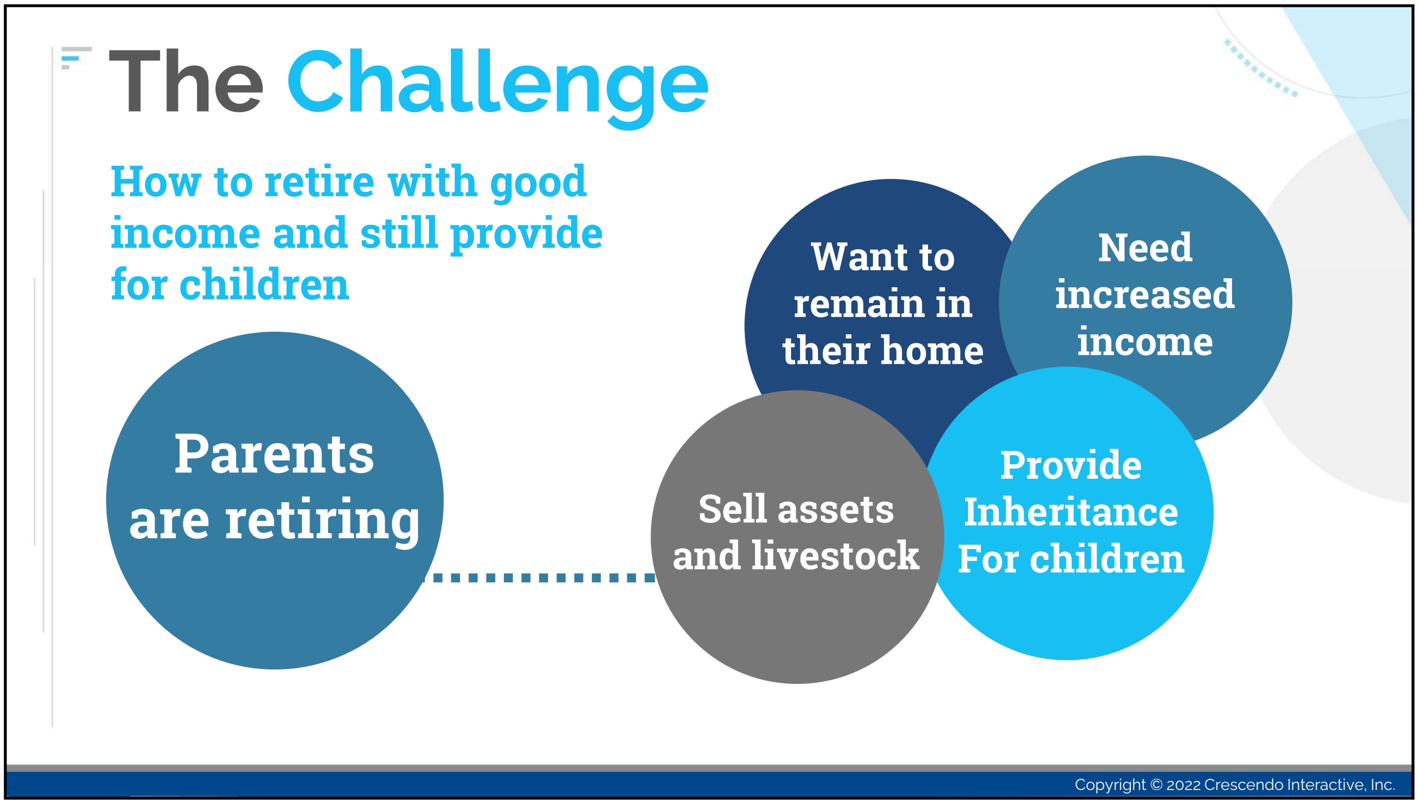
Farm Retirement Plan



CHALLENGE RETIREMENT FROM FARM

John and Mary Jones have lived on the farm all their lives and now have decided to retire. Since the farm is producing only 2% or 3% income as a percent of fair market value, if they lease the farm, they need to find a way to increase their income. However, they would like to remain in the home on the farm where they have lived most of their lives. In addition, they have some stocks of wheat that have been grown over the years and stored for sale in a future year and they also own a number of cattle.

How can they retire with good income and still provide an inheritance for their children?

FARM PROPERTY

The primary asset of the farm is the land. John has tended the land for many years and has a very strong emotional attachment to the land. However, since the children are not remaining on the farm, it is now becoming apparent to John and Mary that this is the time to consider selling the land. The land is of course highly appreciated, since it has been owned by John and Mary for many years.

