

FARM & RANCH ESTATE PLANNING: AN INTRODUCTION

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Introduction

To start, let's ask some common questions. What is estate planning? Essentially, it is planning for the transfer of assets, typically from one generation to the next. This transfer can happen while the owner of the assets is living (this is called *gifting*) or, more commonly, at the time of the owner's death (*time-of-death* transfers). We will discuss some of the reasons a person might choose to make gifts as part of their estate plan, rather than providing for transfers only at the time of death.

How do we plan an estate? The answer to that question of course depends on individual circumstances. However, we are guided by certain principles. First, we want to accomplish the wishes of the owner of the estate. We call these dispositive wishes, as in disposing of assets: Who gets what? When? Under what conditions? Subject to what restrictions or rights? Second, we want to accomplish the transfer of assets in a tax-wise manner. Taxes can play an important role in estate planning, though this is perhaps less true than it used to be. Third, we want to plan an estate for the lowest administrative costs, i.e. the plan should accomplish the transfer and achieve the dispositive wishes with efficiency, both in putting the plan together and in executing the plan. To speak plainly, it shouldn't cost more than it needs to cost. Fourth, though this is related to our third concern for efficiency, the plan should be put together with the least, necessary complexity. Simple is a virtue, so long as the plan is sufficient to the wishes and the taxes.

Let's talk about these wishes for a minute. A person's wishes in planning an estate are not a legal matter; we do not typically look in the law to discover what we want. We look in ourselves, and often in our family. People who are planning an estate should make an effort to describe their goals. Do not be concerned with what the law can or cannot do (that puts the cart before the horse); simply sit down and try to describe what you want to see happen: your goals. If you can, rank them in importance. (Estate plans can involve balancing or choosing between competing goals: succession of the family farm versus equal inheritances for all the kids, for example.)

Some common goals include a) keeping a farm or ranch going viably in the next generation, b) protecting assets from things that go wrong (financial distress, divorce, ill health), c) preserving property for the benefit of future generations, d) maintaining control over property, e) anticipating and minimizing disputes, f) engaging heirs in management, g) encouraging family unity and communication, and h) creating an income

stream for heirs. There are important tax goals to consider as well, such as reducing or eliminating federal transfer tax liability (gift and estate taxes), preserving the time-of-death basis adjustment, planning for state inheritance taxes (where they exist, as in Nebraska), and shifting income within a family. (See Taxes below.)

A Word about Guardianship

This article is primarily concerned with planning for the disposition of property. However, the most important reason to plan is for the guardianship of minor children. Who will take care of minor children should the parents die? Naming of a guardian typically occurs in a will or in a revocable trust. Naming a guardian generally avoids uncertainty and involvement of the courts in appointing a guardian. (It is worth noting that a guardian is responsible for an individual; a conservator is responsible for finances.)

The Basic Parts

An estate plan is typically comprised of four tools. The principal tool, the workhorse of the plan, if you will, is that legal instrument or structure which accomplishes the transfer of assets, as in a Will, or a trust, or titling. The other tools include durable powers of attorney, one for health care and another for property management. These tools are part of incapacity planning. The fourth tool is a health care directive, or living will, and, in those states where it is available, a physician's order.

The Basic Questions

In some respects estate planning involves answering four questions: What is your estate? How will you transfer it? When will you transfer it? To whom will you transfer it? This last question is, as discussed, not a legal but a personal question. We will not spend time with this question. However, you may wish to look at a companion article entitled *Keep it in the Family* which discusses various tools and structures that can be used both to divide an estate and to share it, with consideration given to preserving the viability of an ongoing family farm or ranch. For the other three questions, we will now proceed in the order those questions are presented.

1. What is Your Estate? (Let's talk taxes.)

For those readers who are beginning to plan an estate, or for those who are revisiting their existing plans, it can be very useful to complete an estate questionnaire. In answering a questionnaire you identify your family and heirs, your advisors, your existing estate documents, if any, pre and post marital agreements, if any. You make an inventory of assets, everything from real estate to bank accounts, and itemize your liabilities. You make a list of on-line or digital assets or accounts, including automatic withdrawals and payments. You identify a method of dealing with passwords for online accounts. You identify how assets are owned, i.e. how they are titled, where they are kept, etc. You name responsible persons, such as prospective personal representatives or successor trustees. A questionnaire is not only useful for estate planning, it is also useful for compiling end-of-life information to assist those responsible persons in taking care of matters at the time of death. A completed questionnaire can save time and costs.

