ESTATE PLANNING

Room 202AB

Speaker:

C. Beth Roberts, Lincoln Financial Group

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A Plan of Action

Thanks to a 2-year extension of the current estate tax laws, business owners have a window of opportunity to plan who will inherit family assets, and how. The window may close, or may be altered, at the end of 2012.

By E.C. Carson

Editor's Note: In late 2010, the U.S. government extended the current level of estate taxes for 2 years. Without this extension, the heirs of businesses, such as family ranches, would have faced upwards of 50 percent inheritance tax. In about a year, elected officials will once again debate the merits of estate taxes.

Regardless of upcoming governmental decisions, ranchers can take steps to ensure their life's work is protected when it is transferred to the next generation. Below is the first of a 3-part series on estate planning. This story provides an overview of estate planning, and discuss why many ranchers avoid this vital aspect of business.

Mike Fuller remembers the first time his brother, Mark, discussed estate planning with him.

Mark, a board member for the Association of General Contractors (AGC), traveled each month to Austin, to bid on road construction jobs for the State of Texas. During each monthly meeting, the AGC board invited guest speakers to address key issues impacting the industry and individual contractors.

At a fall meeting in 1998, Texas and Southwestern Cattle Raisers Association (TSCRA) member C. Beth Roberts, a Registered Financial Consultant with Lincoln Financial Advisors, spoke on the value of estate planning. Mark returned to his brother — his best friend and business partner — to outline what he had learned.

Mike and Mark Fuller represented the "Sons" in the L.A. Fuller and Sons Construction, a large paving company founded by their father in the 1940s, responsible for building everything from interstates to parking lots.

When their father passed away in 1990, the brothers had already assumed the day-to-day operation of the company, so the estate planning had occurred naturally over years. However with leadership shared between the siblings, and with each brother responsible for spouses and children (Mike with 4 sons, Mark with a son and a daughter), they knew that estate planning would be essential.

Families in the ranching community are fortunate that the grandparents, parents and grandchildren get to spend time together. Regina and Coleman Locke, Hungerford, enjoyed time with their grandchildren Jessica, Parker and Austin DeBerry at the 2009 TSCRA Convention Weekend, Fort Worth.

Estate planners urge business owners, such as ranchers, to spend time now planning how to pass on assets they've earned and to keep the business or ranch intact and viable.

"We didn't even know what estate planning was at first," Mike Fuller said. "You hear about it and you know that you need to do it, but you think you're going to live to be 110 years old and that you'll take care of estate planning when you're 109."

The Fuller brothers invited Roberts to their base of operation in Amarillo to educate them on estate planning and begin the process. With more than 35 years' experience, Roberts understands the confusion surrounding estate planning.

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"Most people believe that drawing up a will serves as an estate plan, but an estate plan encompasses so much more than that," she said. "An estate plan not only outlines what assets are going to be transferred to the next generation, but details a step-by-step process on how they are going to be passed, as well as outlining what efforts need to be made each year to advance that transition to maximize savings for the owner."

Roberts explained that only 12 percent of family businesses, such as ranches, pass to the third generation primarily because the owner either has no one to take the business or there is a lack of planning.

Take advantage of this window

"The No. 1 reason people do not estate plan is fear," Roberts said. "Most people are afraid to tackle the estate planning because they've heard horror stories about how complicated it is or how much it costs, or they can't face the subject entirely. They don't know how to start so they never do."

Fear was not an obstacle in the Fuller brothers' situation. They just needed knowledge, so Roberts began the process by explaining the current estate tax laws (the very laws that could change dramatically in 2013). For the next 16 months (until the end of 2012), estates with assets, which includes every piece of property owned, from houses and equipment to mineral rights and investments, that total less than $5 million can gift the entire estate to an heir without the penalty of an estate tax. Any assets exceeding $5 million are subject to an increasing graduated tax scale that ranges between 35 to 50 percent.

"Throughout my 35 years of experience, there have been windows to take advantage of tax law, and we are in a window now," Roberts said. "Why wait and see what the government does in 2013, when you can handle your estate under the current guidelines? Some people say the government will get rid of the estate tax. Don't believe that. They're never going to get rid of the estate taxes."

If the federal government ever eliminated the tax, many states, such as Texas, have laws that would become active and would begin a state-level estate tax. Additionally, under the current system, the federal government already sends a portion of the estate taxes back to the states.

Roberts gave the example of a couple who lives in Michigan, but owns a vacation home in Florida. "Their estate is split, so the government gives each state a certain percentage of the taxes collected," she said.

