain a disclaimer option that would put a portion of the assets in a **credit trust**, as described in the next segment of this chapter.

- **Revoking or changing a will**

A will can be revoked by the individual, at any time before death, providing one can meet the above standards for a valid will as the new one is developed. Minor changes can be made to the present will by attaching a properly prepared codicil. Such a codicil indicates the section(s) of the present will being changed and the new wording or provision being inserted.

Developing a list bequeathing tangible personal property

In addition to a will, one should also consider developing a written statement or listing of tangible personal property and the designated beneficiary—the person(s) to whom the property should go upon one's death. This would include personal effects, heirlooms, and selected household items. Disagreements and hard feelings can develop among heirs if such a list is not in place.

This list can be changed periodically, without affecting the will. **However, the existence of such a listing should be mentioned in the will. Otherwise, the validity of such a listing could be challenged.** A sample bequest form is provided at the end of this chapter.

Providing the surviving spouse with management assistance

Often it is necessary and/or desirable to provide the surviving spouse with management assistance. This assistance can be informal, where one of the children simply helps manage the surviving spouse's affairs. More formal arrangements might

take the form of a revocable (living) trust, or a marital trust as part of the will. These more formal arrangements must be in place prior to one's death, or be included as part of the will.
A durable power of attorney could also provide such assistance.

Does the present estate plan treat heirs fairly?

Obviously, one should first be concerned whether the surviving spouse will be adequately cared for. But possibly a more troublesome aspect may well be the treatment of heirs. Usually, they are treated equally **under state intestate law**. If there is a farming heir or possibly a handicapped person involved, equal treatment may be the worst possible scenario. One has merely passed the problem on to the heirs, rather than dealing with it in a fairer manner under one's own will or trust arrangement.

Therefore, one must evaluate the present financial and family situation to determine what might be considered fair treatment of heirs. If the farm business is not going to be continued as an on-going operation by one or more of the heirs, providing for fair treatment is usually a relatively simple process. There are several questions that need to be addressed however. First, what has been done for each heir to this point? This might have involved selected gifting, providing for a college education, etc. Second, what has each heir done for the parent(s)? One or more may have provided for support and care. Others may have done little. Third, are there special needs of one or more heirs?

The next step is to develop provisions in the estate plan that reflect the answers to the above questions. *Remember: fairness is in the eye of the beholder*. For some parents, fairness means equal treatment; for others it may involve disinheriting one or more of the heirs. It's a personal decision!

If the business is to be continued by one or more heirs, the fair-treatment-of-the-heirs issue becomes much more complex and important. The next chapter, Chapter 4, contains a detailed discussion of this fairness issue when the business is to be continued. Even if a business isn't being continued, some of the tools and strategies discussed may have application for one's situation.

Question 4. Does the present estate plan avoid excessive estate settlement costs?

Death-time estate plans should also protect the estate from excessive estate settlement costs and estate taxes. Here, the focus will be on managing estate settlement costs.

When death occurs, the person's estate must be settled. This involves appraisals to determine property values, notification of creditors, court costs, and personal representative and attorney fees. The typical cost of such a process is in the order of $1,500 and up, though there are usually simple probate procedures for smaller estates. Check to see if a given state has such a provision.

Generally, the cost of settling an estate is more closely tied to the amount of planning that *has not been done*, rather than to the size of an estate or the complexity of a plan. There are two major ways of reducing settlement costs: (1) having affairs in good order; and (2) reducing the amount of property that is subject to probate.

Having affairs in good order

If one's personal representative, accountant, or attorney has to spend a lot of time trying to figure out one's affairs, it's going to cost the estate needless expense. This search-and-find process also tends to involve family members at a time when they are trying to adjust to the loss of a loved one. Thus, having affairs in good order is not only comforting to all concerned while one is living; it

also reduces the cost of estate settlement. Completing and updating Worksheet 3-1 (see end of chapter) will be of considerable help for those charged with settling an estate.

Reducing the amount of property that is subject to probate

The purpose of the probate process is to:

- Prove the will (validate it).
- Establish clear title (ownership) of assets.
- Assure that creditors are paid off.
- Establish the rights of heirs to the property.
- Pay necessary estate settlement costs and related taxes.

The property that must be probated includes property held in sole ownership or tenants in common. Property that does not have to be probated (non-probate property) includes:

- Items held in joint tenancy.
- Life insurance policies with designated beneficiary.
- Property in a revocable (living) trust at the time of death.

The key point here is that non-probate assets do not have to be probated because the person(s) who will receive property upon one's death is/are already specified in the document. For example, with joint tenancy property, the decedent's interest in the property passes outright to the surviving joint tenant. However, care must be taken not to get carried away trying to save on probate costs and end up with an even larger attorney's fee, or having to pay unnecessary estate taxes.

Question 4b. Does the present estate plan avoid excessive estate taxes?

Estate taxes are primarily the concern of persons with relatively large estates. In this segment, the Tax Act of 2001 will be reviewed. This is followed by a discussion of strategies and planning tools for managing estate taxes with various sized estates.

Review of Tax Act of 2001

The 1976 Federal Estate and Gift Tax Law provided that each individual in the United States would have a so-called unified credit. This credit was designed to offset at least a portion of any potential tax on taxable gifts made after that date during one's lifetime, as well as the person's resultant net estate at time of death. The term unified means that if a portion of the credit is used to offset taxable gifts during one's lifetime, the credit available at one's death is reduced by that amount. For example, if one uses $200,000 of the unified credit to offset taxable gifts, the credit available to offset estate taxes would be $800,000 in 2003. See table 3-3.

Several changes have been made in the tax laws since that time, particularly as to the size of a person's unified credit. The most recent change occurred with the passage of The Economic Growth and Tax Relief Reconciliation Act of 2001. Table 3-3 provides a summary of the scheduled changes in estate, gift, and generation-skipping exemption amounts over the next ten years, as well as changes in tax rates and basis. For example, the Estate Tax Exemption—or unified credit—is scheduled to increase from $1 million in 2003 to $3.5 million in 2009. In 2010, the Estate Tax provision would be repealed, with the tax rate falling to 0 percent. The inherited basis in the property shifts from a stepped up basis or the value used in the decedent's net estate, to carryover basis. In this latter case the heirs would receive the property with the decedent's basis in it. This essentially would shift the tax burden from the decedent to the heirs. In 2011 the tax exemptions and rates revert to 2002 levels.

The tax exemption for generation skipping trust arrangements from year 2004 through year 2011 is the same as a person's exception amount or credit. By contrast, the gift tax exemption stays at $1,000,000 throughout the period. Tax rates on estates, generation skipping trusts, and gifts decline slightly until 2010, when the rate falls to 0 percent, and reverts to the 2002 level in 2011.

Table 3-3. Economic growth and tax relief reconciliation act of 2001 estate, gift and generation-skipping transfer tax provisions.

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Estate tax exemption amount	$675,000	$1 million	$1 million	$1.5 million	$1.5 million	$2 million	$2 million	$2 million	$3.5 Million	Repealed	$1 million
Generation skipping transfer (GST) tax exemption amount	$1,060,000	Adjusted for inflation after 2001	adjusted for inflation after 2001	$1.5 million	$1.5 million	$2 million	$2 million	$2 million	$3.5 Million	Repealed	$1 million
Gift tax exemption amount	$675,000	$1 million	$1 million	$1 million	$1 million	$1 million	$1 million	$1 million	$1 million	$1 million	$1 million
Estate, GST, & gift tax top rate	55%	50%	49%	48%	47%	46%	45%	45%	45%	0%	55%
Basis of inherited property	Step up	Step up	Step up	Step up	Step up	Step up	Step up	Step up	Step up	Carryover basis	Step up
Example state death tax credit for Minnesota	Available	Reduced 25%	Reduced 50%	Reduced $75	Repealed and replaced with state death tax deduction	State death tax deduction	State death tax deduction	State death tax deduction	State death tax deduction	Not applicable estate tax repealed	State death tax deduction

The basis of inherited property remains at a stepped up basis throughout the period, except in 2010 when a carryover basis applies. The state death tax credit will depend upon laws in each state. The bottom line shows the provisions for Minnesota.

This is obviously a difficult tax law to plan around. If this Tax Law is not changed, one should plan to die in 2009 or 2010, and certainly not in 2011. Since most people will live to 2011 and beyond, one must plan carefully. But, it is likely that Congress will make changes in the law before we get to those later years.

The following are some guidelines to consider when planning in this uncertain environment. Making effective use of the unified credit in a husband-wife situation will be illustrated.

Planning tools to consider when combined estates of husband and wife fall within two unified credits in size

If Step 2 of Worksheet 3-1 determines that the individual or combined estates of a husband and wife exceeded the unified credit for a given year, ($1 million in 2003), it is important to explore ways of reducing the potential estate tax burden. Possible tax-reducing strategies for the husband and wife situation, where their combined net estate is valued between one and two unified credits will now be discussed. For the year 2003, it would involve estates between $1 million and $2 million. Table 3-3 shows the changes in the size of unified credits after 2003.

Table 3-4 shows the tax impact of selected planning tools when dealing with a $2 million estate if both spouses died in 2003. In the example it is assumed that the first to die owned all of the assets. Two traditional estate management tools are compared with the Credit Shelter Trust arrangement in terms of the estimated tax that would be owed on the second death. The following are some tax management/estate planning tools to be considered.

Avoid joint tenancy and simple wills

When estates are larger than one of the spouses' unified credits, then owning property in

Table 3-4. Estimated estate tax on $2,000,000 estate if husband and wife both die in 2003, using alternative planning tools.

	Joint tenancy/simple will		Credit Shelter Trust	
	First Death	Surviving spouse	First death	Surviving spouse
Net estate, beginning	$2,000,000	0	$2,000,000	0
To surviving spouse	—	$2,000,000	—	$2,000,000
Taxable estate	0	$2,000,000	$1,000,000	$1,000,000
Unified credit	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Taxable balance	0	$1,000,000	0	0
Estimated estate tax	0	$490,000	0	0

joint tenancy should be avoided. Each spouse has an undivided half interest in the property. Therefore, upon the first death, the property passes directly to the surviving spouse. This provides maximum financial protection for the surviving spouse. But, upon the surviving spouse's death there may be a substantial estate tax, as all of the property would be in that person's estate. In the example above, $490,000 of unnecessary tax would be owed.

Simple wills can have a similar effect on security versus tax management aspects. With the typical simple will, at the first death all assets pass to the surviving spouse. With this approach, the only unified credit that could be used would be that of the surviving spouse. Of course, the surviving spouse can disclaim portions of the first-to-die's estate. However, the disclaimed property would pass outright to the surviving heirs. The disclaimer approach saves taxes, but the surviving spouse has no control over the disclaimed property and would thus forgo income from the disclaimed property.

Using the credit shelter trust

One of the most common ways of reducing estate taxes is through the use of the Credit Shelter Trust arrangement. See table 3-4 . Here, the individual would have two trusts as part of his or her will. The first would be a Marital Trust, or A Trust. The second would be a Credit Shelter Trust, or B Trust. With this arrangement, a portion of one's estate can be put into the A Trust and a portion into the B or Credit Shelter Trust. In the example above, the first to die would call for one half of the $2 million estate to be put in the Marital Trust, and the other half placed in the Credit Shelter Trust. This approach would avoid all estate taxes if both spouses died in 2003.

Under provisions in the Credit Shelter Trust, the surviving spouse receives the income from the trust. But, that person cannot invade the underlying principal in the Credit Shelter Trust without the trustee's permission. Upon the surviving spouse's death, the underlying principal of the Credit Shelter Trust will pass tax free to the designated beneficiaries, who have held a remainder interest in the property since the first spouse's death.

Two major notes of caution!!!

With the rapidly increasing size of the unified credit under current law (Table 3-3), a spouse might inadvertently cause the bulk of one's estate to pass into the Credit Shelter Trust (B Trust), with very few assets remaining to be distributed to the surviving spouse through the Marital Trust (A Trust). Therefore, one should consider either modifying the formula for distributing the assets among the A and B trusts or include a disclaimer provision. Probably the best method would be to have all of the assets pass to the surviving spouse and have in place a right of first refusal or a provision where the surviving spouse can disclaim portions of the estate, with those assets passing to the heirs via the B Trust.

Another important situation to watch for is the relative size or balance of the estates of both spouses. As can be seen in Table 3-5, a large, totally unbalanced estate will incur the same estate tax liability under a Credit Shelter Trust as with a simple will, if the wrong spouse dies first—wrong meaning that the spouse with the limited asset base dies first. With the Unlimited Marital

Table 3-5. Federal estate tax liability with unbalanced and balanced estates using the Credit Shelter Trust.

	Unbalanced Credit Shelter Trust		Balanced Credit Shelter Trust	
	First death	Surviving spouse	First death	Surviving spouse
Net estate	0	$2,000,000	$1,000,000	$1,000,000
To spouse	—	0	0	0
Taxable estate	0	$2,000,000	$1,000,000	$1,000,000
Unified credit	$1,000,000	$1,000,000	$1,000,000	$1,000,000
Taxable balance	0	$1,000,000	0	0
Estimated estate tax	0	$490,000	0	0

Deduction provision in place, balancing an unbalanced estate is relatively easy. Psychological factors—giving up ownership and concern as to what the surviving spouse might do with the assets—often stand in the way of this necessary balancing process to occur.

The example above illustrates the need for a balanced estate. The balanced estate essentially works as an insurance policy against the wrong spouse (spouse with limited assets) dying first. With current tax law, which permits unlimited gifting between spouses, balancing estates merely involves getting the job done with the aid of an attorney and tax consultant.

Legal life estate

Probably the simplest approach for making effective use of the unified credit is the **legal life estate**. With this approach, the surviving spouse is granted (by will) a life estate in the property up to the size of one unified credit of the deceased spouse's estate. The surviving spouse receives any income from the property for life, and must provide for the maintenance and management of the property.

Since the surviving spouse has no control over the disposition of this property, it will pass tax-free to the children at the surviving spouse's death, thus providing a major tax savings. Legal life estates should be avoided, however, if the surviving spouse will need management help, and particularly if the spouse might require financial support in excess of the income earned by the property. Invading the underlying value of the legal life estate property is difficult, since consent of all residual parties is required, including spouses of the heirs. By contrast, invading a credit trust requires only the sanction of the trustee.