Completing a thorough questionnaire often triggers thinking about things that might otherwise be overlooked.

The questionnaire helps to identify net worth, which is important in determining the amount and type of tax planning, if any, that needs to be done as part of the estate plan. What do you own and what is it worth? How much debt encumbers the estate? We start with a determination of net worth because of something called federal **transfer taxes**. Transfer taxes are perhaps more commonly known as the gift tax and the estate tax. Both taxes are assessed against the value of assets that are transferred. The gift tax applies to transfers that are made while the giver (donor) is alive. Estate taxes are applied to transfers that occur at the time of death. The idea behind transfer taxes is that assets will be exposed to these taxes at each generational level, for the social purpose of preventing the concentration of wealth in too few hands. (Make of that what you will.)

The rate of taxation for both taxes is currently 40% - a hefty tax. But before we lose our breath at the idea that Uncle Sam will take at death almost half of what we worked to own, it is important to know that very few estates actually pay any federal estate (or gift) tax. Why? Because of something called the **unified credit**. To put it simply, each citizen has a credit that can be used to exempt property from transfer taxes. The exemption amount under that credit is currently \$5.43 million per person. The credit was fixed “permanently” at \$5 million per person in 2013, and indexed to inflation. So, in short, if your estate is worth less than the exemption amount (\$5.43 million), it is unlikely that any transfer tax will ever have to be paid.¹

The credit is unified, meaning that it applies for both the gift tax and the estate tax.² It is a cumulative credit, also known as a lifetime credit. We each have one credit for life. If it is used during life to exempt gifts from gift tax, there will be less remaining to exempt time of death transfers from estate tax.

Spouses each have a unified credit, of course, which means that spouses can transfer a marital estate worth up to \$10.86 million free of transfer taxes. There is a new rule which spouses can take advantage of to make sure that neither spouse’s unified credit is squandered. This is called the **Portability Rule**. In the past a certain amount of planning was necessary to make sure that a spousal unified credit did not go unused, thus potentially subjecting the marital estate to transfer taxes. That planning typically included the use of by-pass, credit shelter, or family trusts. Those are still tools that many practitioners continue to use, for a variety of reasons, perhaps not the least of which is concern that Portability could be legislatively eliminated. So long as Portability is around, however, it protects estates from squandering one spouse’s unified credit, typically without advance planning. In a nutshell, it does this through allowing an

¹ It is important to know that the unified credit has been a political football. It is set legislatively. It could be changed again. It is worth noting (though not as a forecast) that the unified credit has never been lowered. It is also worth noting, however, that the President’s revenue proposals for 2016 sought to reduce the unified credit to \$3.5 million. Under the current credit fewer than one percent of all estates pay any estate tax.

² For a number of years, the credit was not truly unified because the gift tax exemption amount was less than the estate tax exemption amount. It became unified again in 2013.

election to be made at the time of the first spouse's death to transfer that deceased spouse's unused unified credit over to the surviving spouse. Many practitioners consider this a very handy rule. It not only protects those marital estates which have not been well planned, but it also allows spouses to consider simpler tools for planning their estates.³

For most Americans, transfer tax planning is no longer an important estate planning concern. Could it again become a significant factor in estate planning? Perhaps. It depends on legislation. For the time being, it may be useful to think of transfer tax planning as existing in certain planning zones. For single persons with estates approaching \$5 million in value, and for married couples with estates approaching \$10 million, it may be prudent to consider somewhat more complex transfer tax planning. There are tools which can be used to undertake this planning, such as special use valuation, closely held entity discounts, gifting plans, and irrevocable trusts. (See companion articles at farmerandrancher.wordpress.com.)

