Farm Management

Be prepared for estate tax changes

Country Counsel

By ROBERT MOORE

EARLIER this year, the Ohio Legislature repealed the state's estate tax. Beginning Jan. 1, Ohioans who pass away in 2013 and beyond will have no estate taxes, regardless of the extent of their wealth.

The future of federal estate taxes is not so certain.

Currently, the federal estate tax exemption is $5 million per person and $10 million per married couple. Any wealth above the $5 million exemption is taxed at 35%. For example, a single person passing away with a $7 million net worth would owe $700,000 in federal estate taxes ($7 million minus $5 million times 35%).

The current federal estate tax law expires at the end of this year. If Congress does not renew the current law or enact a new law, the federal estate tax exemption will be reduced to $1 million, with a top tax rate of 55%. Using the example above, the same person with a $7 million estate will pay $3.3 million.

Recently, the Obama administration proposed a federal estate tax exemption of $3.5 million with a 45% tax rate. The same $7 million estate will result in a tax liability of $1,575,000.

Most experts do not believe the federal estate tax exemption will revert back to $1 million. The resulting taxes would be devastating for farms and small businesses, as the example illustrates. The best guess is an exemption in the $3.5 million to $5 million range.

Gifting opportunity

While the future of federal estate taxes is unclear, there is presently a window of opportunity for gifting. Any individual can gift up to $5 million of his or her assets. Individuals who are above $5 million in new worth should consider gifting some assets to future heirs.

Additionally, with the uncertainty of the federal estate tax exemption, some people are gifting the entire $5 million amount in the event the federal exemption reverts to $1 million. This $5 million gift opportunity expires at the end of the year and will not likely be renewed.

Using the previous example, the individual gifts $5 million to his children. His net worth is now $2 million. Provided that the federal exemption is at least $2 million, he will pay no estate taxes. Even if the federal exemption is reduced to $1 million, he will pay $550,000 in estate taxes rather than $3.3 million.

It is important to understand that a gift cannot have any strings attached. For example, a person gifts $5 million of land with the condition that he or she continues to receive the rent from the land. This is a retained interest and will be included in the person's taxable estate. The land must be gifted with no expectations of receiving any benefit in return.

So what course of action should be taken in spite of the uncertainty of future estate tax exemption levels? The answer depends upon an individual's net worth, type of assets owned, need for income, risk tolerance and other factors.

The best course of action is to have a thorough discussion with an attorney familiar with estate taxes. With the attorney, a plan should be developed that best meets the needs of the individual or family. As is always the case, the worst plan is to have no plan at all.

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Eliminate involuntary investments in ag

On the Money

By JOHN OTTE

AN intriguing concept has evolved from the chatter about shrinking government. I call it the commodity-oriented food security alliance, or COFSA.

Many Americans maintain they can spend their money more wisely than government can. Plus, government at all levels is confiscating taxpayer money and handing it over to private companies. Whether these funds are called grants, tax credits, forgivable loans or farm subsidies, they all allow government to pick winners and losers. Such policy tools force taxpayers to invest in private businesses whether they want to or not. In most cases, taxpayers get no direct benefit in return — think Solyndra.

COFSA could change all of that. Plus, it could make big strides toward balancing the federal budget. In a nutshell:

- Congress would end farm subsidies (and many other subsidies).
- Farmers who need cash would transfer shares of their farms to an alliance, possibly formed by a consortium of commodity organizations.
- The alliance would sell shares of individual farms to individual investors, or bundle shares of similar farms and sell pieces of the bundle to investors.
- Investors could buy shares of farms of most interest to them: grain, cotton, rice or livestock, as examples.
- Farmers would get cash to replace subsidies.
- Farmers could use the cash for capital investments or operating needs.
- Farm shares would pay dividends to investors when crops or livestock are sold.
- Small investors could get in on the agricultural boom, without needing enough money to buy an entire farm.
- The value of shares would rise, or possibly fall, as financial conditions in agriculture changed.
- Farmers who don't need money would not have to participate.

Admittedly, COFSA sounds complex. But the mortgage industry has demonstrated how to take individual investments, slice and dice them, and then repackage them into investor-sized bundles.

A few details remain to be worked out. The housing meltdown shows that individual assets are hard to track after they've been sliced and diced. However, with that weakness exposed, more sophisticated accounting can handle it. A mechanism also would need to be established to conduct orderly buying and selling of shares.

Ample potential benefits

Such a venture, if properly structured and implemented, could:

- reduce government spending
- whittle down the deficit and the debt, or reduce taxes
- provide a vehicle for citizens to voluntarily invest in agriculture and get a direct cash return from their investments
- provide farmers with off-farm equity to expand their businesses
- strengthen or re-establish the link between food on the table and fiber on the backs of consumers now two, three, four or more generations removed from the farm

The concept is intriguing. If extended across the economy, it could trim the ability of businesses to buy tax favors.

It could be a win-win-win all around.

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Alternatives available?

GRANTED, under COFSA farmers could incorporate and then sell shares of their corporations to outside investors to raise capital.

However, that would do nothing to trim government spending, reduce debt and end current policies that make taxpayers captive investors in private business.

Suppose subsidies go away, and farmers don't replace them with private investment capital. Maybe farmers didn't really need taxpayer money.