Outright to the children

Another way of shielding an estate from excessive tax is to pass part or all of the unified credit-equivalent property outright to the children at the death of the first spouse, rather than giving them a remainder interest in the property. This reduces potential estate taxes on the second death just like the life estate and credit trust approaches do. It does, however, reduce the amount of property available to the surviving spouse and, thus, does not provide as much financial security for the survivor as the others do. This approach is best used in very large estate situations, in which the spouse would be well taken care of even if the unified credit portion passes outright to the heirs at the first death.

Generation-skipping trust

With very large estate situations, and/or where heirs (children) have been financially successful as well, consider bypassing a generation, with part of the estate going to grandchildren. Here, a generation-skipping trust could be used, which would provide income for life for heirs, with the property eventually passing to individuals one or two generations removed, as designated in the trust. Under current law, an exemption from about $1,000,000 in 2003 to $3.5 million in 2009 per transferor (person making the bequest) can be used for this purpose. Transfers in excess of this amount are taxed at a flat rate equal to the maximum federal estate and gift tax rate.

Tax management strategies for estates larger than unified credit limits

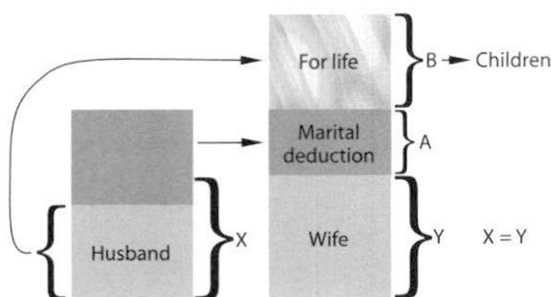
A single person with a net estate above one unified credit, or a husband and wife above two unified credits, will need to consider additional tax management strategies to those described above. Three such strategies will now be discussed:

1. Gifting and selling of assets.
2. The family owned business exclusion.
3. Special use value option.

The optimal size of the marital deduction is influenced by life expectancy of the survivor, expected return on deferred dollars, expectations about inflation or deflation, and expectations as to changes in the tax system. Work with a tax consultant to implement the best strategy.

Gifting/selling assets

Gifting of assets prior to death reduces the size of an estate. One can give tax free each year $10,000 each to as many people as desired ($20,000 if spouse also participates or consents). (Since 1999, this annual gift exclusion has been adjusted for inflation annually.) But with a larger estate, one may want to give more than this amount per year. This is particularly true if one is gifting assets that will likely inflate in value over time. Gifts above these accrued amounts will be considered taxable and will decrease the person's gift tax exemption.



Selling assets might also reduce the size of the estate, but may result in a capital gains tax. But, if one sells some of the higher basis property, the amount of capital gains would likely be small. In any event, the maximum tax rate on net long term capital gain under the 2001 Tax Act for these persons in the 27.5 percent or higher tax bracket qualifying assets held by an individual for more than 12 months is 20 percent. The rate drops to 10 percent if the individual tax rate is 10-15 percent. Starting in 2001, these rates drop even further on assets purchased and held 5 years. This compares with a minimum tax rate of 50 percent on estate amounts above the unified credit limit for that year. However, with sales, the question is: what will one do with the proceeds? Investing them well may actually increase the size of the estate, rather than reduce it.

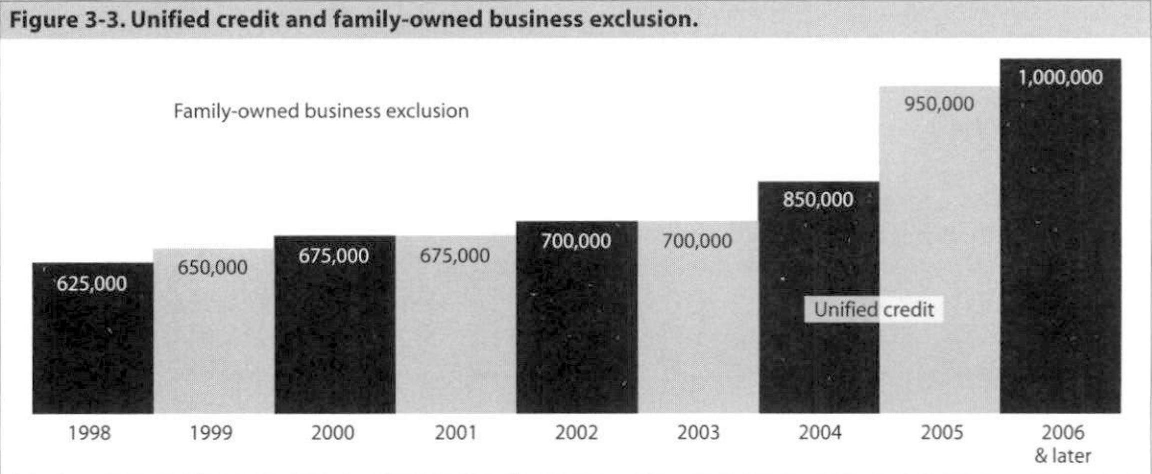
Qualifying for and electing the family-owned business exclusion[2]

The 1997 Tax Act included a new family-owned business exclusion provision. Under this provision, beginning in 1998, an exclusion of $1,300,000 can be used, providing certain requirements can be met. It is likely the exclusion amount will be increased to ease the tax burden on small business owners. There are also recapture provisions should certain requirements not be met later on.

- **Qualifying requirements**
  - The executor or personal representative must elect to use the exclusion and file an agreement of personal liability for possible recapture or repayment of the tax benefits.
  - The aggregate value of the decedent's qualified family-owned business interests must exceed 50 percent of the adjusted gross estate (gross estate less allowable deductions). Assets are to be valued at their fair market value.
  - The decedent or member of the decedent's family must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's retirement, disability or death.
- **Recapture rules**
  - The exclusion rules levy a recapture tax if, within 10 years of the heir's death and

[2] *Recent Developments in Tax Law (Including the Taxpayer Relief Act of 1997)*, by Neil E. Harl, Paper presented at Annual Meeting of the Minnesota chapter of The American Society of Farm Managers and Rural Appraisers, Minneapolis, MN. Feb. 5, 1998.

Figure 3-3. Unified credit and family-owned business exclusion.



before the qualified heir's death, a recapture event occurs. Recapture is triggered by any one of several events.

- Absence of material participation by the qualified heir or a member of the qualified heir's family for more than three years in any eight-year period ending after death causes recapture.

- The recapture rules phase down the recapture tax based on the number of years of material participation as follows:

Recapture event occurs following years of participation	Percentage of recapture tax due
1-6	100%
7	80
8	60
9	40
10	20

- Recapture occurs if the qualified heir disposes of a portion of a qualified family-owned business interest other than to a member of the qualified heir's family or through a qualified conservation contribution.

Qualifying for and electing the special use valuation option

The current estate tax law permits the personal representative to elect a so-called special use valuation procedure that can reduce the value of real estate in an estate by up to 50 percent or more, up to a maximum reduction of $750,000 per estate. From the standpoint of the surviving spouse, this is a secure way of reducing the size of the estate, since only the taxable value of the estate has been reduced, not the total amount of underlying property held.

If considering this approach as part of an estate plan, one should become familiar with the requirements of the provision and take steps now to ensure that the estate will meet the qualifications. A brief description of the special use valuation option follows.

■ Valuation procedure

Under this procedure, the special use value of real estate is determined by dividing the per acre cash rent minus property taxes for comparable land for the past five years, by the previous five-year average Federal Land Bank (FLB) interest rate for the district of residence. For example:

$$\frac{\text{Gross cash rent - property taxes/Acre}}{\text{FLB interest rate}} = \frac{\$100 - 10}{.09}$$

$$= \frac{\$90}{.09} = \$1{,}000 \text{ special use value}$$

Using a more typical capitalization factor of four to five percent, the fair market value of this land would be around $2,000. Thus, normally a substantial reduction in the estate value is obtained using the special use approach. The rules passed in 1981 indicate that if cash rental data are not available for use in this formula, crop share rents can be used.

- **Qualifying property for special use**

  To qualify for this special valuation procedure, several tests must be met:

  - The value of the farm or other closely-held business real and personal assets less debts attributable to the property, must equal at least 50 percent of the adjusted value of the gross estate, and must pass to a qualified heir or heirs. Qualified heirs can be any member of the decedent's family.

  - At least 25 percent of the adjusted value of the gross estate must be qualified farm or business **real** property.

  - The decedent or a member of the decedent's family must have owned the real property and must have participated materially in managing the farming operation for five or more of the eight years preceding death, disability, or retirement, and receipt of social security.

  - The decedent or a member of the decedent's family must also have had an equity interest (assumed some risk) in the property for five or more of the eight years prior to and at the time of death. A cash or crop share lease to a family member qualifies as an equity interest. But, if the property is leased to a **non-family member**, it must be a crop share rental arrangement.

  - All who have an interest in the property must agree in writing to the election of this valuation procedure. They must also agree to the payment of any additional tax if the land is disposed of or managed so as to trigger recapture of part or all of the tax benefits from the special use valuation. This includes renting the land to a non-family member on a cash rent basis (see above).

- **A special lien is imposed on the real property for which the election is made.**

  This is for the purpose of recapturing any estate taxes due if special use provisions (see below) are violated. The Treasury Department may subordinate the special lien to other obligations, if sufficient collateral exists to adequately protect the Treasury's interest.

- **Recapture provisions**

  Recapture of the tax savings is triggered if within 10 years of the decedent's death:
  1. The farm is sold to a person other than a qualified heir.
  2. The use of the land is changed to some nonqualifying use.
  3. The heirs fail to meet the material participation test in more than three years of any eight-year period that ends within ten years after the decedent's death.

  The material participation test for a spouse or qualified heir who is a student, a minor, or disabled, is defined as active management, which means making management decisions, but does not require making daily operating decisions. For other qualified heirs, a cash rent arrangement can be used during a two-year grace period to meet the qualified use (equity interest) test. **But once the two years have passed, at least a crop share lease must be used to avoid recapture.**

  If planning to use this special use valuation procedure, check carefully to ensure that the material participation and equity interest requirements can be met. Also, be sure to meet the real and personal property percentage requirements. These rules may also influence the kind and amount of property that should be transferred to others before death.

Providing sufficient liquidity to make an estate plan operable

After evaluating an estate situation and having selected a possible death-time transfer plan, check to see if there is sufficient liquidity to meet various estate settlement costs and taxes. There are several options for reducing the burden of meeting these costs. These include:
1. Using the deferred payment of tax provision.
2. Paying the taxes from savings or sale of assets.

3. Using life insurance.
4. Borrowing money to meet payments.

Option 1. Deferring payment of estate tax

One way to ease the consequences of paying estate taxes and settlement costs is to spread the payments of estate taxes over a period of years. The following provisions of the law permit deferred payment of estate taxes:

- One-year extension of payments. For deaths after 1976, a one-year extension of time to pay the federal estate tax may be secured by providing **reasonable cause** (as compared to the old law, which required proof of undue hardship). Interest on the deferred payment is at the prime rate, adjusted periodically.

- Fifteen-year installment payment. Eligibility requirements include:

- A closely-held business must make up more than 35 percent of the adjusted gross estate. Improvements to the farm residence and other buildings are included if the buildings are occupied on a regular basis by an owner, tenant, or employee.

- With this plan, the federal estate tax can be totally deferred for five years after death, with the tax paid in up to ten equal annual installments thereafter. Interest must be paid on the unpaid balance annually. But the interest rate is at two percent (compounded daily) on the tax due on the first $1 million of taxable estate, less the allowable unified credit—attributable to the business. For the year 2000, for example, the eligible amount could range from $675,000 and $1,675,000. First calculate the tax on the total estate within this range and subtract $220,550 unified tax credit to arrive at the tax due. The interest rate is increased to 45 percent of the adjusted prime rate on taxes due above this amount.

- Eligibility is lost if 50 percent or more of the closely-held business is disposed of during the 15-year period.

- A lien may be placed against "real and other property" expected to survive the deferral period to the extent of the tax plus interest. This lien can be subordinated to superior priority type obligations.

The economic benefit from delaying tax payments that are subject to only a two percent interest charge can be considerable. Depending on the interest rates for borrowing or saving, the net savings from delaying payment of the tax may be sufficient to pay the original tax burden plus the interest charge on the unpaid tax bill.

Option 2. Savings or sale of assets; stock redemptions

If the earnings accrued from the delayed payment plan are not sufficient to pay taxes, costs, and debts, necessary liquidity may be available in the form of savings, or sale of assets. If the decedent's farm was organized under the corporate form, a special provision for stock redemption under Section 303 of the Internal Revenue Code may help meet estate settlement costs and estate taxes.

Option 3. Life insurance

No liquidity problems should exist if the business is to be sold at death. However, if the business is to be continued by a farming heir or the farm is to be held in the family, a liquidity crunch may develop. When analysis of the current liquidity position suggests a problem, consider investing in more life insurance. Also consider the funding of a buy-sell agreement that would place one's farming son or daughter in a stronger financial position to control the business should something happen to the retiree and spouse. (See Chapter 4 for a more detailed discussion of this strategy.)

Option 4. Borrowing to meet settlement costs and taxes

Borrowing money to meet these costs may also be a good option, particularly if conditions suggest that the sale of property to meet these commitments would not be a wise move, taxwise, at the time.

Application: Selected financial situations; business to be discontinued

In Chapter 2 and preceding segments of this chapter, the process of developing a satisfying retirement lifestyle and financial security concerns of the parents was discussed. The process of firming up retirement and estate plans for two very common, but entirely different, financial situations will now be illustrated: (1) the marginally adequate to inadequate financial situation; and (2) the adequate to very adequate financial situation. However, it is assumed that they do have one thing in common: *the farm business is not likely to be continued as a separate entity by a family member or unrelated party*. The business-to-be-continued situation is discussed in Chapter 4.

Situation 1. The marginally adequate to inadequate financial situation

If financial analysis shows that the financial base is likely to be marginally adequate to inadequate in meeting the expenses associated with committed or desired retirement lifestyle, one must first decide how best to reconcile the income/lifestyle cost dilemma. The discussion begins on this note. Then, some concerns relative to lifestyle and health, followed by a discussion of financial management and asset transfer plans, including the resultant fair treatment of children are discussed.