There are cattle and also some crops in storage. Since John and Mary are cash basis taxpayers, the cattle and crops have been expensed and have essentially a zero cost basis. These represent potential ordinary income to John and Mary.

Modern farming requires expensive machinery. Tractors and combines and other machinery can have a value of $400,000 to $900,000 for a medium or large size farm.

Finally, the farmhouse is a good solid dwelling and residence and they wish to remain there for a period of years.

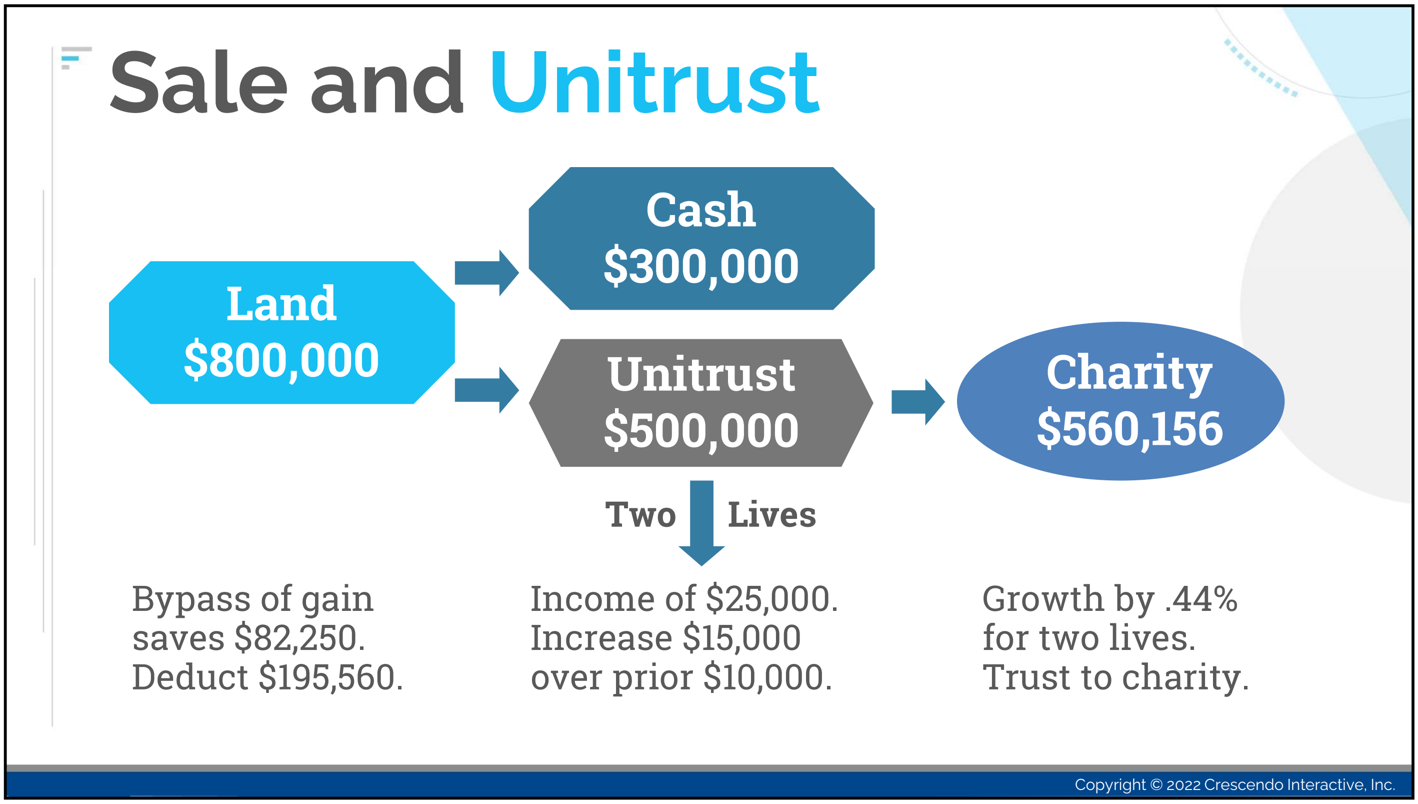
THE SOLUTION

The land could go into a zero tax trust. Part of the land is sold for cash and the other part is first transferred to the trust and then sold tax free through the trust. The part that is sold for cash produces necessary liquidity. The portion sold through the trust both enables a bypass of capital gain and produces enough charitable deduction to offset the tax on the gain for the portion sold.