A tax planning concern that may pertain to more estates is **basis adjustment**. In a nutshell, transferring assets in a time-of-death transfer allows the heirs (the new owners of the transferred property) to acquire a step-up in basis in the assets, and potentially to avoid capital gain taxes. Here's how it works. **Basis** is a tax term to describe the cost of an asset to the owner, and it is used to calculate capital gain. For example, if you purchased a piece of land for \$1000 an acre fifteen years ago, and that land is now worth \$3000 per acre, there is \$2000 of capital gain "built-in" to each acre of that land. If you were to sell it, you would likely have to pay capital gain tax on that \$2000. (The maximum federal capital gain tax rate is presently 20%, to which some states will add their own capital gain tax. In Nebraska, the rate is approximately 7%. In addition, there may be imposed approximately 3% in federal tax for passive gains.) Now, if you transfer that land to your heirs in a time-of-death transfer, they can receive a stepped-up basis, that is, the law will deem that they paid for the land whatever it is worth at the time of your death. (\$3000, in our example.) This happens without the payment of capital gain tax. Should your heirs then turn around and sell the land, little or no capital gains tax would have to be paid, because their basis would presumably be equal to the selling price.

Only assets that transfer at the time of death qualify for the step up in basis.⁴ For example, property that is transferred by a will or by a revocable trust typically constitutes a time-of-death transfer. There are some transfers that occur while the donor is alive that may still qualify as time-of-death transfers for basis adjustment purposes: transfers in the "give it away now but with strings attached" category. For example, a **life estate deed**. In a life estate deed, you deed your land to an heir but keep for yourself a life estate, which basically means that you are legally entitled to possess and control the property for

³ For more information and analysis of the uses of the Portability Rule, and spousal transfer tax planning in general, see the companion article entitled *Spousal Unified Credit Planning & the Portability Rule*, available at farmerandrancher.wordpress.com.

⁴ An asset transferred by gift is not eligible for basis step-up. The person who receives the gift, i.e. the donee, will have the same basis in the asset as the donor had. This is why people speak of preserving the basis adjustment through time of death transfers. A reason in some cases not to consider gifting away assets while alive.

as long as you live. Your heir becomes what the law calls a **remainder person** and you become the **life tenant**. You possess the property and have some of the rights and obligations of ownership for the duration of your life, i.e. you pay the taxes, you get the income, you manage the asset. The remainder person has a legally enforceable property interest, because the only thing that comes between the remainder person and possession of the property is your life, and death is certain. The IRS considers a life estate deed to be an incomplete gift and, as such, it qualifies as a time-of-death transfer under which the remainder person can acquire a stepped-up basis at the time of the life-tenant's death.⁵

Of course, another way to avoid paying capital gain tax on an appreciated asset is never to sell the asset. To some farm and ranch parents, leaving the built-in capital gain in the land may be part of an estate plan intended to ensure that their heirs do not sell the land. The idea being that the prospect of having to pay up to 30% of the sale price to federal and state government will discourage the heirs from selling the land.

There have been legislative and administrative proposals to remove the step-up in basis, both federal and Nebraska state efforts. Thus far, the step-up remains part of the law and an important part of tax planning for most estates.

It is also important to know about something called the gift tax **annual exclusion**. A person can give away each year as much as \$14,000 (2015) to as many separate people as he or she likes, without having either to pay gift tax or to file a gift tax return. In addition, this annual exclusion amount does not use up a person's unified credit. For example, you may give \$14,000 to each of your children each year with no transfer tax consequence, nor will your children pay income tax on the gift. However, if you were to give each child in each year any amount over \$14,000, you would trigger an obligation to file a gift tax return and the excess over \$14,000 would be a taxable gift. So, for example, if you were to give your daughter \$20,000 this year, unless you chose to pay gift tax on the \$6000, you would decrease your unified credit by \$6000.

The annual exclusion is not cumulative, that is, there is no lifetime limit on annual exclusion gifts. Nor can you store up annual exclusions for use all in one year.

There is an unlimited annual gift tax exclusion for gifts made for the benefit of another person directly to an educational institution for tuition or to a health care provider for medical services. This exclusion is available for contributions to 529 tuition programs.