Reconciling income/lifestyle cost dilemma

If one's financial base has been deemed to be marginally adequate to inadequate relative to providing some desired level of living, the options are quite limited relative to about 10 to 15 years earlier in one's career. At that time, one could have made adjustments in the business, reduced current family spending, etc., which might have resulted in a stronger financial position for retirement (see Chapter 8, Part II, of this series).

Once one reaches age 60-65, slowing down in terms of farming endeavors may be desired, but reality may require continued farming to 65 and beyond. Or, an off-farm job may be best, while either renting out or selling the farm assets. In any event, full-time retirement will likely have to be delayed to help make ends meet. It may also mean a reduction in one's desired retirement lifestyle. This may involve changes in living arrangements, travel plans, etc.

This reconciliation process should not prevent enjoyment of one's prime time years, however. Reduced farming or part-time work can still leave time for some indulgences, although the activities may cost less or be done closer to home than previously desired or anticipated. And, of course, if one has to continue working into retirement years, it is necessary to take good care of one's health.

Protecting the financial situation from undue risks and costs

Since the financial situation is likely to be marginal at best, one should be particularly concerned about managing financial risks and costs associated with the situation. This may involve changing the farming operation into a less risky mode, and/or diversifying investments. Health care costs can be devastating for persons in this type of financial situation. Therefore, analyze health insurance coverage. Also, take steps to protect and improve overall health through exercise, diet, etc.

Put estate management and asset transfer plans in place

One should also have estate management and asset transfer plans in place.

- **Estate management**

  There are two estate management aspects to be concerned with: (1) management of affairs in case of incapacity; and (2) estate settlement and probate costs. It is important to at least have in place a durable power of attorney so that someone can manage affairs if one should become incompetent or incapacitated. A living will, or durable power of attorney for health care, that will indicate preferred health treatment if one becomes temporarily incapacitated or terminally ill, is also highly recommended.

A revocable (living) trust would provide for the management of affairs, whether one is incapacitated or just wants someone to manage affairs. The living or revocable trust would also reduce estate settlement and probate costs, as the trust provides for the transfer of assets. Consider placing some property in joint tenancy, as it also avoids probate costs.

- **Asset transfer plans/business to be discontinued**

By now children are likely well established in their careers. Thus, one's prime estate planning concern should be to protect the spouse through the use of a simple will, joint tenancy, etc. The business will probably not continue as a stand-alone unit, but rather, it will likely be taken over by another farm operator—who just might be one of the children who "spun-off" from the home farm some time back (see Chapters 2 and 4, Part V of this series). This will likely involve some form of rental arrangement. One may even sell part of the holdings. But be careful with a contract sale in which case one might outlive the stream of contract payments.

As far as the heirs are concerned, equitable treatment in this situation often means nearly equal treatment. Of course, in making this determination, consider what has been done for each child up to this point, as well as what each has done. Do not try to do too much for them too soon. In most cases, the property should pass to the heirs only after the death of the surviving spouse.

Monitoring and adjusting plans over time

In this potentially vulnerable financial situation, one should monitor the financial situation closely and make needed adjustments. Also, continue to check the will and other transfer tools to make sure plans properly reflect financial situation and ultimate transfer desires.

Situation 2. The adequate to very adequate financial situation

If financial projections show that the financial base is likely to be adequate to very adequate in terms of meeting retirement lifestyle needs and desires, one should feel quite fortunate. Most retirees today retire into a less-than-adequate income situation. In addition to a favorable financial situation, one doesn't have to walk the proverbial tightrope that parents find themselves in when the farm business is to be continued by one or more farming heirs. (See Chapter 4.)

But this does not preclude the need to:

1. Firm up retirement lifestyle plans.
2. Protect the business and other assets from undue risks.
3. Have in place an estate management and asset transfer plan that treats heirs fairly and manages estate settlement and related taxes effectively.

Retirement lifestyle

One who owns a business has the privilege of deciding when to retire and how retired to become. But, this much flexibility often results in procrastination over the whole question of retirement. And since transferring the business to a farming heir is not an issue, one has another excuse for not facing up to the realities of retirement.

In a favorable financial situation, one also has a wide range of options relative to retirement lifestyle. Thus, it is important to spend considerable time and money exploring lifestyle options. Follow the process outlined in Chapter 2 and really test out the options. The more things one tries, the more likely one will find things to enjoy outside of farming. This is an ideal situation for developing a very meaningful and satisfying retirement lifestyle. Don't waste the opportunity!

Protecting the financial situation from undue risks and costs

Given a desirable financial position, be sure to enact means of protecting the financial situation from financial and health risks. Be sure to review earlier sections in this chapter relating to investment risk management and catastrophic health risks.

The estate may also be of a size where estate taxes are of a concern. Explore the possibility of trust arrangements and balancing estates (retiree's and spouse's). Also consider some gifting of assets to heirs to take advantage of the annual gift exclusion of $10,000 per recipient per year ($20,000 if spouse consents).

Having estate management and asset transfer plans in place

Since there is a fairly large bundle of assets to be managed, establish management provisions in case one becomes incapacitated or dies. This might include a durable power of attorney or possibly a revocable (living) trust. Also consider having at least a marital trust in the will, so that the trustee could help with management. If the combined estates are above the unified credit for that year, then consider a credit trust. (See the discussion of the credit trust on page 33 of this chapter.)

Since it has also been decided that the business will not be continued as a going operation by the heirs, place high priority on protecting one's own financial security, unless there is a special need situation among heirs. Thus, one probably should hold onto the property as long as it is consistent with good tax planning and existing family needs. Options include:

1. Holding on to the farm and either operating it or leasing it out.
2. Selling the farm to one or more heirs or to an unrelated party.
3. Exchanging the farm for other like property.

Fair treatment of heirs should be a relatively simple matter if past treatment and special needs are taken into account. Heirs, in turn, will have to decide whether they will keep the farm as an investment or dispose of the property. With the exception of the special family need situation, transfer planning alternatives will be influenced by particular estate situation, projected financial needs, and the potential impact of taxes on the amount of assets available for transfer to heirs. Refer to Chapter 4 for a discussion of asset transfer methods, tax aspects, and strategies.

Selecting, implementing, and adjusting the plans

Having a very favorable financial situation should not preclude one from making a careful selection of estate management and transfer plans. It is also important to begin the implementation of a plan, and make needed adjustments as the situation warrants. Refer to the last section of Chapter 4 for a more detailed discussion of these final steps in the retirement/estate planning process.

Worksheet 3-1. Financial profile and estate planning questionnaire.

Instructions

- **Step 1.** Describe present family situation (page 43).

  Record information about retiree and spouse (if any); list children and/or dependents; and living parents (if any). Also indicate if there are special need situations or other factors that may affect planning.

- **Step 2.** Estimate present net estate (page 44).

  List all the assets retiree and spouse (if any) own or control. These assets should be valued at their current fair market value, and the ownership (husband, wife or joint tenancy) of these assets should be noted in the columns provided. Any liabilities involved should then be subtracted to determine **net estate**. Allocate any joint tenancy property on a 50/50 basis to each spouse and add to the total net estate of each spouse.

- **Step 3.** Record any gifts made since 1976 (page 45).

  Record any gifts made after 1976 (the year a major change was made in the Federal gift and estate tax law). List gifts made under the annual gift exclusion as well as gifts made that exceeded this exclusion in any given year to any given individual. These latter gifts were potentially taxable and will be added back into the total estate upon death. Indicating the amount of previous gifts and to whom they were made will also be helpful in planning the future fair treatment of heirs.

- **Step 4.** Estimate potential estate tax liability (page 45).

  Estimate potential estate tax liability at present. If the combined net estates of retiree and spouse (if any) are near or above the unified credit for the year (see Table 3- 6), complete the tax calculations as outlined. If not, this step can be skipped for now.

- **Step 5.** List current insurance programs (page 46).

  List the insurance protection programs in effect. This includes life insurance, disability income policies, health related policies, etc.

- **Step 6.** Project living expenses and income (page 47).

  First calculate current average cost of living. Then estimate what it might be like during the early years of retirement. Differentiate between committed expenses (living needs), and discretionary expenses, which reflect a desired standard of living.

- **Step 7.** Determine the balance between expenses and income (page 48).

  Estimate present income and the expected income during early retirement years. Then compare expected income with projected expenses. This will indicate the income that will likely be left after meeting committed expenses and discretionary expenses.

- **Step 8.** Sort out financial concerns and priorities (page 49).

  Indicate the importance of several aspects relative to the financial situation. Indicate overall risk tolerance relative to financial matters, and then rank the importance of several financial aspects.

- **Step 9.** Describe the general nature of present estate plans (page 50).

  This includes questions relating to: wills or trusts in place; a guardianship in place for minor or otherwise dependent children; a personal representative to settle the estate; and provisions for managing business affairs should incapacitation or death occur.

- **Step 10.** Indicate estate planning objectives (page 51).

  Record the desired goals to accomplish through estate planning, including for retiree and spouse, for children or other heirs, and for other persons or charities.

- **Steps 11 and 12.** List current financial and estate advisors and location of important documents (pages 51 and 52).

Worksheet 3-1 (continued). Financial profile and estate planning questionnaire.

Step 1. Describe your present family situation.

Name ______________________ Occupation ______________________

Social Security no. ______________________ Date of birth ______________________

Spouse ______________________ Occupation ______________________

Social Security no. ______________________ Date of birth ______________________

Address ______________________ Health–husband ______________________

Phone No. (______) ______________________ Health–wife ______________________

Marital status: Single ______ Married ______ Widowed ______ Divorced ______

Date of marriage ______________________ Date widowed or divorced ______________________

Are you paying child support? Yes ______ No ______ $ ______;

Alimony? Yes ______ No ______ $ ______

Children/dependents (note any special need or handicapped family members)

Name	Date born	Age	Address	Spouse's name	Occupation(s)	Name & ages of children

- Are both of you parents of the children named above? Yes ______ No ______ (If no, indicate relationship in table above.)

Living Parents

Name	Date born	Age	Address	Financial situation/implications

- Note any gifts or inheritances you expect to receive from your parents/others ______________________

Worksheet 3-1 (continued). Financial profile and estate planning questionnaire.

Step 2. Estimate your present net worth/net estate–as of ____________________.
Date

	Husband	Wife	Jointly	
Assets				
Checking accounts	$	$	$	
Savings accounts				
Money market funds				
Cash value, life insurance				
____________				
Sub-total liquid assets	$	$	$	1
Farm assets (use current values)				
Crops and livestock	$	$	$	
Breeding stock				
Machinery/equipment				
Farmland				
Buildings				
Sub-total farm assets	$	$	$	2
Other investments				
Other personal property	$	$	$	
Other real estate				
Bonds/bond mutual funds				
Stocks/stock mutual funds				
Annuities–fixed/variable				
Retirement plans: IRA, Keogh, 401K				
____________				
____________				
Sub-total other assets	$	$	$	3
Other property				
Home furnishings, autos, etc.	$	$	$	
____________				
____________				
Sub-total other property	$	$	$	4
Total assets (1 + 2 + 3 + 4)	$	$	$	5
Liabilities				
Real estate debt	$	$	$	
Personal property debt				
Personal guarantees				
____________				
Total liabilities	$	$	$	6
Sub-total (5 - 6)	$	$	$	7
Allocation of joint property (from line 7)				8
Net worth estate (7 + 8)	$	$		9

Worksheet 3-1 (continued). Financial profile and estate planning questionnaire.

Step 3 - Record gifts made after 1976.

Gifts made under annual exclusion.

Date	To whom	Amount given by	
		Husband	Wife

Taxable gifts above annual exclusion.

Amount given by		Tax paid if any	Face value
Husband	Wife		

Step 4. Estimate your estate tax liability.
(Do this step only if your combined net estate and taxable gifts are over one unified credit in that year.)

	Husband dies first		Wife dies first		
	Husband	Wife	Wife	Husband	
Your net estate (line 9, page 44)	$	$	$	$	1
Marital deduction					2
Charitable deduction					3
Taxable estate [1 - (2 + 3)]					4
Other taxable gifts and taxes after 1976[a]					5
Tentative tax base (line 4 + 5)					6
Tentative tax (from table on page 46)					7
Gift tax paid after 1976, if any					8
Unified tax credit (from Table 3-6 below)					9
Estimated estate tax [7 - (8 + 9)][b]					10
Estimated estate tax, both estates					11

[a] From the table in Step 3.

[b] Assumes state tax equals state tax credit

Table 3- 6. Unified tax credit amounts; by years, 2001-2010.

Year	Asset Amount	Tax Credit	Year	Asset Amount	Tax Credit
2001	$675,000	$220,550	2006	$2,000,000	$780,000
2002	$1,000,000	$345,800	2007	$2,000,000	$780,000
2003	$1,000,000	$345,800	2008	$2,000,000	$780,000
2004	$1,500,000	$555,800	2009	$3,500,000	
2005	$1,500,000	$555,800	2010	Repeal	

Continued on next page

Worksheet 3-1 (continued). Financial profile and estate planning questionnaire.

Step 4 (continued). Estimate your estate tax liability.

Unified gift and estate tax rate schedule

If the amount is:		Tentative tax is:		
Over	But not over	Tax +	%	On excess over
$ 0	$ 10,000	$ 0	18	$ 0
10,000	20,000	1,800	20	10,000
20,000	40,000	3,800	22	20,000
40,000	60,000	8,200	24	40,000
60,000	80,000	13,000	26	60,000
80,000	100,000	18,200	28	80,000
100,000	150,000	23,800	30	100,000
150,000	250,000	38,000	32	150,000
250,000	500,000	70,800	34	250,000
500,000	600,000	155,800	37	500,000
600,000	750,000	192,800	37	600,000
750,000	1,000,000	248,300	39	750,000
1,000,000	1,250,000	345,800	41	1,000,000
1,250,000	1,500,000	448,300	43	1,250,000
1,500,000	2,000,000	555,800	45	1,500,000
2,000,000	2,500,000	--- See tax rates in Table 3-3 ---		2,000,000
2,500,000	10,000,000			2,500,000
10,000,000	18,340,000	--- See tax rates in Table 3-3 ---		10,000,000
18,340,000	---			18,340,000

Step 5. Insurance protection programs in effect.