Arthur Uhl, an attorney who specializes in estate taxes, a TSCRA director and chairman of the TSCRA legislative and tax committee, echoes Roberts' call for ranchers to pursue estate planning, especially under the current law. Uhl says unless the estate tax laws are changed in less than a year and a half, the law will automatically shift to a 50-percent tax on any assets exceeding $1 million.

"To be safe, you should prepare now," Uhl says. "We have a decent situation now, but unworkable situation looming unless a new law is passed."

Businesses like ranching and construction are usually among the industries hardest hit by the estate taxes, because they require large capital assets and have low returns. "The rate of return for the ranching industry is usually less than 1 percent," he says. "It usually takes millions of dollars worth of land and equipment to produce thousands of dollars of food."

Uhl says, beyond facing extraordinary operational challenges from weather to animal health, ranchers often pay taxes multiple times on the same asset, making estate taxes redundant and ineffective.

"Ranchers pay taxes every minute of their life and multiple times on the same piece of property. To tax their heirs is not right. It is a patently unfair tax," Uhl says. "Additionally, estate taxes bring in less than the cost of compliance. In other words, the amount of revenue generated from estate taxes is less than the amount it costs to operate the program. Still, these taxes exist, and if a rancher does not plan for them, they can be disastrous for a ranch and the people who depend on it."

Like many ranchers, the Fuller brothers' construction business requires a great deal of capital investments. They knew they were going to exceed the assets threshold and be subject to extraordinary taxes rates, making estate planning even more vital. "Most people in our business are second or third generation contractors, just like farmers and ranchers," Fuller said. "You just can't wake up and want to get into these types of businesses, because of the capital required. You have to spend half a million dollars on a piece of equipment and not bat an eye. It just costs too much. "

Assembling a cost-effective planning team

Cost is often a deterrent to estate planning. Many ranchers believe that the cost of estate planning (both time and resources expended) will far outweigh any benefit achieved. Fuller understands that thought process, but summed up his argument for estate planning with a little simple math.

"You can pay some fees to knowledge people, or you can lose 50 percent to taxes," he said. "It would have cost us a whole lot of more money to be unprepared than be prepared."

Roberts, Uhl and Fuller all believe the key to developing a successful estate plan was assembling the right team with specialized knowledge.

Roberts, who is a financial planner, not an attorney nor an accountant, acts as the "quarterback of the team," working to outline the goals and objectives of the family; bringing in the right attorneys and accountants to produce the correct documents; and then review every line of documentation with the family, so they fully understand each aspect of their estate plan.

Roberts offered some straightforward advice for those who are considering beginning their own plan. "If you decide not to bring a financial advisor and, instead, just to work with a lawyer and accountant yourself, then I urge you not to go to an oil-and-gas attorney, a real-estate attorney or your family attorney," she said. "Go to a specialist. Go to a tax attorney. Go to someone who knows this particular set of laws."

Additionally, Roberts said not to use your local bank as a trustee. "Your local bank is usually not your friend," she

said. “Local banks want to hold onto the money. I have seen countless horror stories from widows who needed foundation repairs, to children who need money for college, that were denied funds from the bank.”

Uhl offered additional advice for first-time estate planners, who are selecting professional help. “Do your research on any attorney or any financial advisory group,” he said. “Ask for references. If you don’t understand what they’re saying, then go find someone who will. If it sounds too good to be true, then it probably is.”

As for the Fullers, their estate planning went smoothly. In about a year and a half, the brothers — led by Roberts’ team — had assembled a plan that ensured a seamless transition of the business in the event that either brother passed away. (The Fuller brothers’ complete estate planning process, as well as tips on subjects ranging from decoupling to community property, will be detailed in the second-part of *The Cattleman’s* special series on estate planning.)

“Nobody likes to think about when they’re going to die,” Fuller said. “Apprehension of that is what keeps people from doing their estate planning. They get foolish about it. Dying is a part of living. It’s not going to go away. The only thing you can do is prepare the best you possibly can because that moment will catch up with us sooner or later.”

Unfortunately, that moment came much too soon for Mark Fuller, who was diagnosed with cancer less than 2 years after the brothers had locked in their plan.

“When he was first diagnosed, you have all the emotions and thoughts that run through your mind. There is fixation on the chemo and radiation. You know it’s going to be awful,” Mike Fuller said. “Even with all of that hanging over our heads, we knew that if he got well, we’d continue as planned. We also knew if he didn’t make it, the company and his family were not going to be in peril.”