Nebraska has an inheritance tax, and there is a companion article on **Nebraska's inheritance tax**. It is enough to mention here that Nebraska imposes an inheritance tax on assets transferred at the time of death or within the three years before death. The rate is only 1% (above the first \$40,000 exemption amount) to any immediate family, ascendants or descendants, which includes siblings, parents, children, grandchildren, etc. (There is no tax at all on transfers to a spouse.) For transfers to more distant relatives the rate rockets up to 13% and the exemption shrinks to \$15,000. For unrelated party

⁵ For more information on life estate deeds, see the companion article entitled *Future Interests and The Life Estate Deed*.

transfers, the rate is 18%, and the exemption \$10,000. There is little planning one can do to eliminate the inheritance tax, short of giving property away with no strings attached (thus precluding a step-up in basis) and living for three years, or moving out of state. If one is willing to consider the latter, there may be inheritance tax planning that can be done even with respect to real estate in Nebraska.

2. How Will You Transfer your Estate?

There are three basic tools to use to transfer an estate: titling, will, and trust.⁶ (Trusts are technically a type of titling but it is useful to discuss them as a separate tool.) Let's take them one at a time. Again, for each of these tools there is available a more in-depth companion article, and the following discussion will therefore be brief.

Titling

Some property is titled, such as real estate, most vehicles, and most account assets (checking accounts, CDs, IRAs, mutual funds, brokerage accounts, etc.). Other property is not titled, such as much farm machinery and equipment, and most livestock. It is possible to use titling to accomplish estate planning for titled assets. For example, in joint tenancy, which is characterized by something called the right of survivorship, the last of the joint owners to survive owns the entire property. Joint tenancy is most common between spouses. At the death of the first spouse, nothing needs to happen to transfer ownership of the jointly held property to the surviving spouse. Automatically, by operation of law, the deceased spouse's interest in the property ends with life and the surviving spouse now owns it all alone. This form of titling is administratively efficient. Joint tenancy is different from **tenancy in common**, in which each owner owns an undivided share in the property.⁷ In tenancy in common, each owner is able to transfer his or her share at the time of death, regardless of the order of death.

Let's illustrate with an example. Imagine that two brothers, Mac and Harv, own land as joint tenants. (Joint tenancy is not common between brothers, as it is between spouses, but it helps with the example.) Imagine that each brother has a will, under which the land is to go to his children. Let's say that Mac dies before Harv. Will Mac's children inherit any of the land? No. Harv owns it all, through operation of the joint tenancy titling, and it does not matter what Mac's will provides. Joint tenancy is a kind of estate plan in itself, i.e. the last one standing gets to plan the estate. Now, had the brothers owned the land as tenants in common, Mac's undivided interest would have transferred to his children through Mac's will, and those children would then become tenants in common with their uncle Harv.

There are other forms of titling that may constitute estate planning. The most common is probably the beneficiary designation, also sometimes called a payment or transfer on

⁶ It is, of course, also possible to transfer assets or the use of assets by sale or by lease. Indeed, installment contracts, long term leases and buy-sell rights may be useful tools for both succession and retirement planning. Such tools are discussed in a separate, companion article on succession structures.

⁷ For a more in depth discussion of joint tenancy and tenancy in common, see companion article entitled *Joint Tenancy & Tenancy in Common*.

death designation. Most people may be familiar with these designations through life insurance, in which a policy typically designates the beneficiaries of the policy, i.e., those people to whom the death benefits will be paid upon the death of the insured. These beneficiary designations may be used with many account assets. These designations are administratively efficient. Typically, when the account owner dies, the designated beneficiaries may take possession of the account assets simply by furnishing a death certificate and proof of identity. No need for transfer through a probate or trust. Most beneficiary designations can be changed at any time by the account owner; they are revocable.

It is possible in Nebraska (and numerous other states) to use beneficiary designations to transfer real estate at the time-of-death of the owner. This is relatively new tool in Nebraska (2013). It is called a transfer on death real estate deed, or, sometimes, a revocable real estate deed. There is a companion piece on transfer on death real estate deeds, and you are encouraged to review it for additional information.

Payment or transfer on death titling does not typically create any present interest in the beneficiaries; it does not give them rights until after the death of the owner. These designations do not accomplish any kind of tax planning; the titled assets remain part of the owner's taxable estate. They do not provide long term care planning. Finally, transfer on death titling as an estate planning tool is limited in providing for contingencies or asset protections. They are not for every estate. However, for some plans, they can be a handy and inexpensive tool for transferring property. They can also be used to provide for the efficient time-of-death transfer of assets into a trust or an entity, such as an LLC.