Cattle could be transferred into a "rawhide trust". These cattle could be sold tax free through this trust. The service in a private letter ruling has permitted this to be done, but one should be careful not to incur any potential unrelated business income by continuing to operate a cattle feeding business within the trust. Thus, the best strategy is to transfer the cattle into the trust and then immediately take the cattle to an appropriate yard for sale of the cattle.

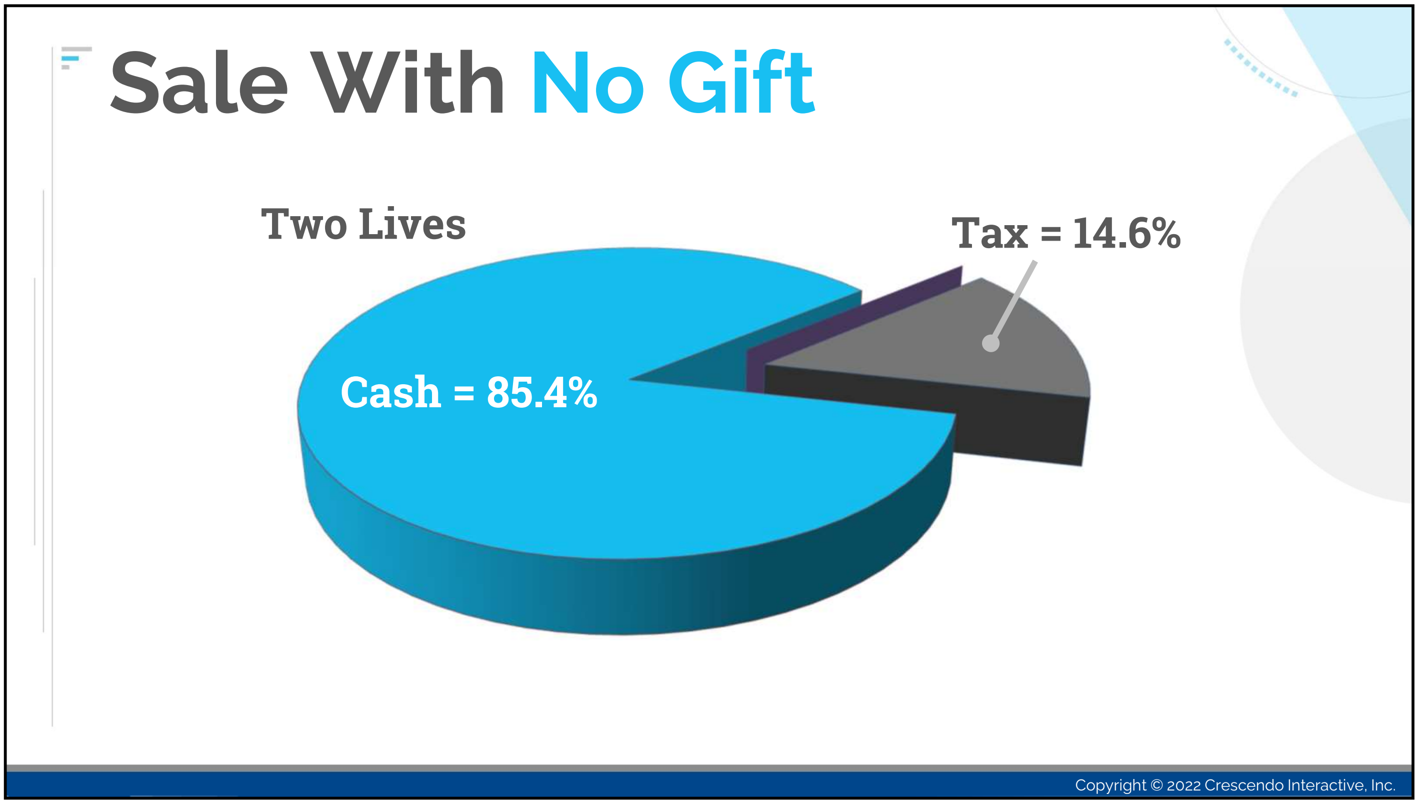
If John and Mary wish to live in the home, it is frequently appropriate to retain the right to the homestead. When the new buyer buys the farm, the new buyer may also then wish to purchase the remainder interest in the life estate from John and Mary. Alternatively, if the new buyer has no interest in acquiring the homestead, John and Mary might choose to give the remainder interest to the charity and retain the life estate for themselves.