In 2004, Mark Fuller passed away at the age of 54. “You always think you have plenty of time to get your estate in order,” his brother said. “We all think we’re bullet proof. We all think we have a lot of life left and a lot of time to do things, but no one is guaranteed the next moment.”

The estate plan that Mark was so eager to initiate worked flawlessly, providing his family ample means to live and Mike the ability to keep the company functioning.

“Mark was more than my brother he was my best friend,” Fuller said. “I miss him terribly every day. We hunted together. We skied together. We worked and played together. That’s why you do estate planning. You do it for your family. You do it because you love them.”■

A Plan of Action

Assembling the Parts of the Plan

By E.C. Carson

Vintage family photos like this are probably common among ranching families. Careful planning will help business-owning families, like ranchers, add more generations to photos taken on the family ranch.

Editor's Note: *The following story is the second feature in 3-part series on estate planning. This story covers key areas that must be considered when assembling an effective estate plan.*

C. Beth Roberts knows the window is closing.

Having been a Registered Financial Consultant for 25 years, a registered representative with Lincoln Financial Advisors, and a member of the Texas and Southwestern Cattle Raisers Association (TSCRA), Roberts' experience tells her farmers and ranchers must act now to protect their estates.

In late 2010, the U.S. federal government extended the current level of estate taxes for 2 years. Without this extension, the heirs of businesses, such as family ranches, would have faced upwards of 50 percent inheritance tax on any income over $5 million. In less than 15 months, elected officials will once again debate the merits of estate taxes and there remains the potential for the taxable threshold to be dropped to $1 million.

"The federal government could make sweeping changes in less than a year and a half, so this is the time to act," Roberts says. "Most people are afraid to tackle estate planning because they've heard horror stories about how complicated it is or how much it costs. They don't know how or where to start, so they never do."

Arthur Uhl, a TSCRA director and chairman of the TSCRA legislative and tax committee, specializes in estate planning for those in the agricultural industry. His advice for taking the first step — find an accountant and/or an attorney dedicated to estate planning.

"This is a complicated field," Uhl says. "Individuals beginning an estate plan need to find an advisor who understands the specific laws that govern estate planning, instead of just a general practitioner."

Roberts believes financial planners, such as she, can provide an additional service, becoming the quarterback of a team of attorneys and accountants, while providing clear direction and translating sometimes complicated legal issues to the client. "No matter if you choose just an attorney, or select a financial planner, always remember that if someone is talking above you, go find someone else," Roberts says. "You need to find someone [clients] trust. It will make the process much smoother."

What do you consider a successful life?

Mike Fuller can attest to the value of smooth estate planning process.

Fuller, along with this brother, best friend and business partner, Mark, owned L.A. Fuller and Sons Construction, a large paving contractor founded by their father in the 1940s.

The company has built everything from interstates to parking lots in Texas and, like many agricultural operations, consists of millions of dollars in overhead and machinery. In the fall of 1998, the pair hired Roberts to help map out an estate plan that would protect both brothers and their respective families in the case that either passed away.

Unfortunately, the Fuller brothers' estate plan was put into action much sooner than expected when Mark passed away from cancer in 2004 at the age of 54.

"You're never guaranteed the next moment," Mike Fuller says. "You have to be prepared. If you own a business, it is the responsible thing to do."

Roberts explains that all successful estate planning begins with a question that will define the rest of the process: What is a successful conclusion to your life? "The answer to this question will help them formulate the specific objectives," she says. "Those objectives serve as the foundation for the plan."

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Additionally, the family dynamic is an early-stage variable that must be addressed. Only spouses, not children or the children's spouses should be involved in the formulating the estate planning. "When I speak of children, I mean people who are in their 40s or older," Roberts says. "There is a tremendous amount of emotion involved in this topic, and couples have to work through that emotion without the influence of their children. The worse thing they can do is bring their children into the mix.

"They must remember 2 things. You are dealing with human nature, and discussing who gets what and why. That is complicated at best. The second thing they must remember is they are doing this for their family. If there is no plan in place when they pass, the grieving will turn into conflict, which will turn into chaos, and that ultimately turns into a legal battle."

In the case of the Fuller brothers and their wives, they found unity in the process. "We were all on board," Fuller says. "Had someone not been on board, it would have been awkward. We all wanted the best not only for the company, but best for the family, so that was our goal from the start and we worked from there."

Assembling the details

Once goals have been defined and family dynamics considered, those who undergo estate planning will need to provide virtually every imaginable document pertaining to their life and finances including bank accounts, investments, tax returns, business agreements and investments.