I. Life insurance policies

Company name				
Policy number				
Type of insurance				
Owner				
Insured				
Primary beneficiary				
Current death benefit	$	$	$	$
Cash surrender value	$	$	$	$
Outstanding loan value	$	$	$	$
Annual premium	$	$	$	$

II. Disability/long-term care insurance policies

Company name	Social Security			
Policy number				
Insured				
Annual benefits	$	$	$	$
Waiting period				
Benefit period				
Annual premium	$	$	$	$

III. Other health-related policies (describe type/costs etc.)

Regular/major medical health insurance ________

Medicare/Medigap ________

Other ________

Worksheet 3-1 (continued). Financial profile and estate planning questionnaire.

Step 6. Estimate expected living expenses.

Committed expenses	Average at present	Expected early years of retirement	
Household			
Real estate taxes	$	$	
Insurance: Residence/personal property			
Utilities, home			
Maintenance/upkeep			
______			
Food (at home)			
Clothing			
Personal care			
Health care			
Drug/doctors (uncovered amount)			
Health insurance			
Transportation			
License			
Insurance			
Fuel			
Repairs			
______			
Other committed expenses			
Life insurance			
Other insurance			
Dependent care			
Alimony, etc.			
Total committed living expenses	$	$	1
Discretionary expenses			
Home improvements			
Entertainment			
Dining out			
Recreation/hobbies			
Travel/Education			
Gifts/contributions			
Savings/reinvest earnings			
______			
______			
Total discretionary living expenses	$	$	2
Total estimated living expenses (1 + 2)	$	$	3

Worksheet 3-1 (continued). Financial profile and estate planning questionnaire.

Step 7. Estimate expected income; income/expense balance.

Income from business/investments	Average at present	Expected early years of retirement	
Adjusted (net) business profits	$	$	
Adjusted (net) rental income			
Taxable dividends			
Taxable interest			
Non-taxable interest			
Total business/investment income	$	$	1
Non-business/investment income			
Wages/salary–self	$	$	
Wages/salary–spouse			
Social Security income–self			
Social Security income–spouse			
Retirement funds (Keogh, etc.)			
Contract for deed payments from others			
Income from annuities			
Total non-business/investment income	$	$	2
Total estimated income (1 + 2)			3
Income/expense balance			
Estimated federal/state income tax on above income	$	$	4
Annual principal and interest payments due			5
Other financial commitments			6
Total estimated income available for living expenses [line 3 - (4 + 5 + 6)]	$	$	7
Total committed living expenses (line 1, page 47)			8
Balance available for discretionary expenses (7 - 8)	$	$	9
Total Discretionary expenses (line 2, page 47)			10
Balance: surplus or deficit (9 - 10)	$	$	11

Worksheet 3-1 (continued). Financial profile and estate planning questionnaire.

Step 8. Sort out financial concerns/priorities.

I. Importance of various financial aspects. [Husband (H) and wife (W) should both complete this part.]

	Very important H	Very important W	Not important H	Not important W
1. Readily available funds for:				
Emergencies	☐	☐	☐	☐
Personal Opportunities	☐	☐	☐	☐
Investment Opportunities	☐	☐	☐	☐
2. Accumulating assets to:				
Provide adequate retirement income	☐	☐	☐	☐
Provide education for children/grandchildren	☐	☐	☐	☐
____________________	☐	☐	☐	☐
3. Protect financial position against:				
Disability, hospitalization, long-term care	☐	☐	☐	☐
Unnecessary income/estate taxes	☐	☐	☐	☐
Business/investment risk	☐	☐	☐	☐
4. Putting affairs in order to:				
Simplify financial affairs	☐	☐	☐	☐
Assure smooth transfer of assets to family while living	☐	☐	☐	☐
Assure smooth transfer of assets to family/others at death	☐	☐	☐	☐

II. Indicate your overall risk tolerance toward investments/financial matters. (circle one)

- Husband .... Safe 0 - 2 - 4 - 6 - 8 - 10 Risky
- Wife .... Safe 0 - 2 - 4 - 6 - 8 - 10 Risky

III. Rank the following factors when planning your financial future.

(1 being most important, 5 being least important)

H	W	
____	____	Marketability/flexibility of assets
____	____	Stability of income/asset values
____	____	Diversification to spread risks
____	____	After tax rate of return
____	____	Growth potential

Worksheet 3-1 (continued). Financial profile and estate planning questionnaire.

Step 9. Describe the general nature of current estate plan.

1. Tools to manage your affairs; health care

	Self		Spouse	
a. Durable power of attorney?	Yes ____	No ____	Yes ____	No ____
b. Durable power of attorney for health care?	Yes ____	No ____	Yes ____	No ____
c. Living will?	Yes ____	No ____	Yes ____	No ____

2. Wills in place

	Self		Spouse	
a. Do you have a will?	Yes ____	No ____	Yes ____	No ____
b. If yes, date written	________		________	
c. Date last reviewed	________		________	

d. Other comments: ____________________

Letter of instruction ____________________

3. Trusts

	Self		Spouse	
a. Do you have a revocable (living) trust?	Yes ____	No ____	Yes ____	No ____
Trustee(s):	________		________	
Beneficiaries:	________		________	
b. Insurance trust?	________		________	
Trustee(s):	________		________	
Beneficiaries:	________		________	
c. Testamentary trust:	________		________	
Trustee(s):	________		________	
Beneficiaries:	________		________	
d. Q-tip trust? (second marriages)	________		________	
Trustee(s):	________		________	
Beneficiaries:	________		________	

4. Are you in a business partnership? ______ A corporation? ______ Limited partnership? ______

5. Have you named guardians for any children? ______Yes ______No

Provide name and address of person chosen: ____________________

____

6. Have you named a personal representative for settling your estate? (Executor or Executrix)?

Provide name and address of person: ____________________

____

Backup: ____________________

____

7. If you died, what provision have you made for assisting your spouse or children in managing business affairs, etc.?

____

____

Worksheet 3-1 (continued). Financial profile and estate planning questionnaire.

Step 10. Indicate what you would like to accomplish through estate planning:

I. For yourself and your spouse:

____

____

____

II. For your children:
(Who will get which assets and when?)

- For a farming heir, if any?

____

____

____

- For other heirs?

____

____

____

III. For other persons/charities?

____

____

____

Step 11. List your current estate advisors.

	Name	Address	Phone
Attorney			
Tax advisor			
Financial consultant			
Insurance agent			
Banker/lender			
Investment advisor			

Worksheet 3-1 (continued). Financial profile and estate planning questionnaire.

Step 12. Indicate location of important documents.

Birth certificates .... ____________________
Marriage certificates .... ____________________
Divorce decrees/separation .... ____________________
Military service record .... ____________________
Social security cards .... ____________________
Medical records .... ____________________
Living will .... ____________________
Durable power of attorney for health care .... ____________________
Durable power of attorney .... ____________________
Bequest list of tangible personal property[a] .... ____________________
Wills/trust agreements .... ____________________
Cemetery deeds/burial instructions .... ____________________
List of special bequests .... ____________________
Insurance policies .... ____________________
Stocks/bonds .... ____________________
Real estate deeds .... ____________________
Notes, mortgages, contracts, receivables .... ____________________
Partnership/corporation agreements .... ____________________
Checking/savings accounts .... ____________________
Bank statements/canceled checks .... ____________________
Pension/profit sharing .... ____________________
Income/gift tax returns .... ____________________
Business financial statements .... ____________________
Safety deposit box .... ____________________
Safe combination/key .... ____________________
____________________ .... ____________________
____________________ .... ____________________

[a] See page 53.

Worksheet 3-1 (continued). Financial profile and estate planning questionnaire.

My bequest of tangible personal property

One's will, by written statement or list, allows the disposal of items of tangible personal property not otherwise specifically disposed of by the will. (This list could include items such as art work, dishes, guns, antiques, etc.) This disposition of property cannot include money, evidences of indebtedness, documents of title, and securities, and property used in a trade or business.

This written statement must be either in one's own handwriting or signed by the bequestor. The items of personal property must be specifically described. And the person who is to receive the item must be specifically named.

The designated items of personal property and the designated beneficiaries can be changed by the bequestor at any time. However, any changes or additions must be clearly described, and it would be helpful if such changes were dated. **Be sure to make note in the will that such a list exists.**

Name of Item	Designated Beneficiary	Date & Signature

Farm business continuation and transfer planning

4

- Considerations when planning asset transfers
- Methods/strategies when transferring current assets
- Methods/strategies when transferring breeding stock and machinery
- Methods/strategies when transferring real estate
- Some additional tools to aid the transfer process
- Firming up retirement and asset transfer plans
- Implementing and adjusting estate and transfer plans

A much more complex area of pre-retirement planning is the adequate to very adequate income situation, where the farm business is to be continued by one or more heirs (or possibly an unrelated party). Retiring parents in this situation often feel as though they are walking a tightrope as they try to decide how to shift assets and management responsibilities to the farming heir(s), while protecting their own financial security and the interests of other heirs. This situation is depicted graphically in Figure 4-1.

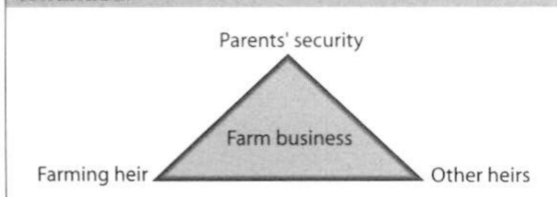
Because every business and family situation is different, each family requires a different transfer plan. Values, goals, priorities, and estate sizes vary. Farming heirs vary in their managerial abilities, their goals and objectives, their degree of experience in operating the business with their parents, and their age relative to that of their parents. Finally, goals, objectives and the number of other heirs vary, particularly in relation to farming and the farm property.

When faced with this situation, one must develop an effective plan for transferring assets and management responsibility that:

1. Protects one's own financial security.
2. Helps establish the farming heir's career in farming.
3. Treats nonfarm heirs fairly.

If parents transfer business assets too soon they may jeopardize their own financial security, create financial problems for the farming heir, or end up with very unhappy nonfarm heirs. Or, if they unduly delay the transfer of assets and management responsibility, the

Figure 4-1. Considerations when farm business is continued.



farming heir may not be able to financially control or manage the business effectively.

This chapter covers issues related to planning asset transfer, various ways of transferring ownership and/or control of assets, and some additional tools to aid the transfer process. The chapter closes with a brief discussion of the process of firming up retirement, estate management, and transfer plans, and the implementation and updating of these plans.

Considerations when planning asset transfers

There are three major aspects to consider when transferring farm assets:

1. One's personal and financial considerations.
2. The fair treatment of all heirs.
3. Tax considerations.

Personal and financial considerations

Transferring farm assets to the next generation seldom involves an abrupt change. It normally takes place gradually over time. It usually takes a number of years for the younger generation to buy into the business, and to fully assume the management role. (See discussion in Chapter 3, Part V of this series.) Most farm businesses consist of several classes of assets, including current assets, such as growing and stored crops, and intermediate assets such as breeding livestock and machinery and equipment. In addition, farmland and buildings represent substantial assets, which must be transferred. To complete a transfer of these assets, which may be worth well over $500,000, usually takes many years and some careful planning.

There are three major personal and financial factors to be considered when beginning this transfer process.

Does the financial position enable assets transfer?

The analysis in the previous chapter is necessary to answer this question. If one is concerned about the financial situation, then asset transfer should be postponed—possibly until both farmer and spouse have died. **In this chapter, it is assumed that the parents are in a strong financial position and that the business is to be continued by the next generation.**

Are retirees psychologically ready to transfer farm assets and management?

Transferring assets and management to the younger generation means that parents will no longer be in full control of the farm business. One who can't let go, or can't stand to see someone else in the power role, should not retire until a reduced role is acceptable. If farming is one's whole life, with nearly every waking moment spent building and working on the farm, and if there is little else in life that "turns you on," expect some emotional and business transfer related problems when moving toward retirement.

Leaving the farm should be planned well in advance. One who can relate to the following statements positively may well be psychologically ready to transfer the business:

- There are several ways to use present work time after retirement: golfing, traveling, socializing, and finally getting to some hobbies.
- I can continue to feel fulfilled as a contributing human being by volunteering or helping my children after I retire.
- Although we will do many things together, I plan to let my spouse have her/his own space. I will establish my own friends and spend time independently of him/her at times.
- We are willing to move off the farm and out of our home, so that the younger family can

work and live at the headquarters of the farm business. **This needs to be an agreed upon joint decision by farmer and spouse.**

Is the farming heir(s) in a financial position to acquire these assets?

Does the farming heir(s) have considerable equity in the farm business? Can he/she afford principal and interest payments for assets that are being considered for transfer? Will he/she have a business of sufficient size and efficiency to generate an adequate living for a family? If the answer to these questions is "No" or "maybe" consider delaying transfer of assets until he/she is in a better financial position. Otherwise, retirees must plan to make major financial concessions to get them in a position to control the business.

The fair treatment of heirs[1]

One of the most potentially explosive aspects of asset transfers — the fair or equitable treatment of heirs—will now be discussed. All too often parents get so involved (even obsessed) in transferring the farm to the farming heir that they end up destroying the family as a unit. This is a very gray area; fairness is in the eye of the beholder. Parents may feel that they have been and are treating all children fairly. But some of the nonfarm heirs, and particularly their spouses, may think otherwise.

Reaching agreement on two key issues

Obviously, assets belong to the parents to dispose of as they see fit. But it is important to develop a win/win solution to this complex issue. Therefore, before getting into the specifics of how to treat farming heir(s) versus non-farm heirs, it is important that the whole family reach general agreement on two key issues:

- Issue 1. Family members want the farm business to continue in the family. Both farm and nonfarm heirs must agree that it is important that the farm business be continued as a part of their family's legacy.

- Issue 2. Nonfarm heirs are **willing** to leave their portion of the assets in the business, at least for the foreseeable future. Though these issues should have been addressed earlier in the transfer process (see Chapter 3, Part V of this series), it is not too late to affirm them now. They are critical to the transfer process and the long-term future of the business.

First, the farming heir needs access to these assets in order to have an adequate income, and one somewhat comparable to the other heirs. If the nonfarm heirs force the sale of their interest or become the banker via a contract for deed, it is likely that the farming heir will be faced with too much debt just to maintain access to the income-producing assets. This would place the farming operation at risk as well as the farming heir's career.