Will

This is the traditional estate planning tool. What are the basic things to know about using a will? It is revocable; you can change your will. In general, it is always the "*last will and testament*" that matters, the one that most closely precedes death. In general, a will requires a probate in order to accomplish its dispositive provisions. Probate is a court proceeding. Probate is not a four-letter word. In most states, probate proceedings have become fairly simple and straightforward under the Uniform Probate Code. The vast majority of probates are informal, which means among other things that the procedure is intended to work efficiently. In addition, the costs of probate have been reduced from the days when lawyers charged a fee based on percentage of the estate. It is worth noting, also, that in states which have an inheritance tax proceeding, such as Nebraska, much of the work that goes into a probate proceeding must still occur in order to determine the state inheritance tax, even where property has been previously transferred out of the probate estate, as through titling or revocable trusts. In addition, there are advantages to probate that are not otherwise available. For example, in probate proceedings, creditors have a specific amount of time to file claims against the decedent's estate, after which time those claims are forever barred. The world is put on notice of death in a probate and probate is intended to reflect the finality of life in its resolution of the deceased person's affairs. Finally, there is a long history of law behind wills and probate, which more often than not helps to create certainty in planning estates through wills.

If you are intent upon avoiding probate, in Nebraska it is critical that you reduce the value of your probate estate to \$50,000 or less. This typically means relying on titling or trusts or gifts to transfer your estate. (A **probate estate** is made up of those assets that must transfer through the probate, either under the will or under the rules of intestacy, should the deceased person have died without a valid will. The probate estate is not necessarily the same as a person's **taxable estate**. The taxable estate in general is made up of all that property which the person had an interest in at the time of death, which may include property that transfers through titling or through trust.)

A couple of other matters bear mention under the subject of the will, namely intestacy and the spousal elective share. In addition to directing you to the companion articles, suffice it to say if you do not plan your estate (if you die with no valid will and have not otherwise provided for the transfer of your estate, i.e. you die intestate) the laws of Nebraska will provide for distribution of your estate among your heirs according to those laws, essentially according to marriage and degrees of kinship. As to the spousal elective share, perhaps it is enough here to say that it is very difficult to disinherit a spouse.

A will, once it is filed in a probate proceeding in the county court, in general becomes a public document. For some people, this is reason enough to avoid the use of wills. Indeed, if your will states things about some of your heirs that you would prefer not to tell the world, perhaps you should look carefully at the use of a trust or titling.

Trust

The trust may be the most flexible of all estate planning tools. There is far too much to say about trusts meaningfully to summarize in this article. Nonetheless, a brief and hopefully useful discussion follows.

A trust is a legal relationship in which a person (the trustee) holds property (as in takes title to and manages) for the benefit of another person (the beneficiary, the person who is to benefit from the property that is being held in trust by the trustee). A trust separates ownership into two parts, legal ownership (which the trustee has) and equitable ownership (for the beneficiary). The legal relationship between the trustee and the beneficiary is a fiduciary relationship (indeed, a trustee is sometimes referred to as a fiduciary) under which the trustee owes legally enforceable duties of good faith and loyalty to the beneficiary.

It may be useful to state that in practice trusts are used commonly in one of two ways. (These are by no means the exclusive uses of trusts.) In one practice, the trust may be used simply as a will substitute, a tool for transferring property at the time of death outside of probate. This is perhaps the most common use of trusts and such trusts are often referred to as "living" revocable trusts. The trust typically terminates after the property is distributed to the beneficiaries. The second common practice extends the existence of the trust into time beyond death. The trust lasts, and in lasting the trust typically shapes how posterity enjoys the property that is in trust. Again, this is a simplification of the uses of trust, but perhaps in a useful service: in considering whether

or not to use a trust (a common consideration), one useful question to ask yourself is how far into the future of the world beyond your life you wish to shape or restrict or protect the enjoyment of property.