One of the primary methods for providing inheritance for the children is a life insurance trust. A portion of the increased income from the charitable trust can be transferred to the insurance trust. If the insurance trust is handled properly, the proceeds can be transferred free of both income and estate taxes to the children.



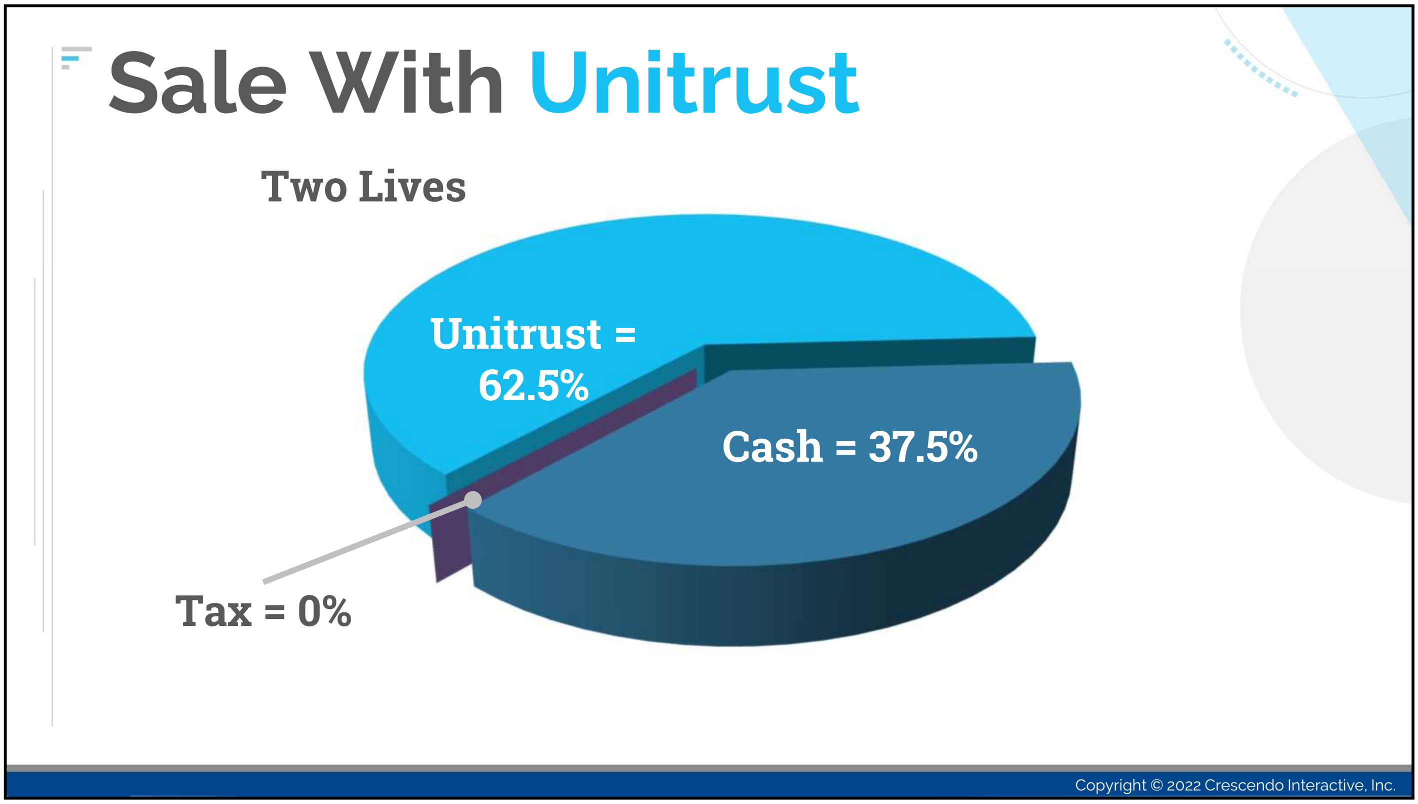
SALE AND UNITRUST

In this example, part of the farm is transferred to a charitable remainder trust. This part is sold with no capital gains tax and also produces an additional deduction. The charitable deduction considerably reduces the tax that would otherwise be payable on the property sold for cash. While there is still a smaller amount of capital gains tax paid, the transaction enables John and Mary to enjoy both maximum income and good liquidity with minimal shrinkage due to capital gains taxation.