Thus, if there is considerable real estate involved, the off-farm heirs should consider becoming **investors** rather than **bankers**. Their equity interest could be put into a limited partnership, where they would receive rental income and any appreciation in the underlying value of the property in return.

Of course, life insurance on the parents could be used to provide non-farm heirs with the insurance proceeds as part of their inheritance. But, as businesses get larger, the cost of adequate amounts of insurance can become prohibitive. On the other hand, an equity interest in the business could provide the non-farm heirs with an interest in the home farm, and a reasonable income from the property, while providing the farming heir with a workable financial situation.

Once agreement has been reached on these two issues, consider what would be fair treatment of the heirs. Three questions need to be addressed:

1. How fairly have the heirs been treated to this point?
2. What are some ways parents can help protect the farming heir's future in farming?
3. What are some ways parents can be fair to the off-farm heirs?

How fairly have the heirs been treated to this point? What have they done for the parents?

To answer this first question, consider: what gifts have been made to date? To whom?

[1] Adapted from *Transferring The Farm Series* fact sheets
FS-6309A - Protecting The On-Farm Heirs
FS-6310A - How To Be Fair With Off-Farm Heirs
by Erlin J. Weness, Minnesota Extension Service, University of Minnesota, 1994.

The amount spent on their advanced schooling? Price breaks made on assets transferred to this point?

A related, but often overlooked question is, what have the heirs done in terms of caring for parents' needs, etc.? Often the farming heir gets high marks in this area. Some of the reasons cited by parents for favoring the farming heir in the transfer process include:

- The farming heir helped create part of the present estate by actively contributing to the parents' business over the years, thus making him/her entitled to a larger share of the estate.
- Parents want the farm to "stay in the family." Consequently they are willing to give more to the heir whose goal is to stay on the farm.
- The farming heir(s) is getting delayed compensation for work performed in the early years when he/she was underpaid.
- The farming heir(s) has or will attend to the physical and business needs of the parents in their declining years. Nonfarm heirs may not have helped in the past and may not be available in the future.

Fairness and farming heir(s)

The farm business can be a fragile structure. The high risk nature of farming, coupled with high start up costs and narrow profit margins, dictates the need for safeguards to protect the farming heir(s). Farming children can protect themselves by carrying life insurance on their parents, by carrying risk insurance on their assets, and by seeking continued education to upgrade their management skills.

The parents, however, also have to play a key role in protecting the financial position of the farming heir(s). It is not enough to say, "You'll be taken care of when we are gone." Decisions and intentions need to be in writing to make it happen. Farming heirs who are insecure as to their future in the business are often unhappy, indifferent, and easily alienated from farming as a career.

Following are some ways parents can help secure the financial future of the farming heir(s):

- **Develop a transfer plan**

  Formulate a detailed written transfer plan with the help and input of all parties involved, especially spouses and in-laws. Discuss it, sign it, and work from it, so everyone knows what's ahead. (See a later segment in this chapter regarding the development of a transfer plan.)

- **Offer a purchase option agreement**

  If there aren't any commitments as to the sale of real estate assets, a purchase option may be useful. The purchase option gives the buyer the right, but not the obligation, to buy farm property at a later date. The agreement can involve land, buildings, livestock, or machinery. It should state the price, terms of payment and date of execution. It is binding on the spouse and off-farm heirs, and gives the farming heir(s) a definite and reasonable purchase price and terms for buying farm assets. It may avoid the farming heir(s) having to buy out non-farm heirs in an unsatisfactory lump sum amount after the parent's death.

- **Protecting them in a will or revocable (living) trust**

  When developing a will or revocable (living) trust, make sensible provisions for farming heir(s) in it. One might wish to establish provisions as to how, when, at what price and terms, the farming heir(s) can buy out the others. For example:

  - Will the farmstead and adjoining land and equipment go to the farming heir(s), while some cash, real estate, nonfarm assets are passed to nonfarm heirs.
  - Enact a provision allowing farming heir(s) to buy the land from the trust over a period of years at a stated interest rate, with specified principal payments per year.
  - Pass farm property to all children equally, but establish reasonable terms as to how

farming heir(s) might buy out the others over time, or put property in a limited partnership.

- **Life insurance planning**

As a parent, there are several options regarding the use of life insurance:

- Carry enough insurance to provide adequate dollars to pay off the nonfarm heirs, leaving farm assets to the farming heir(s). The use of second-to-die insurance would permit greater coverage at the same cost.

- Gift some money to farming heir(s) during one's lifetime which they would use to purchase life insurance on the parent(s). This would provide money to help them buy out non-farm heirs upon death of the parent(s).

- If parents are in debt, having a life insurance policy on oneself can provide money for debt repayment, and for any estate tax obligations. This can relieve heirs of having to liquidate vital farm assets to pay off debts and estate taxes.

- **Passing on farming know-how**

A key to protecting the farming heir is to spend some quality time during the transition years transferring overall management and farm operation skills. Spend time helping the younger generation with:

- How to do the physical things. Pass on electrical, carpentry, and mechanical skills by showing them how to make repairs, etc.

- How to handle management. Share how to make decisions, whom to listen to for advice, and how to make the best use of resources. Pay particular attention to successes in terms of financial matters.

- Pass on wisdom. Share rules of thumb; things that went bad; and what has always worked philosophies.

Younger generations may not always appear receptive to ideas. However, transferring knowledge and know-how to successors can give them a competitive edge over others less fortunate. It can also help ensure their success in managing the farm business, even though they may not admit it.

Fairness and non-farm heirs

One of the most difficult questions many retiring farm families face is how to protect a son or daughter's farming career while being fair to nonfarm heirs. To get a young person firmly established in farming in today's farm economy usually takes a great deal of parental help. This help is usually provided through below-market charges for housing, machine and land rents, interest rates, and gifting of assets, coupled with other supplemental help. Unless the young person starts out with a sizeable nest egg, parental concessions are needed if the young farmer is to get started successfully.

But most parents are concerned with being fair to all of their children at estate settlement time. Fairness, however, may not mean equal treatment of heirs. Some reasons parents might give for favoring the farming heir were noted earlier in this section.

The following are some methods that can be used to increase the non-farm heirs shares of an estate:

- Life insurance purchased by the parents, insuring the parents' lives and making the non-farm heirs the beneficiaries. Farm heirs would get farm assets, and non-farm heirs would get the cash generated by the insurance and other sources.

- The will of the parents might provide a final opportunity to equalize or to make fair previous distributions to the heirs, if the farming heir (or any heir who has received earlier compensation) may get less than the other heirs via the will.

- Non-farm heirs may be willed cash, nonfarm assets, or other farm land holdings, while "the base operation" farm assets are willed to farm heirs.

Special Note: In most cases, a disproportionate amount of farm assets must pass to the farming heir if the business is to continue.

Communicate resultant plans

It is a good practice to involve all heirs in the transfer process and to communicate to them the plans for the distribution of the estate and transfer of assets. This communication should be done prior to parents' deaths so the farming heir(s) isn't left in the embarrassing position of trying to explain why he/she was treated more favorably than the siblings.

Tax considerations when transferring farm assets

When planning the transfer of assets, keep in mind that there are potential tax ramifications at almost every turn. Therefore, it is important to involve a tax advisor or financial consultant before making transfers. Here, the types of taxes involved are discussed first. Then, the so-called income tax basis issue and its implications when transferring various assets is discussed.

Income, gift and estate taxes—a brief look

There are three basic ways of transferring assets:

1. Sale.
2. Gift.
3. Through an estate.

In each case, there may be important tax implications:

- If an asset is sold, there is a potential for an income tax to be levied. For example, if one sells grain to a son, the sale amount will be taxed as ordinary income. If selling a purchased asset like machinery or land, there is a potential depreciation recapture or capital gains tax involved. (See the discussion of tax basis.)

- If the asset is transferred via a gift to a person other than one's spouse, there is an annual gift exclusion per recipient of $10,000 per donor. Thus, a husband and wife could transfer $20,000 per year per recipient. (Since 1999, the annual gift exclusion amount has been adjusted for inflation.) If the gift's fair market value exceeds this annual exclusion, then the unified credit comes into play. As noted earlier in Chapter 3, this credit allows each person to transfer via a gift or through his/her estate up to the amount of the unified credit of assets tax free.

  For example, if a parent gifted to a daughter in the year 2003 assets with a fair market value of $50,000 and the spouse also participated so that the annual gift exclusion was $20,000, $30,000 would be subject to a gift tax. If there had not been any taxable gifts previously, the $30,000 would be subtracted from the $1,000,000 unified credit for that year, leaving a $970,000 credit ($1,000,000 - $30,000) to be used against other taxable gifts or the net estate at the time of death. If taxable gifts exceed the $1,000,000 unified credit, then a tax will be assessed against the amount in excess of the credit. Also, at time of death, one would not be able to use the unified credit, as it already would have been used through gifting.

- If assets are transferred at time of death, the fair market value of one's net estate is subtracted from the remaining unified credit—$970,000 in the above example. See the earlier discussion in Chapter 3, regarding making effective use of unified credit, if the estate exceeds the appropriate unified credit (or the remaining balance as noted in the discussion of taxable gifts).

Determining the income tax basis of an asset

Income tax basis is the cost to recover when an asset is sold. The cost basis in the property is determined by how the asset was acquired plus the cost of any improvements made, less any depreciation taken.

How the asset was acquired can have a marked effect on one's income tax basis. For example:

- If one purchased an asset, the basis is what was paid for it, plus any improvements made to it, minus any depreciation taken. Example: a tractor purchased for $50,000, depreciated for three years claiming a total of $15,000 depreciation, has a remaining tax basis of $35,000. If one purchased land and claimed no depreciation or made no improvements, the tax basis is the original purchase price.

- If one received an asset as a gift, the basis is the same as the donor's (giver's) basis at the time of the gift, plus any improvements made by the recipient, less any depreciation taken. Example: a gift of farmland is valued at $160,000, but had a donor's basis of only $25,000. If no improvements have been made or depreciation taken, the basis in the property is the **donor's basis** of $25,000.

- On an inherited asset, the tax basis is the fair market value (or special use value) assigned to the asset as it passed through the estate to the recipient—plus any improvements made, less depreciation taken. Example: If inherited farmland is valued in the estate at $160,000, with no improvements or any depreciation in prior years, the tax basis is $160,000. If the recipient were to sell the farm for $300,000, there would be $140,000 of gain ($300,000 - $160,000 basis) subject to capital gains tax.

Tax basis and transfer plans/strategies

Thus, as parents begin to transfer assets, it is important to consider the tax basis situation. **Also keep in mind the tax basis that heirs will have in the assets they acquire from parents.** Their basis will be determined in the same manner as discussed above. Table 4-1 illustrates this.

Thus, income tax basis in a property is an extremely important factor in determining which assets to transfer by sale, gift, or through an estate. Now for some strategizing:

- **Transferring low basis property**

If the income tax basis in the property is low relative to its potential sale value, consider transferring the property through the estate. This is because assets which pass through an estate receive a new stepped up basis. The stepped up basis is usually the fair market value of the property at the date of death. This avoids the capital gains tax one would have paid if the asset were sold. By gifting low basis property, one would merely pass one's tax basis problem on to the heirs. The parents' basis would become the heirs' basis. Also, there may be a taxable gift situation as well.

Example: Sally Smith sold 300 acres of farmland for $1,500/acre, or $450,000. It had a tax basis of $100,000. Her taxable gain, whether the property was sold for cash or by the installment payment method, would be $350,000. Because of the sale, either Sally or her heirs must pay capital gains tax on the $350,000. If, however, Sally retained the property until her death, the estate would assign a stepped up basis of $450,000 (FMV). The heirs could later

Table 4-1. Tax consequences of alternative transfer procedures for parents' tax situation and heirs' income tax basis[a] in property received.

Transfer procedure	Parents tax situation	Heirs income tax basis
By gift	Subject to federal gift tax on gifts above $10,000 per year ($20,000 if both spouses join in the gift) per recipient. May be a state gift tax.	Donors' (givers') basis
By sale	Subject to capital gains tax on difference between parents' basis in property and actual sale price.	Purchase price
By inheritance	Subject to federal estate tax at death: tax based on fair market value or special use value if qualification requirements are met.	Value used in determining estate tax

[a] Income tax basis is that part of asset value that already has been through the tax mill and, thus is not subject to tax again. It then becomes the beginning point for figuring the future income tax.

sell the property for that amount and pay no income tax on the sale amount, as the new basis would be $450,000.

- **Transferring high basis property**

If property has a high tax basis (near or above the present market value) then selling or gifting the property becomes a viable option. Work with a tax consultant, as there are limits as to the tax losses one can claim if the tax basis is higher than the present market value.

The key message: check out the tax ramifications of any asset transfer with a tax consultant BEFORE making the transfer!

Methods/strategies when transferring current assets

The easiest assets to transfer are current assets, such as crops and market livestock. They can either be sold or gifted to the farming heir(s).

Transferring grain and market livestock by sale[2]

Here, the tax consequences of selling grain and market livestock are discussed first and then this process is illustrated.

Income and self-employment tax aspects

Selling current assets usually involves income tax and self-employment tax consequences. Income taxes must be paid on the sale of crops and market livestock when received by a cash basis farmer. Selling everything in one year can put one into a higher income tax bracket. Spreading the income over a couple of years may provide some tax relief. One might also use a deferred payment contract to spread income to future years.

Self-employment (Social Security) taxes must also be paid when crops or market livestock are sold. Consider the following strategies:

- Selling everything in one year may lessen overall self-employment tax. For 1998, a social security tax of 12.4 percent is charged on personal income up to $68,400, and the 2.9 percent Medicare tax is charged on all self-employment income. The maximum amount of self-employment income subject to social security tax increases on a year by year basis. With self-employment income, one no longer pays the 12.4 percent self-employment tax, but is required to pay the 2.9 percent on all self-employment income.

- Watch the timing when selling crops or market livestock in the year of retirement. It can cause a reduction in social security benefits for that year. Farm inventory sold between retirement and the end of that year can count against benefits for that year. If one exceeds exempted amounts, social security income for that year will be reduced. However, selling crops or livestock produced **before retirement**, in the year one began taking social security checks, usually will not reduce social security benefits.