"I never consider the process burdensome. It was just sort of in the background," Fuller says. "Assembling some of the information was tedious since we were trying to run a business, but it is much less painful than you expect. More so, you're protecting what you've spent a lifetime building, and that's worth any amount of time and effort."

Often, appraisals will need to be made on the estate's assets. Uhl points out that land appreciates rapidly, which could easily impact the overall value of the estate, and needs to be tracked. "Ranches that are worth $3 million today could be worth $10 million in 15 years," Uhl says. "This is something to consider at the very beginning."

When working with a financial planner, such as Roberts, the documents and appraisals are dissected by a team, which develops a variety of options. Among the alternatives are holding assets or beginning a gradual transfer to the next generation. Additionally, investment opportunities are discussed, and insurance policies are usually updated or purchased.

"A good estate planner will provide you with several options, then educate you on what is possible," Roberts says. "Each option can have varying degrees of risk, so again make sure that you and your spouse fully understand each step."

Uhl usually suggests ranchers consider transferring the estate into a limited family partnership, which reduces the tax burden on any one individual. "In a limited family partnership, no one owns the ranch; instead, they own a stake in it," Uhl says. "This discounts the value because of the lack of liquidity and lack of control. This is usually a helpful step."

The Fullers developed a buy-sell agreement wherein if a brother passed away, his spouse would sell to the remaining brother. Neither wife wanted to be a partner, nor had the experience to manage a massive paving business. The estate plan provided financial security for Mark's wife, and removed the pressures of the business from her, while allowing the business to pass securely to Mike. "There could have been many uncomfortable scenarios if we had not had a plan in place," Fuller says. "Suppose we had nothing, no plan. We were just going down the road and then something happens," Fuller says. "We would have had a huge problem. My sister-in-law would have had a huge tax issue. I'd want to buy the business from her, but maybe couldn't have afforded it. The business and the family would have suffered. It could have been a complete disaster."

The Fullers' estate plan took about a year and a half to develop; however, Uhl says that many can be completed in 2 to 6 months. Still, every plan is unique and every timeline is different. Roberts emphasizes a few of the more tricky factors that can gum up the estate planning process, specifically decoupling and community property states.

Decoupling refers to a potential division between the federal government and individual states in the collection of estate taxes. Currently, the federal government provides a certain amount of estate taxes back to each state. However, a handful of state governments, such as in Massachusetts, are writing their own estate tax laws that no longer run in tandem with the federal agenda. This means that even if an estate does not reach the minimum $5 million value to be taxed by Uncle Sam, it could still be subject to estate taxes at the state level.

This decoupling factor also would play a role if the federal government ever abolished estate taxes — a political red herring, according to Roberts. "There was some talk of getting rid of estate tax, which will never happen," Roberts says. "When the discussions heated up, each state wrote their own laws. If the federal estate tax went away, then the state laws would kick in. There are no freebies in life."

Another blind spot in estate planning are the 9 (sometimes 10) community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, Wisconsin and, in some cases, Alaska).

In a community property state, each spouse owns a "present, equal and undivided interest in each asset." In other words, everything is split 50-50. However, if the spouse dies, their family could lay claim to that spouse's share of the assets, meaning in-laws in community property states could take a portion of the ranch, cash, etc. "This just shows another value of estate planning, which is radically different from a will," Roberts says. "Through an estate plan, you can ensure that the ranch passes only along the family line."

Lastly, Roberts brings the discussion back to family, specifically, children. Dividing property among siblings is often difficult, especially if one child is involved in the family business and one is not. Parents often look for an even split; however, Roberts suggests that "fair and equal are not necessarily the same thing."

While not as arduous as most people imagine, assembling an effective estate plan does require time and patience, as well as careful consideration about family dynamics. Still Roberts knows it is worth any potential cost or time. "The only barrier keeping someone from beginning an estate plan is their own fear, but they have to remember the window is closing," Roberts says. "My estate plan is done, and I have to tell you, I sleep well at night."■

A Plan of Action

Vintage family photos like this are probably common among ranching families. Careful planning will help business-owning families, like ranchers, add more generations to photos taken on the family ranch.

Plan Your Work, Work Your Plan

By E.C. Carson

Editor's Note: *This is the final installment in the 3-part series on estate planning. This story, the series finale, will provide pointers on properly implementing an estate tax plan.*

At its core, an estate plan is a living document. Business owners, such as ranchers, develop an estate plan to provide a step-by-step outline of ongoing actions that secure and transition assets to the next generation. Unfortunately, estate plans are sometimes treated as "break-in-case-of-emergency" documents — developed with the best of intentions and then left unattended. Ultimately, the plan loses effectiveness.