Which leads us to this: why do people use trusts? The following is an attempt to describe some of the prevalent and historic uses of trust; it should not be taken as a limitation on the uses of trusts. Here are some of those reasons for the use of trusts, together with a brief comment:

- Avoiding probate or minimizing probate costs
 - For both privacy, efficiency, and for those who think probate is a four letter word
- Protecting assets from creditors, divorces, ill health
 - Nothing shields property from the vicissitudes of life like a trust
- Separating management from enjoyment
 - Some heirs just can't - or won't - manage property
- Dividing property among different owners
 - A trust can direct to some extent how they get along
- Shaping the use of property through time
 - With a good lawyer and an imaginative client, the sky (or rather perpetuity) is the limit
- Succession planning
 - For example, farming heir gets to rent land from trust with rents going to off-farm heirs
- Providing for disabled heirs
 - A long, humane and specialized history of use
- Charitable giving
 - If you mean to accomplish charity as part of your plan, trusts can be very attractive

Here is a list of questions you might ask yourself that may bear upon whether or not you should or need to use a trust:

- How much, and for how long, do you want to shape, control, limit or protect the use and enjoyment of property after you are gone?
- Are your heirs going to own property separately or together?⁸

⁸ Partition fears. Ownership of property by more than one person may be through a trust or other entity, e.g. LLC, in part to address what is called the right of partition. People who own property directly as tenants in common or joint tenants each have a right of partition, which means that any one of them has the right to compel a court physically to divide the property. If a court is unable to divide the property equally, which is most often the case, the court orders a sale of the property and divides the money among the owners, after costs are taken. This right of partition either causes the co-owners to figure out ways to be reasonable, or it causes parents not to leave property to their heirs as tenants in common. In addition to being subject to the right of partition, tenancy in common provides no structure for joint decision making or for buyouts among the co-owners. For further discussion, see article on *Tenancy in Common and Joint Tenancy*.

- Do you want to see property stay in the family?
- Do any heirs need to use more property than they might directly receive?
 - Access to assets for on-farm heir/successor
- Do you own real estate in two or more jurisdictions?
 - If so, trusts will likely save money
- Does your plan include things that you prefer the public not know?

As a final list on trusts, the following are basic decisions that you face in using a trust.

- Who is the trustee(s)? Who is the successor trustee?
- Who are the beneficiaries?
- If the trust is to continue well beyond lifetime
 - How will subsequent trustees be chosen?
 - How will beneficial interests transfer? To whom?
- How will property/income be distributed?
 - These are the dispositive provisions of a trust
- How long will the trust last?
- How will the trust end?
- What happens to property when trust ends?

If a trust is being used in part to avoid probate in the transfer of property at death, it is important to verify that the property is already in trust (has actually been transferred to the trustee), or that there is some mechanism to get the property into trust that does not require a probate (like a transfer on death real estate deed that names the trustee as the time-of-death beneficiary).

Remember, Nebraska has an inheritance tax. The use of a trust rather than a will as the estate planning workhorse does not typically change the need to file a petition in the county court at the time of death to determine the inheritance tax, which requires among other things an inventory and valuation of the estate of the deceased person.

3. When will you transfer your estate?

During life or at death, might be the simple answer. As mentioned there is also a kind of transfer that is partly accomplished during life and then completed at death, a hybrid, if you like, between gifting and time-of-death transfer. Basically, these are the three choices.

Lifetime transfers, such as gifts and irrevocable transfers into trust, typically mean no step up in basis. They also typically mean the loss of the use, benefit, income and security form that transferred property. Under tax law, a gift must be complete in order to count as a gift. What does this mean? Let's say that a couple want to remove some highly appreciating property from their taxable estate. (Assume their estate is so large that the unified credits are insufficient to protect it from transfer taxes, so they are trying to reduce its value.) They begin gifting shares in their farming operation to their children under the annual exclusion. Assume, however, that they fail to allocate the income from

those gifted shares to their children, instead keeping all the farm income for themselves each year. The IRS is likely to treat the gifts as incomplete and therefore pull the value of the transferred shares back into the parents' estates at the time of death, thus potentially undoing the gifting plan and subjecting the estate to higher estate tax.

Why make transfers at all before death? After all, one of the cardinal principles in estate planning is to keep the plan flexible; people and circumstances change, and you should be able to respond to those changes in your plan. As the old adage has it, don't give away your clothes too soon.⁹

Still, there are reasons for lifetime transfers. Some of the more common ones include a) reducing an estate's value for transfer tax purposes, b) shifting income to family members who are in a lower tax bracket, c) helping the kids out while they need it, d) acknowledging or compensating contributions of successors (*How long the hired hand?*), or e) long term care planning (about which more shortly). Or as an old Arab adage urges: *Give with warm hands.*

Time of death transfers, such as wills, revocable trusts, beneficiary designations, preserve not only flexibility and security in your estate plan, but the step up in basis.