Example: Transferring a hog operation

If one were to sell a hog operation to a son or daughter, it may be possible to do so using the following procedure.

- Set a date for the transfer to occur. Take fair market value appraisal of assets as of that day. There are two ways to transfer the market hogs:

- **Option 1.** The farming son/daughter buys the small piglets still nursing the sow, while the exiting farmer (Dad) retains ownership in all weaned pigs through market weights. Dad sells off his pigs as they become ready for market. Feed and operating expenses must be split between the two entities while

[2] IFS-6305A - Selling Crops and Market Livestock

Dad sells off his remaining hogs. This method keeps the farming heir's initial investment proportionally low, but he/she also receives no cash flow until his/her first hogs are sold.

- **Option 2.** The farming son/daughter buys out all market hogs on a given day and assumes all feed and operating expenses as of that day. The exiting farmer (Dad) would receive payments based on a percentage or fixed dollar amount for each hog sold to ease financing demands on the son/daughter. Example: Son pays 60-80 percent or $70-$90 per market hog sold. Payment is made each time hogs are sold until they are all paid for. This method gives the farming son/daughter an immediate cash flow of both income and expense, but he/she assumes more market price risk in the process.

Making gifts of grain and market livestock[3]

Current assets like grain and livestock can also be transferred by gift. If a parent gives grain or market livestock to a farming heir, the following tax ramifications should be kept in mind:

- If the fair market value is under $10,000 ($20,000 if the spouse participates), no gift tax ramifications are involved. Remember, this gift exclusion can be taken each year, and is per recipient. (Since 1999, this annual gift exclusion has been adjusted for inflation.)

- The cash basis parent does not include the commodity on his/her tax return, thus reducing both income and self-employment (SE) taxes.

- Once the property is sold, the farming heir must show the income on his/her tax return and pay income tax on it. No social security tax is involved, since the farming heir did not produce it.

- If the parent gifted the grain or livestock in the year of production, he/she must reduce deductible expenses by the cost of producing the grain and livestock. The farming heir gets to use the carryover of basis as an expense. If the gift is made with grain produced in a year prior to the gift, the basis in the grain is zero to the farming heir. When giving produce, the best advice is to give crops or livestock that were produced in the year prior to the time of the gift.

- Special note: in the case of a terminal illness situation, such assets should be passed through the estate and receive a stepped up basis. Sale of their assets to pay doctor bills will result in an unnecessary taxable situation.

[3] FS-6308A - Gifting Farm Assets (See page 57.)

Methods/strategies when transferring breeding stock and machinery

It is important to seek good tax and legal advice before implementing any transfer of breeding stock and machinery. Here, the tax consequences of selling these assets are discussed first and then other transfer alternatives are reviewed.

Tax consequences of selling breeding livestock and machinery[3]

The good news about transferring breeding stock or machinery and equipment is that sale income from these assets is not subject to self-employment (SE) tax. However, one will have to pay income tax on the difference between the adjusted tax basis of these assets and the sale price. For example: selling $200,000 worth of machinery, cows, and sows having an unclaimed depreciation amount of $20,000, will result in $180,000 of taxable depreciation recapture or capital gains income.

Breeding livestock can be transferred using the installment sale approach. This approach spreads the resultant taxable income over a period of years. Machinery, on the other hand, does not qualify for installment reporting. Consider selling machinery on a piecemeal basis. For example, sell a tractor this year, a planter next year, etc. This approach spreads the tax burden and lets the farming heir gain ownership without excessive interest costs on any loans involved.

Other transfer methods and their tax effects[3]

Other methods of transferring breeding livestock and machinery, include leases, gifts, and some possible hybrid methods.

Leasing breeding stock and machinery

Leasing lets the parents receive rental income, while retaining ownership and depreciation deductions on the property. If one does this, please note:

- The lease agreement should not indicate any specific buy-out provision. With a buy-out provision, the IRS will likely disqualify the lease and call the entire transaction a sale subject to immediate taxation.
- One may have to pay state sales tax on the annual lease payments. Minnesota, for example, presently has a 2.5 percent sales tax for machinery and equipment leases.
- Leasing any personal property may require that one pay self-employment tax on the net proceeds. The IRS has an increased tendency to declare leasing activity as a leasing business subject to self-employment tax.

Gifting breeding stock and machinery[4]

If one can afford to do it, it may be prudent to gift pieces of machinery or breeding stock to the next generation. Giving a plow or six cows to a son or daughter moves the property to them. They can show it on their financial statement as they take possession of it. Gifted property passes to them with the same income tax basis as it had with the parent. If a parent makes a gift of property and it is under $10,000 in value, one need not report the transaction to the IRS. If one gives more than $10,000 annually to any one person, one must file a gift tax return. There will be no gift tax on excess over $10,000 ($20,000 if the spouse participates) until the unified credit is used up.

Gifting low basis machinery to the next generation can reduce the parents' income tax and provide the children with needed equity and borrowing power. When gifting a machine, document the gift in writing; sign it, and have it notarized on the current date. Any remaining depreciation on the gifted machine passes to the receiver of the gift. Example: Dad gives to his daughter a tractor that has a $10,000 balance to depreciate over the next three years. Dad loses the $10,000 depreciation deduction; however, his daughter can claim the remaining basis by claiming $10,000 of depreciation.

If indebtedness on the gifted asset exceeds the donor's basis, the excess is considered a taxable gain to the donor. Example: John gifts a completely

[3] FS-6306A - Transferring Breeding Stock and Machinery (See page 57.)

[4] FS-6308A - Gifting Farm Assets (See page 57.)

depreciated combine valued at $30,000 to Mary, if she will assume a $15,000 debt on it. As a result, John has $25,000 of taxable gain and has made a $15,000 gift. Gifting can remove assets from an estate, reduce one's income tax burden, and help the next generation get started. **Be sure to document clearly the fact that a gift was made with a notarized statement or legal document.**

Hybrids methods of transferring breeding stock and machinery[3]

When transferring breeding stock and machinery, it may make sense to combine the above three transfer methods (sale, lease, or gift) to some degree. For example:

- Lease a few items that have a lot of depreciation remaining, while gifting and/or selling other items.
- Gift some assets annually (usually low basis items), while selling piecemeal (high basis) other assets. Remember: gifting low basis property, essentially passes one's tax problems onto the receiver of the gift.

[3] FS-6306A - Transferring Breeding Stock and Machinery (See page 57)

Methods/strategies when transferring real estate[5]

A major portion of many farmers' asset base is in land, buildings, and personal residence. Thus, the eventual transfer of these properties is a major decision point that must be planned carefully. Some general methods of transferring real property will be discussed first. Then considerations and specific ways of transferring land, buildings, and the personal residence will be presented.

General methods used in transferring control and ownership of real property

The transfer of control of property through leasing and the establishment of an option to buy will be discussed first. Then the transfer strategies with low basis property will be discussed.

Renting the real estate; establishing an option to buy

Often the first step in transferring control of real estate is for parents to rent the farm or part of the farm to the farming heir(s). This usually takes place when the older farmer retires, although with a large acreage operation, it may involve a gradual shifting of control prior to retirement. The type of rental arrangement used should be consistent with other aspects of the parents' estate plan. For example, a cash rental arrangement retains the property's qualification for the special use valuation procedure, whereas the crop share arrangement is required for the 15-year delayed tax payment provision. Always check with estate advisors on the specific situation.

The farming heir may not be in a financial position to buy all of the real estate. An interim step might be to set up an **option to buy** on a piece of the farm real estate. Such an approach would ensure that the farming heir would have a chance to buy it and would permit freezing the value or at least tempering potential price increases if inflation is a concern. The option would specify a particular purchase price or a formula for determining the price, and a future date by which the purchase agreement must be exercised or the option will expire.

A valid option to buy must be accompanied by reasonable compensation when the option is negotiated. For example, an option to buy agreement between a parent and a child in which the child has the option to buy the farm anytime within the next ten years at today's value, would

[5] FS-6307A - Should You Sell Your Real Estate?

be suspect unless the child pays a reasonable amount for that option. A reasonable payment would be determined by the amount an unrelated third party would be willing to pay for such an option in an arms-length transaction. Seek good legal and tax counsel in developing such option agreements.

Selling methods used in transferring real estate

If selling all or part of the real estate, there are four broad transfer options:

- **Option 1.** Sell it for **cash in a lump sum** and pay any accompanying capital gains taxes. The tax will be on the capital gains associated with the property: the difference between the sale price and one's tax basis in the property.

- **Option 2.** Sell the land on a **parcel-by-parcel basis** as the buyer can afford to purchase it. Using this method, the buyer can apply all purchase money toward principal and none toward interest. Example: In year one, Mom decides to sell a designated ten acres to her son, Bill, for $10,000. In year two, she sells another five acres for $5,500, and in year three, Bill had a good year and was able to purchase 15 acres for $16,000. Bill has thus acquired 30 acres in three years, has them paid for, and has no debt or further obligation to Mom. However, this approach would involve considerable legal work. Putting the property in a limited partnership would accomplish the same goal and with no ongoing legal work, except the original cost of setting up and funding of the limited partnership (see discussion of the limited partnership later in this chapter).

- **Option 3.** Sell on a **contract for deed.** A contract puts the parent in the position of lender. As the contract payments are made, include them in taxable income over a specified period of years. By signing a contract for deed with installment sale, one does obligate oneself or the heirs to paying the income tax on any gain. Upon parent's death, the estate receives no stepped up basis on any remaining principal due with installment contract. Selling on a contract can provide the buyer with a source of credit and at terms he/she can afford. This method, however, obligates the buyer to pay a considerable amount of interest over the life of the contract. Interest received from the buyer is fully taxable to the parents. When becoming a contract for deed holder, one assumes the risk of default by the buyer. One may get the land back through forfeiture or become embroiled in a maze of mediation, restructuring and other legal procedures. (See Chapter 2, Part IV of this series for a more detailed discussion of the contract for deed approach.)

- **Option 4.** Consider the **tax-free exchange** approach. Exchanging like kind property with a farming heir can postpone the taxation of gain. For example: Assume parents own a 160-acre farm worth $160,000, and have a tax basis of $40,000. By exchanging it even up for similar property worth $160,000, one now owns the new property with a basis in it of $40,000. No income taxes are paid on tax-free exchanges, if no money or unlike kind property is involved. This approach has the affect of postponing tax on the capital gains involved ($160,000 - $40,000 = $120,000). If this new property is held to pass through the estate, the gain will be eliminated because of the stepped-up basis feature.

  There are regulations relative to time limits when exchanges must be completed. Also note that for exchanges between related parties, if either party transfers the property within two years of the transaction, the exchange is taxable. Exceptions are provided for death or an involuntary conversion.

Gifting land/contract payments[4]

There are several approaches to transferring real estate through gifting:

- **Option 1.** Gift land by deeding over actual acres. For example: Parents may give the West 20 acres to John and the East 20 acres to Mary. Giving actual acres requires legal work and legal descriptions of property when each gift is made.

[4] FS-6308A - Gifting Farm Assets (See page 57.)

- **Option 2.** Gift land by deeding an undivided interest in property to the children. For example: Give a 10 percent interest in the 160 acres to John and Mary (together or separately). This method may require less legal work.

- **Option 3.** Forgive contract for deed payments. The proper procedure is to take a check for the principal and interest payment, and then issue a check back for any gift one wishes to make. Ignoring the check exchange can result in the children not having complete evidence of having paid for the property. One must declare the principal and interest payments received on the income tax return. These payments must be declared even though the payments are forgiven later via a gift back.

Transferring low basis real property through an estate

Often parents will find that they have a low tax basis (see earlier discussion of tax basis) on at least part of their real estate holdings. In such a case, if they sell the land, they will be faced with a substantial capital gains tax on the difference between the tax basis and the sale price. If they decide to gift the property, they will likely be using up part of their unified credit, but more importantly, they have passed their low basis tax problem on to the individual(s) receiving the property.

At this writing, the preferred strategy would be to retain ownership of this low basis property and let it pass through the estate. Under current law, by passing the property through the estate, the person receiving the property will receive a so-called stepped-up basis equal to the value of the property in the parents' estate. Thus, all of the potential capital gains would be eliminated. Of course, the parents' estate will be subject to possible estate tax on the property.

Transferring larger land holdings—the land partnership/entity route

In the preceding segment, general methods of transferring control and ownership of real property, including land, were discussed. The focus here will be on transferring land using a land partnership/entity approach. This partnership can take the form of a general partnership, a limited partnership, or a limited liability partnership. The main reason for such an approach is to get the property inside an entity other than in sole ownership. This affords several advantages as discussed below. This segment closes with a discussion of the limited partnership, which is often used in this situation.

General description of land partnership arrangement; its advantages

Figure 4-2 illustrates the basic components of the land partnership arrangement. It represents, in this case, a section of land that is owned by the partners, with the parents usually owning the largest amount. The parents' interest in the partnership would be handled as a life estate. Using a Quit Claim Deed, the remainder interest is held by the children. The farming heir(s) and nonfarm heirs would own an undivided interest in the property.

Buy/sell agreements in the partnership would provide a mechanism for transferring property via:

1. A sale.
2. Gift.
3. As heirs of the partnership interest.

The children would include the farming partner who would have the first right to buy the property.

There will be rental income to the partnership from the use of the property by the operating entity. The manager(s) of the property—usually the farming heir(s)—could also receive a guaranteed payment as their management fee. This would tend to further limit profits accruing to the partnership.