Implementation of a completed estate plan seems inevitable. After all, the individual who initiated the plan recognized the need for such a document, and spent time and financial resources on its development. However, C. Beth Roberts has seen well-constructed estate plans slip into obscurity from inaction.

"A plan sitting on the corner of a desk or locked away in a safe is a lot of wasted time and money," says Roberts, who has been a Registered Financial Consultant for 25 years, and is a registered representative with Lincoln Financial Advisors and a member of the Texas and Southwestern Cattle Raisers Association (TSCRA).

Implementation begins at the end of the development phase of the estate planning process, when the legal documents are drafted by attorneys and tax professionals. Roberts encourages her clients to read each document paragraph by paragraph so they fully understand every facet.

"If I have done my job properly, I have educated you on every part of the plan," she says. "If you are estate planning and you are not clear about any aspect of the plan then do not move forward until you have clarification."

Once a business owner is confident in the framework of the plan, he or she will begin implementing the outlined steps. Often an estate plan will require the individual to re-work wills and trusts, as well as purchase investments and insurance policies.

"We encourage people to get their plan set as soon as possible," Roberts says. "However, we also suggest allotting yourself several months to implement the necessary changes. It is better to be thorough than to rush. Again, you must make sure to read and understand every legal document."

The implementation phase also includes opening a dialogue with family members or partners who will be directly involved in receiving assets. Roberts recommends that individuals or couples not involve [adult] children during the initial estate planning process, instead allowing the estate planner to work without distractions. When the next generation is finally included in the conversation during implementation, Roberts suggests that only the children, and not their spouses, be involved in the conversation.

"Spouses usually complicate the situation," she said. "Parents usually do not want the influence of the spouses in the room."

Of course, there is the potential that the child may not have a spouse, be through college or even eligible to inherit property. Estate planners must take extra steps to properly ensure passing their estate to children younger than 18 years old, who cannot legally inherit assets.

Roberts also suggested that the financial guardians be kept separate from health care guardians. "It is wise to keep them independent of each other," she says. "If you have a sister and she passes away and you become the guardian for your niece in all matters, it means you, as the guardian, may get something while the niece does not. It's best to have someone else handling the financial matters."

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Arthur Uhl, a TSCRA director and chairman of the TSCRA Legislative and Tax Committee, specializes in estate planning for those in the agricultural industry. Uhl explains, while the family dynamic can complicate the estate planning process, the process can also benefit the family.

"It is difficult to go through sometimes, but it usually ends up being helpful in the long run," Uhl says. "It forces the family to sit down and have a discussion about how the property, usually a ranch, will be run in the future. When the family focuses on what is best for each other and thinks about how much money could be saved by going through estate planning, they are usually motivated to get it done together."

Uhl suggests owners of small farms and ranches that do not meet the tax threshold have the estate planning discussion. "The process is helpful," he says. "Even if you don't have to develop a family partnership and trusts, just going through the discussion is ordinarily a huge step in the right direction."

Implementation of the estate plan may also include some form of annual gifting, which allows the business owner to slowly shift assets to the next generation free of a tax burden.

Every year, an individual can give $13,000 worth of property to anyone and be exempt from the gift tax. The owner must prove the value of the property, which usually includes the need for appraisals. This gifting process takes additional time, expense and personal dedication. "This is not a practice that most people have done on an ordinary basis," Uhl says. "It takes some discipline to do things like this every year, but in the long run it is worth it."

Both estate planning experts, Roberts and Uhl, say that property owners can modify and update their estate plan through the years. "It's better to change plans," Roberts says, "than be caught without one."

In extreme situations, such as a diagnosis of a fatal disease that requires immediate action, business owners with no estate plan in place will face penalties when they transfer assets.

"You cannot do things in anticipation of death," Roberts said. "If you are moving assets quickly, the IRS will get you." However, if the individual has a documented estate plan — even one that is not fully completed — he or she will be covered in most cases.

While estate planning remains a complex and sometimes difficult subject to discuss, both Roberts and Uhl see it as an absolute must for ranchers. In fact, both experts have the same final piece of advice — don't wait to begin an estate plan.

"The worst thing they can do is put it off," Uhl says. "People have put it off and then something happens. It costs them millions of dollars. They are forced to mortgage the ranch or come up with cash to pay the estate tax. People have lost the family ranch because of estate taxes."

Roberts echoes Uhl's sentiment with a final question for all those considering estate planning, "If you've taken a lifetime to accumulate your wealth, why not take a year to put in place a plan that will keep it in the family?"■

Notes

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