The hybrid transfer partakes of both gifting and time-of death transfers. Take the life estate deed: it is irrevocable but retains some of the benefits of ownership in the donor, such as rights to income; because those lifetime rights are retained, it typically remains part of the taxable estate of the donor, which means both that it is part of donor's taxable estate and also that the step up in basis is preserved.

Long Term Care and Medicaid

Many people express concern about the cost of extended stays in long-term care. They worry that everything they worked to own will have to be sold to pay for such care, the annual cost of which presently averages \$65,000. In farm and ranch situations, it may be that the farm or ranch itself would have to be sold to pay for long-term care. That farm or ranch may represent the livelihood of the next generation.

How to plan for the possibility of costly, extended stays in care facilities? Some people choose to buy long-term care insurance. (This may be becoming more difficult and costly given that insurance companies have been losing on these policies and some have stated that they are no longer intending to write policies.) Some people plan on having sufficient income to pay for such care, so that assets will not have to be sold to pay for care, which is a kind of self-insurance. Some people choose to roll the dice, so to speak,

⁹ Or, as another character put it: Father's that wear rags
 Do make their children blind.
 But fathers that bear bags
 Shall see their children kind.

in reliance on the statistical fact that most of us will not spend extended periods in long-term care. Some people expect to rely on Medicaid.

If a person cannot meet the costs of long-term care, they may apply for Medicaid. Medicaid rules and regulations are complicated, and they are subject to change. Planning for Medicaid became significantly more difficult with the passage of the federal Deficit Reduction Act on February 8, 2006 (“DRA”). The following discussion is a simplification of the rules and regulations.

Medicaid is a welfare program. It is designed to pay nursing home costs for those who cannot otherwise afford long-term care. It is funded federally and by the state. In order to receive Medicaid benefits, a person needs to prove eligibility. In general, eligibility is based on Medical criteria and financial criteria. The medical criteria include being 65 years of age or older, or being younger than 65 and being blind or disabled. Financial eligibility is based on an income test and an asset test.

In the income test, in the nursing home context, an applicant must expect to commit essentially all of his or her income to meet nursing home costs. The costs that are not covered by an applicant’s income may then be paid under Medicaid, if the person is otherwise eligible. The income that is counted for this test is the income of the applicant, and not income that is received solely in the applicant’s spouse’s name. Jointly received income is typically divided pro rata between the spouses. There are somewhat complicated rules that allow the spouse of an applicant to keep a minimum amount of income whether that income is received in the applicant’s name or jointly. These amounts are typically adjusted annually.

In the asset test, to over-simplify, the general rule is that an applicant’s assets (sometimes called resources) must be worth no more than \$4000. (This is the figure for Nebraska. It may differ by state.) Certain assets, called excluded assets, are not counted. In addition, Medicaid rules allow for the spouse of an applicant to keep certain assets, assuming that spouse is not applying for Medicaid benefits for him or herself. (This spouse is called the community spouse.) Generally stated, if the couple’s combined assets are worth less than \$23,448, the community spouse may keep all of the assets. If the couple’s assets are worth more than \$23,448, the community spouse may keep half of those assets up to a value of \$117,240. In either case, the applicant spouse also keeps the \$4000. All other assets must be sold and the proceeds in general used to pay nursing home costs before Medicaid will step in to pay.

Congress imposed a penalty on people who transfer assets for less than fair market value that could otherwise have been used to pay for long term care. The penalty works like this: the value of the asset that was transferred for less than fair market value is determined, that value is divided by the monthly cost of the nursing home and the applicant becomes ineligible for Medicaid for however many months that asset would have paid for long term care (the penalty period). For example, if you give away a farm that is worth \$300,000, and the monthly cost of care is \$3000, you will be ineligible for Medicaid for 100 months. However, the only transfers that are considered under this

penalty rule are those that occurred within 60 months of the date a Medicaid application is made. This is called the look-back period. So, to continue the example, if you transferred the farm for less than fair market value on January 1, 2010 and applied for Medicaid on February 1, 2015 – 61 months later – the transfer of the farm would not likely affect your Medicaid eligibility. If you applied for Medicaid in December, 2015, only 59 months after the transfer, you would be ineligible for Medicaid for the 100 months.