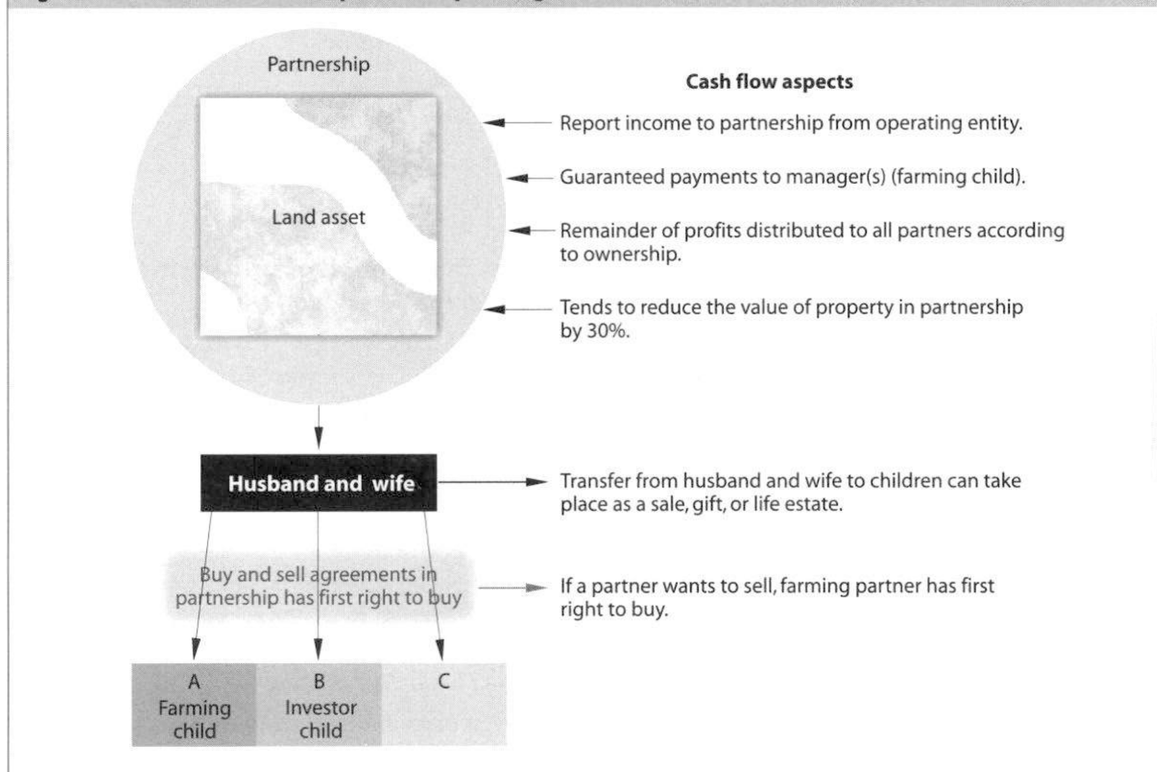
This arrangement has several advantages:

- It keeps the nonfarm heirs in an investor role rather than as a "banker/seller."

- Being inside an entity leaves all of the partners with an undivided remainder interest in the property. This remainder interest feature tends to reduce the market value of the property by about 30 percent.

- Since the assets are inside an entity, it provides greater protection from lawsuits against the business or one of the partners such as in a divorce proceeding.

Figure 4-2. Schematic of land partnership arrangement.



- Liability insurance should be carried on the various entities and the individuals to cover claims against the entity and the parties involved.

The limited partnership/limited liability partnership

Parents who still have a considerable land holding and are concerned with how they might shift property to the heirs in a fair manner and still retain control of it might consider putting these holdings in a **limited partnership**. The limited partnership is a special form of partnership permitted by state law to have one or more partners whose liability for partnership debts and obligations is limited to their investment in the business. A limited partner is just an investor; a limited partner who participates in management becomes liable for all partnership obligations as a general partner. A limited partnership must have at least one general partner who handles the management of the business and who is fully liable for all partnership debts and obligations.

To use this alternative in a real estate transfer situation, the title of the personally owned farm real estate (or a portion of it) must be transferred to the limited partnership in exchange for **partnership units**. These units can be set up as strictly growth units, or as growth and **frozen units**. With the latter dual arrangement, the frozen units would be kept by the parents to freeze the value of their estate and to guarantee themselves a fixed income. In turn, the growth units would be transferred over time to the heirs. **Caution:** This scheme works very well during inflationary periods, but if land values decline, the value of the heirs' units could decrease rapidly, as would have happened during the farm crisis of the mid-'80s, when real estate values declined substantially.

Once established, the general partner would rent the land to the farm operating unit, which may be a **sole proprietorship, general partnership, or corporation.** Or it may be rented to an outside party if the farm operation is not being continued. One of the expense items often includes payment for management services. Typically, the parents will receive this payment as general partners, which provides them with income. After paying expenses relating to land ownership, such

as taxes, insurance, and repairs, the net income would be distributed to the limited partners according to the percentage of units held. With the consent of the general partner, the limited partners may transfer units of ownership by gift, sale, or through will.

One of the advantages of the limited partnership over the contract for deed is that purchases can vary according to whether one has a good or bad year financially. A contract for deed has a scheduled payment amount. Since one can vary purchase of units with earnings, the limited partnership permits the allocation of all payments to pay principal or gain equity or units in the business, thus avoiding the need to pay interest on debt as occurs with the contract for deed. One can also make annual gifts of units at least up to the amount of the annual gift exclusion of $10,000 or $20,000 per year tax free. Relative to the contract for deed, two disadvantages of the limited partnership are that: (1) it does not freeze the purchase price of the farm or units (the unit price depends on the market value of the property at each sale); and (2) the buyer doesn't own the property until all units have been acquired. If several people own units, it is owned in co-ownership. This co-ownership feature can also reduce the impact of a possible sale of some of the property by one of the heirs or the potential impact of a divorce settlement. (See Chapter 3, Part V of this series for a discussion of this issue.)

Some of the advantages of the limited partnership over the corporation are:

1. It represents a less radical change in the way of doing business.

2. There is generally no recognition of gain upon termination of the partnership if the assets are distributed to the partners (although it is possible to trigger an income tax liability on termination).

3. It provides a source of income for the parents upon retirement as well as for the nonfarm heirs who own a piece of the action. One of its disadvantages is that for tax purposes, the income flows out to the individual, who does not benefit from the favorable tax rates of the regular C corporation.

The limited partnership can play a useful role in easing the real estate transfer process for many farm families. Like any business arrangement, it has its advantages and disadvantages, and it works better in some situations than in others. So if it appears to have merit, explore it with a tax consultant or attorney who understands its workings and application. Also explore the possible use of the **Limited Liability Partnership** as discussed in Chapter 7, Part II of this series.

Transferring farm buildings and residence

There are several factors and/or approaches to consider when transferring farm buildings and one's residence.

Transferring farm buildings

Maintaining farm buildings is expensive. There is a never-ending list of repairs, insurance, utility, real estate taxes, and other costs to pay. Also, tenants or the farming heir(s) may be requesting additions and improvements periodically. Sometimes retaining a good tenant is a problem if adequate buildings are not provided.

It can be difficult to maintain buildings when retired, particularly in the role of landlord. Consequently, many farmers dispose of their buildings. Disposal can take place by:

- Selling them. Here, low-basis assets may create a substantial tax bill. Selling a quarter section of farmland or a farm building site for $250,000 which has a cost basis of $50,000 will result in $200,000 of taxable gain. That can result in $40,000 of capital gains tax.

- Giving them away. Farm buildings can be given to a farming heir, usually tax free. Here, low basis in the property will be transferred to the farming heir.

- Using a like-kind exchange. As discussed earlier, one may consider a like-kind exchange. For example, the other party would purchase a bare piece of land, and then exchange it for the property that has buildings on it.

Transferring/selling personal residence

If selling a farm that includes a personal residence, it is usually best to parcel out the house portion of the sale, since it qualifies for special tax treatment under the 1997 Tax Act: a taxpayer has a $250,000 exclusion ($500,000 on a joint return) per transaction on the sale or exchange of the principal residence.

- The exclusion is allowed no more frequently than once every two years.
- The taxpayer must have owned and occupied it as a personal residence for at least two of the last five years prior to the sale or exchange.

Homestead credit considerations

Qualifying owners who live on the farm or in the residence may receive a reduced real estate tax like that provided in Minnesota Homestead Tax Laws. (Other states may have similar provisions.) This credit can reduce real estate taxes substantially each year. Thus, one should structure transfer plans to make the best use of this credit. Home owners who have relatives living on their farm may qualify for a double homestead credit—one on their personal residence plus a second on a one-acre portion of the farm, if a relative lives there.

However, be careful not to get tripped up by other provisions of tax law. For example, in Minnesota, if one sells a residence, but retains a life estate, it disqualifies that person from using the over age 55 capital gains exclusion noted above. But the Homestead Credit is retained.

Some additional tools to aid the transfer process

Several additional tools can be used to aid the transfer process. Tools discussed here are:

1. Buy-sell agreements.
2. Trusts funded during one's lifetime.
3. Farm corporations.

The buy-sell agreement/life insurance funding

The purpose of a buy-sell agreement is to provide for the orderly transfer and continuation of control of the business in the hands of the farming heir(s). The agreement would specify the conditions under which a given business party must offer to sell the business to the other business party.

The agreement can be a straight **buy-sell agreement**, which sets forth the terms: interest rate, frequency of payments, amount of payments, security, and remedies for not meeting the terms of the agreement. Or, the agreement may include a **right of first refusal** in which case the potential buyer must match the terms offered by a third party. The agreement can also mandate that all nonfarm heirs are required to sell their share or part of the business to the farming heir within a specified period of time, and at a price determined by formula.

Life insurance is often used to fund the agreement. This insurance is designed to aid the farming heir to gain control of the property, while providing funds to the nonfarm heirs. This would generally be a term life policy on one or both parents. For example, the farming heir might buy a $250,000 policy on the father or $125,000 on each parent. The latter approach provides greater flexibility in that the proceeds of the policy on the first to die can be used to fund in part the second policy.

Such life insurance premiums are generally not tax deductible, but the proceeds are not taxable to the recipient (the farming heir).

Trusts funded during one's lifetime

Two types of trusts can be funded during one's lifetime: (1) the revocable or living trust, and (2) the irrevocable trust.

The revocable (living) trust

With a revocable or living trust, title to the property is transferred into the trust, but as one of the trustees, the parent retains control of the property. As the name implies, the arrangement is revocable. Some desirable features include:

1. Providing for management assistance in case of parent's incapacity as well as for the surviving spouse.
2. Saving estate settlement costs because property held in the trust does not go through probate.
3. Including estate tax management provisions since it continues after death.

Like any planning tool, it has its place. For example, under certain conditions the initial cost of setting up the trust and the annual maintenance costs may exceed any eventual probate cost that might be incurred without the trust.

The irrevocable trust

The irrevocable trust is also set up while parent(s) are still living. But once property is put into the trust, it cannot be revoked by or controlled by the parent. One common use of this trust is the **insurance trust**, which essentially keeps insurance proceeds out of the estate.

The corporation

From a transfer standpoint, the corporation has the potential advantages of providing continuity, control, and ease of transfer. Often parents want to transfer part of their property to the farming heir or other heirs without giving up too much control over the business. The corporation is a nearly ideal tool for accomplishing these two objectives. As little as a share of stock in a corporation can be sold or given away at a time, making an interest in the business easily transferable. And as long as the parents retain at least 51 percent of the common stock, they have control of the business.

Two key issues that arise at the time of corporate formation can have a major impact on the ease with which property and control are transferred to the farming heir later on. These issues are: (1) What property should be put in the corporation? and (2) What type of capital structure should be used? (See the discussion of these two issues in Chapter 7, Part II of this series.) If all the farm property of the shareholders is put in the corporation, with the owners receiving common stock in return, then the farming heir must in effect gain control of 51 percent of the total assets to control the business. Obviously, all the property is in an easily transferable form—stock—but gaining control of the business will likely be a problem.

An alternative would be to place all the assets in the corporation and use a capital structure that includes **preferred stock** and **debentures** as well as **common stock** or having a combination of voting and non-voting common stock. This would reduce the amount of voting common stock needed to control the business, as well as freeze the value of that portion of the underlying assets represented by the preferred stock and debentures. Thus, the farming heir could gain control of the business with less investment and be able to gain control of other assets at a fixed value rather than at an inflated cost. A drawback, however, is that some of the special tax provisions for farmers, such as the special use valuation, may not be available if debentures constitute too large a proportion of the parents' estate at death.

Another alternative would be to keep certain property out of the corporation: for example, placing low basis land in a limited partnership. Such a strategy, coupled with a preferred stock or debenture program, would further reduce the amount of equity that the younger farmer needs to control the business. It also would ease the problem of getting income out of the corporation for the parents' use during retirement, and for the nonfarm heirs. **Caution:** Again, check with a tax consultant and attorney to avoid the adverse tax consequences of such a business organization change.

Firming up retirement and asset transfer plans

With the personal and financial information gathered in Chapter 3, and the planning tools discussed earlier in this Chapter as background, the process of firming up retirement and asset transfer plans will now be discussed. The firming up of retirement and financial security aspects, as discussed earlier in Chapters 2 and 3 of this part of the series, will be discussed first. Then, a worksheet is introduced that can be used in roughing out a proposed transfer plan. Then check the plan with selected parties, and, with the help of a tax consultant and attorney, put it in writing.

Firming up retirement plans and financial security aspects

Before trying to firm up an asset transfer plan, firm up a retirement plan and check the financial security aspects of the present situation.

Retirement plan: Timing and how retired to become?

There are at least five factors to consider when deciding when to retire and/or how retired to become:

1. Psychological frame of mind relative to retirement.
2. Health.
3. Social security considerations.
4. Farm program payment caps.
5. Estate tax provisions, such as special use valuation.

- **Psychological frame of mind**

The number one question to be addressed is that of psychological readiness for retirement. Many reach an enviable financial position through a lot of hard work, and often not much play time. Still others place a high value on status and having that useful feeling. Others may be just downright scared of giving up the known (farming) for an unknown (retirement).

In any event, only the retirees can make this decision; they must feel comfortable with it. Otherwise retirement may be a short honeymoon phase, followed by a possibly extended period of disenchantment and reorientation, before reaching a stable, comfortable retirement lifestyle (see Chapter 2). But, like other small business owners, easing into retirement by helping a farming son or daughter, or helping the neighbors during peak labor periods may be an option.

- **Health of retiree and spouse**

The present and/or projected state of health of retiree and spouse should receive important consideration when setting a retirement date and mode of retirement living. Obviously, there is little control over many health aspects during retirement. The only thing that is sure is that everybody goes through an aging process. Thus, the longer one puts off doing the things you always wanted to do together, the more likely they will never get done, or a cane or walker may be in the picture. Again, this has to be a personal choice.