SALE AND UNITRUST

In this example, half of the farm is transferred to a charitable remainder trust. This one half is sold with no capital gains tax and also produces an additional deduction. The charitable deduction considerably reduces the tax that would otherwise be payable on the property sold for cash. While there is still a smaller amount of capital gains tax paid, the transaction enables John and Mary to enjoy both maximum income and good liquidity with minimal shrinkage due to capital gains taxation.



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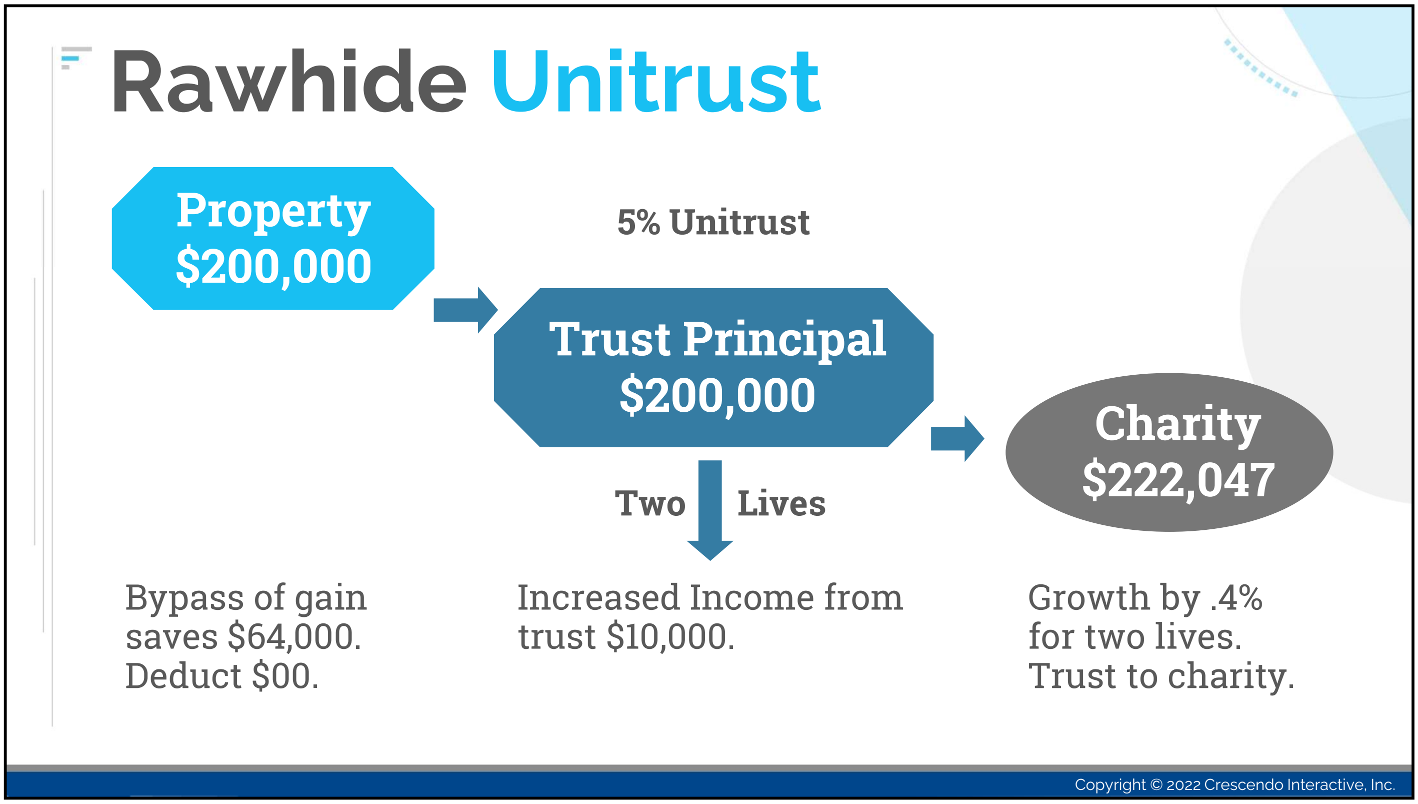
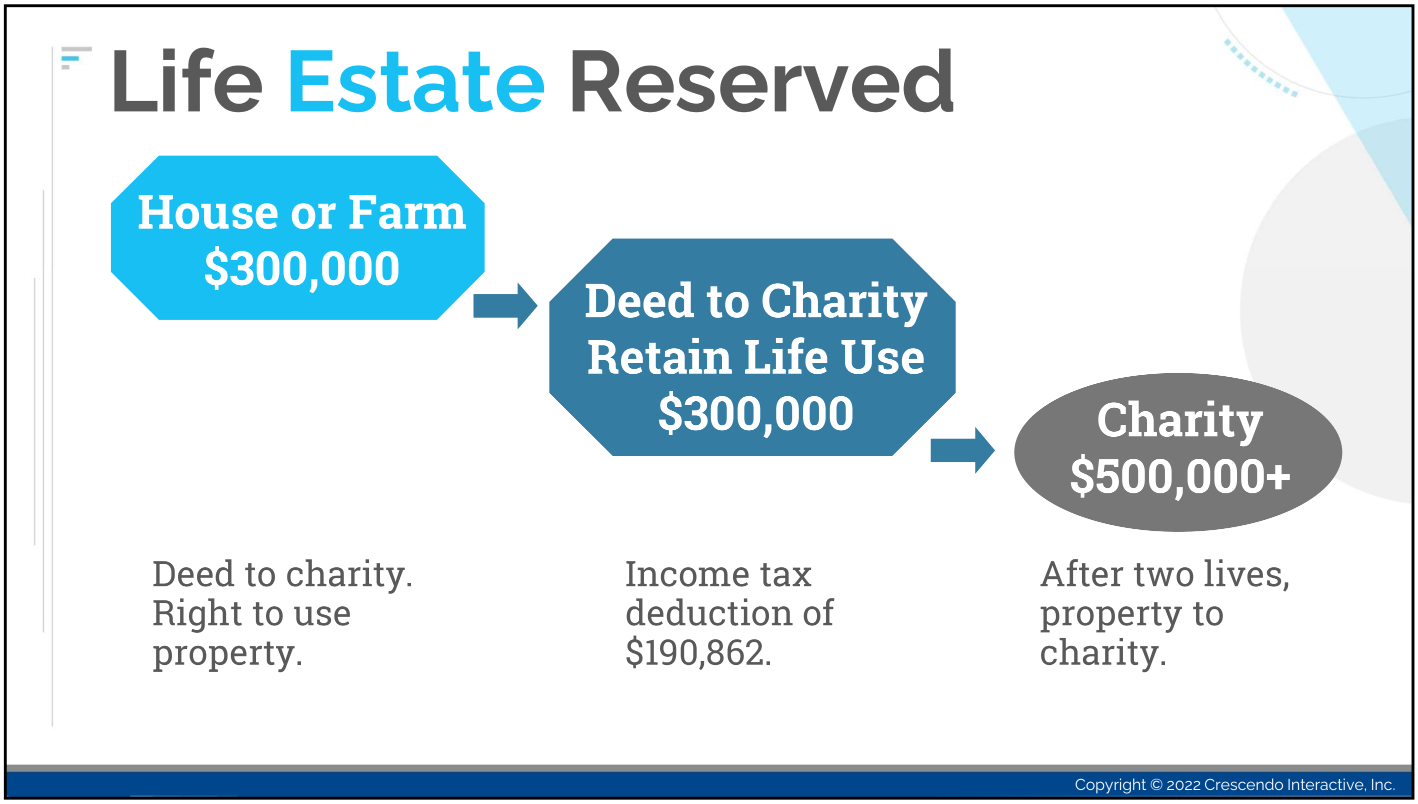


LIVING UNITRUST

If there is $200,000 of cattle, wheat or machinery, this could be transferred into a charitable trust. Because this would be tangible personal property and perhaps zero basis property, there may not be any charitable income tax deduction. However, it is possible to sell the ordinary income asset and avoid payment of tax on the increased value.



LIFE ESTATE RESERVED

If John and Mary desire to live in the residence for their lifetimes and then benefit charity after the two lives with property, it would be possible to create a life estate with remainder to charity on the family residence and "reasonable surrounding grounds". The life estate is created quite simply with a deed to the charity. John and Mary retain the right to live in the farmstead house for their lifetimes. There would be an income tax deduction for the gift of the remainder interest. Since John and Mary quite possibly may live 20 - 25 years, this is a percentage of the total value of the home.

Generally, it is appropriate to have an agreement that specifies the arrangement with respect to maintenance insurance and taxes for the home. Since John and Mary are living in the home, they will usually cover these expenses.