The DRA made another significant change in the asset test. Under the old law, the ineligibility period (the 100 months in our example) would begin to run from the month of the transfer, or the very next month. Under the DRA, the 100-month ineligibility period does not begin to run until you have a) moved to a nursing home, b) spent down your other assets (if any) to the \$4000 asset limit, c) applied for Medicaid and d) been approved for coverage but for the transfer.

Planning for Medicaid can be complicated and almost invariably requires an analysis of individual circumstances. It must occur within the restrictions imposed by the rules and regulations that govern Medicaid. The look-back period, the spousal impoverishment program, the spend-down period, homestead protections, exclusions for trade and business property, the use of trusts, annuities, installment contracts and life estate deeds, all present possibilities for planning in the Medicaid context. It is also important to note that planning for long-term care in the farm and ranch context is often only one piece of an estate planning puzzle. Many other concerns crop up: cash flow, taxes, control, succession planning, and treatment of heirs.

Finally, planning for Medicaid typically falls into the category of “give it away now,” which often means that Medicaid planning conflicts with other estate planning purposes, such as continuing control over one’s assets and basis adjustment. The “give it away now with strings attached” category may have some Medicaid advantages, but even a “transfer with strings attached” typically must occur more than five years before a Medicaid application is made.

Incapacity Tools

As mentioned previously, an estate plan typically will – and should – include incapacity planning, including durable powers of attorney for property management and for health care. A **durable power of attorney** for property management (DPOA) is a document that typically authorizes another person to look after assets and manage affairs in the event of incompetence. It is an extensive grant of authority to another person. Choosing the right person to act as one’s agent under a DPOA is an important decision. A DPOA may be drafted to take effect only upon a determination of incompetence or it may take effect upon its execution. A DPOA will likely avoid the need for an incompetence hearing in court or the approval of a guardian.¹⁰

¹⁰ For a more thorough discussion of DPOAs, including choosing an agent, deciding upon the timing of effectiveness, and understanding the powers that are extended, see the companion article *Durable Power of Attorney: Planning for Disability*.

Like the DPOA, a **health care power of attorney** is also durable, meaning that it remains effective beyond an onset of incapacity. The Health Care POA authorizes someone to make medical decisions on your behalf should you be unable to make those decisions yourself. It is the grant of power to another person to make what may be life or death decisions on your behalf. It may also contain specific instructions as to life-sustaining treatment and artificial administration of nutrition and hydration. The Health Care POA is typically (and advisably) a separate document from the DPOA.¹¹

Both the DPOA and the Health Care POA are revocable, provided that a person retains the capacity to revoke.

A **living will** or **health care directive** sets forth your wishes with respect to life-sustaining medical treatment, typically in the context of terminal illness, permanent unconsciousness or the end stages of a fatal illness. Physicians can refuse to follow the instructions of a living will, but they are granted immunity if they choose to follow them. This document may ease difficult decisions for your survivors. Your wishes as set forth in the living will are often – and advisably – reflected in the Health Care POA.

Some practitioners recommend reviewing your Health Care POA and Living Will when you reach a new decade in life, when a loved one dies, in a divorce, in a diagnosis of serious illness or should you find yourself in a deteriorating mental condition.

Conclusion

For reasons almost as varied as people's lives, planning an estate can be complicated. It may also be simple. Individual circumstances need to be considered before determining a plan. Most important, the plan needs to reflect and accomplish a person's wishes. It should be repeated, however, that laws exist in most states (called the **rules of intestacy**) to provide for the transfer of assets upon death where the decedent remained silent as to his or her wishes. And, to end on a less somber note, it should also be pointed out that there is a fourth possibility beyond gifting, time-of-death transfers and the hybrid gift-with-strings-attached, namely don't give it away at all: the estate plan in which the last check bounces. There are no companion articles on this estate plan as it is typically self-executing.

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¹¹ For further information see *Health Care Powers of Attorney and Living Wills: Advance Health Care Directives*.