- **Social security considerations**

Should one retire early at age 62, or wait until 65? The answer to this begs another question, how long does one expect to live? Studies show that, using net present value procedures and a 7 percent annual return, one would have to live to age 84 or 85 before earning more money retiring at age 65, versus starting to receive benefits at age 62. Though one would forego a full salary for the three years, one still could work part-time without reducing social security benefits. Obviously, this is a complex decision to be made with a tax consultant knowledgeable in this area. **But it should be just one of the considerations.** If one doesn't feel comfortable about retiring at age 62, foregoing social security benefits should not be the determining factor.

- **Farm program payment limits and special use valuation provisions**

Farmers with larger operations need to consider two other factors in setting their retirement date. If the farm operation is unincorporated and is large enough to bump up against the government program payment limit, the parent may want to consider postponing retirement. Even if he/she owns all the land and would get the full government program payment, that would put him/her over the upper limit for receiving full social security and his/her social security payment could be reduced. He/she would be better off waiting until age 65 or older when his/her social security payment would be larger and possibly the government program payment limit would not be that large a factor. Under the Freedom to Farm legislation, price support and disaster payment programs are to be phased out.

For very large estates, the special use valuation election can save substantial estate taxes (see Chapter 3). If one has been actively farming the property up until retirement, heirs shouldn't have trouble qualifying the property for the special use election at the parent's death. (The law requires that one "materially participate in five of the eight years prior to disability, retirement, or death—whichever occurs first.") But if one uses the date of retirement, be sure not to earn so much in one year to disallow social security benefits or one could lose special use eligibility. Again, this applies to very large estate situations—in excess of two unified credits, if both spouses are living at the time of retirement.

When contemplating retirement, seek out financial and tax consultants who are schooled in social security, government farm program issues, and special use valuation aspects, before deciding on a retirement date.

Estate management: Protecting business and other assets from undue risks and taxes

These are rapidly changing times. Therefore, as one prepares for retirement and the transfer of business assets, one should review the financial portfolio carefully to see if diversification-seeking out quieter, less risky waters—is in order. (See Chapter 3 for a discussion of investment planning.)

Also make sure that retiree and spouse have adequate health insurance. Over time, one's health will likely deteriorate and may even result in nursing home care. Certainly, major medical and disability insurance should be continued. Obtaining long-term care insurance is open to question. The larger the estate is, the more unnecessary it becomes because earnings from assets will likely be able to pay for needed care. Selling assets will not likely be required. Be sure to review the situation with a financial consultant, as extended, long-term care costs could erode an estate considerably.

If the combined estate (retiree and spouse) approaches or exceeds one unified credit, seek out a financial consultant and attorney to develop an estate plan that will keep estate taxes at a minimum. This will likely involve the use of a credit trust or life estate, to make maximum use of the one unified credit of each spouse. Using the unlimited gifting provision between spouses, one should be moving toward a more balanced estate situation, thus eliminating the order-of-death problem. See Chapter 3 for a discussion of some of these strategies and options.

Firming up an asset transfer plan

The next step in the process is to firm up the asset transfer plan. This involves roughing out a plan, checking it out, and then putting it in writing.

Roughing out an asset transfer plan

The first step in the process is to rough out an asset transfer plan for the specific business situation. It is important that the parents, farming heir(s), and their spouse(s) are involved at this stage. Worksheet 4-1, which begins on page 76, is designed to aid this process. Use it as a guide. Include as many specific details as possible. Details make the plan more useful and reduce future questions.

Checking the plan with others; making a final check

Next, check the plan with advisors, such as a tax consultant, financial consultant, and other business advisors. When the plan is nearly

developed, seek an attorney's opinion on it and ask him/her to do the final drafting and required legal work.

It is a good idea also to inform (or involve) the nonfarm heirs as to the details of the plan. Point out to them that making a business-like, systematic approach to transferring the business is the goal. Let them know that their rights as heirs are being protected.

Give the plan one final check with questions such as the following:

- Does the plan allow for maximum use and enjoyment of assets by parents and heirs?
- Does the plan treat heirs fairly, yet permit continuation of the business, if that is desired?
- Is the plan easy to understand and carry out?
- Will the plan stand up under legal challenge?
- Can the plan be modified at reasonable cost?
- Does the plan minimize tax and administrative costs, consistent with other goals and objectives?

Deciding on a plan; putting it in writing

As decisions regarding an estate and asset transfer are made, keep two points in mind. First, few if any transfer plans will ever be perfect because no one can predict the future with certainty. Don't expect perfection and don't expect to ever be able to see the future perfectly. Second, don't procrastinate. Make a decision. Without a written plan, the message is that the present plan is acceptable, which may not be true at all.

Putting the plan in writing is a must! If it is not written down, details are easily forgotten and often misconstrued as time goes by. After a first writing, all parties should review the plan and check it out with their advisors, etc. All involved parties should review and sign the final agreement.

Implementing and adjusting estate and transfer plans

Given a basic decision and plan, two steps remain: (1) implementing the plan; and (2) making adjustments when needed.

Implementing an estate/asset transfer plan

Implementation may involve activities such as the selling of assets, transferring by gift, preparing and executing wills and trusts, making changes in property titles, buying life insurance policies, or changing methods of doing business. Most of these activities will involve the expertise of estate advisors.

Two remaining phases of implementation involve the retiree directly. First, become quite knowledgeable about the nature of the transfer plan and its implications for future business activities. This may require spending some extra time and money with an attorney or tax consultant. A first step in this process might be to draw up spreadsheets that summarize the distribution plans for the estate. One spreadsheet could show what lifetime transfers are planned, to whom, when, and the method of transfer to be used. The other could show death-time transfers: what, to whom, the value, and the method of transfer.

Also learn more about the **planning tools** used in the plan, as well as **tax laws** that affect any future business changes under consideration. This too may require spending some extra time and money with an attorney or tax consultant.

The second step is to review the new plan with the affected parties, particularly the heirs. Whether the heirs should have been involved earlier in the selection process is up to the retiree. At some point, however, they should be informed about decisions and plans. They will thereby be forced to evaluate the plan in the current setting, rather than having the benefit of hindsight,

10 or 20 years from now. They also will be able to better plan their future in light of the plans. Some insights gained during this process may call for future adjustments.

The most important objective is the maintenance of good family relationships. A well-thought out plan and good communications can go a long way toward achieving this goal.

Adjusting the plan over time

Once a plan is implemented, it must be dated. One's estate situation may change; family situations or priorities may change; and of course, tax laws may change. Plan to review the plan with an estate advisor periodically, at least every two years under current conditions.

It is also important to keep one's estate inventory up to date. Such information will be invaluable to those responsible for settling the estate and carrying out the estate transfer plan after the retiree's death. Remember, this very sobering thought: **the question about our dying is not if, but when.**

Worksheet 4-1. Roughing out an estate/asset transfer plan[6].

I. How will grain, feed, market livestock be transferred (sale? gift?) ______

II. How will breeding stock and machinery be transferred?

Breeding stock: Outright sale? Installment sale? Gradual sale? Lease with buy out? ______

Machinery: Gift? Sale? Lease?

Who will pay for: Insurance? ______ Major repairs? ______

III. How will real estate be transferred?

If rented: cash/crop share? Rental rates and payments? Determining future rental rates?

Options to buy/buy-sell/insurance

What arrangements will there be to aid the farming heir in gaining ownership? ______

Will land be sold? If so, when and how will the price be determined? ______

Farm buildings.

Rental rate, if any? ______

Arrangements for transfer? Sale? Gift? Tax free exchange? ______

The residences.

Rental rate, if any? ______

Housing arrangements for the long term? ______

[6] FS-6311A - Developing a Written Transfer Plan (See page 57..)

Worksheet 4-1 (continued). Roughing out an estate/asset transfer plan.

IV. Handling of parents' underlying debt.

Will farm heir(s) assume existing debt? ____________________

Borrow elsewhere; pay off debt? ____________________

Tax considerations for parents? ____________________

____

____

V. What will be the arrangement for transfer of management responsibility?

____

____

____

VI. What will be the Involvement of parent(s) in farming operation after retirement? Compensation?

____

____

____

____

____

____

Farm Management Publications Available Through MWPS

Income Tax Management for Farmers, NCR-2
This publication is a guide to helping farm business managers minimize income taxes while maximizing after-tax income. Main topics of discussion include depreciation, government payments, special rules for droughts and other disasters, capital gains and losses, and income averaging for farmers. 32 pages. Revised, 2002

The Farm Corporation, NCR-11
This publication examines the three basic forms of farm business organization and its variations. These include the sole proprietorship, partnership, corporation, limited partnership, limited liability company, and the S corporation. 32 pages. New, 2002

Tax Planning When Buying or Selling a Farm, NCR-43
This publication outlines the many aspects of farm transfer that can affect your tax bill, now and in the future. Topics include how to increase net earnings, how to avoid unnecessary taxes, how to delay the recognition of income and postpone tax payment, when to buy and sell a farm, and what the tax consequences are when buying and selling a farm. 16 pages. Revised, 1997.

Long-term Installment Land Contracts, NCR-56
This publication covers the advantages and disadvantages for the buyer and the seller. Topics include the basic considerations in preparing the installment land contract, transferring property by installment contract, method and time of payment, operation and use of property, costs, and income and default and possible remedies. 14 pages. Revised, 1997

Fixed and Flexible Cash Rental Arrangements for your Farm, NCR-75
The purpose of this publication is to help tenants and landlords develop fair cash-rent arrangements and assist them in making sound decisions based on a fair evaluation of resources. A sample lease form also is included. (Cash Farm Lease Form, NCR-76 also is available separately as a free download at www.mwpshq.org) 18 pages. Revised, 1997.

Crop-share or Crop-share/Cash Rental Arrangements for your Farm, NCR-105
This publication helps tenants and landlords develop fair crop-share arrangements and assists them in making sound decisions based on a fair evaluation of resources. The publication includes a sample lease form. (Crop-share or Crop-share/Cash Farm Lease form, NCR-77 also is available separately as a free download at www.mwpshq.org) 14 pages. Revised, 1997.

Irrigation Crop-share and Cash Rental Arrangements for your Farm, NCR-148
This publication helps tenants and landlords develop fair crop-share or cash-rent irrigation leases. The publication includes a sample lease form. (Irrigation Crop-share or Crop-share/Cash Farm Lease form, NCR-106 also is available separately as a free download at www.mwpshq.org) 18 pages. Revised, 1997.

Pasture Rental Arrangements for your Farm, NCR-149
The purpose of this publication is to help make sound decisions and develop fair pasture rental arrangements. It provides background information on animal units and stocking rates, discuss establishing lease rates on a per-head or per-acre basis, addresses leasing tame-grass pasture. A sample lease form is included. (Pasture Lease Form, NCR-109 also is available separately as a free download at www.mwpshq.org.) 18 pages. Revised, 1997.

Rental Agreements for Farm Buildings and Livestock Facilities, NCR-214
This publication examines the major considerations in developing rental agreements for crop and livestock buildings and facilities from both the owner's and renter's point of view. The publication includes a sample lease form. (Farm Building Lease Form, NCR-215 also is available separately as a free download at www.mwpshq.org.) 12 pages. New, 2000.

Managing Risk in Agriculture, NCR-406
This publication is designed to help farmers develop their own integrated risk management strategies appropriate to their own attitudes and circumstances by reviewing the factors affecting decision making in a risky environment, discussing the sources of these risks, producers' views of variability, and information to improve decision making. Finally, it outlines risk management strategies available to producers. 21 pages. 1st Ed. 1998.

Planning the Financial/Organizational Structure of Farm and Agribusiness Firms: What Are the Options?, NCR-568
This publication provides a comprehensive listing of organizational and financing options for farm and agribusiness firms and explains the circumstances under which these options are most useful. 17 pages. Revised, 1998.

Purchasing and Leasing Farm Equipment, NCR-615
NCR-615 covers different types of purchase, rental, and lease agreements for farm equipment. Topics covered are: Purchase plans, the leasing process, contract details, advantages of purchasing and leasing, comparing finance plans and computer decision making aids. 1st Ed. April, 2001

Managing Risks and Profits: Grains, MWPS-MRPG
Along with greatly increased exposure to yield, market, and financial risk, producers face a complex array of new tools for managing risks of adverse yield, price, and income changes. This book was written to help farmers and professionals serving farmers to understand the sources and degree of risk involved in this dramatically changing environment. It was also written as a guide in developing financial analysis and marketing skills to form a management strategy for the individual farm and financial needs of the farm family. 164 pages. 1st Ed. 1999.

Planning and Managing Your Farm Business Center, NCFMEC-233
The purpose of this publication is to provide guidelines and suggestions for planning your farm business center. Topics covered are: center purposes, design types, office furniture and equipment, managing the flow of information, deciding what records to keep, using time efficiently, electronic communications, and farm operator's tips.

For more information or to order any of these publications contact:

MidWest Plan Service
122 Davidson Hall, ISU
Ames, IA 50011-3080
Phone: 800-562-3618
email: MWPS@iastate.edu
www: MWPSHQ.org

Publications in **Business Management for Farmers** series available through **MWPS**

Part I
Developing a Longer Range Strategic Farm Business Plan

- Longer range business planning - an introduction
- Evaluating the present business situation; setting goals
- Developing a longer range business plan
- Developing a workable transition plan
- Managing the financially stressed farm business

Part II
Business Management for Farmers

People skills and legal aspects
- Evaluating/improving "people skills"
- Contracts and property law; a guide to other legal aspects

Managing financial aspects of a business
- Developing/implementing/controlling annual financial plans
- Financing non-real estate aspects of a business
- Income tax planning and management
- Using insurance in managing business and family-related risks

Business arrangements; retirement and estate planning
- Developing/updating farm business arrangements
- Mid-career check of retirement and estate plans

Part III
Managing Production and Marketing Systems

- Economic fundamentals and related planning tools
- Managing crop enterprises and related systems
- Managing livestock enterprises/systems
- Evaluating/developing production contract arrangements

Part IV
Acquiring and Managing Resources for the Farm Business

- Renting farmland and facilities
- Analyzing/financing farm real estate purchases
- Managing the machinery system
- Farm personnel—planning and staffing
- Managing the work force effectively

Part V
Getting Established in Farming

- Choosing farming as a career
- Farming with someone else?
- Getting established; The multi-owner/operator route
- Getting established partly/mostly on one's own

MWPS
MidWest Plan Service
A Foundation of Knowledge