

SANDWICH GENERATION

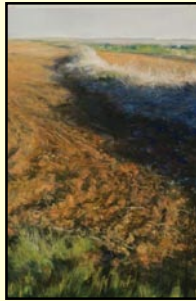


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**UNL Extension
North Central Extension Risk Management Education**

Need For Personal Legal Advice

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PART I Issues, Anxieties, Background



ISSUES and ANXIETIES

- Access to assets
- Taxes
- Long-term care
- Feasibility
- Independence
- Uncertainty
- Contests and disputes

ISSUES and ANXIETIES

- Access to assets
 - Will we have authority to run the ranch?
 - Who will control the ranch assets?
- Taxes
 - Will we have to sell assets to pay the taxes?
 - How much tax can we expect to have to pay?

ISSUES and ANXIETIES

- Long-term care
 - How big is this risk?
 - Will parents have to sell assets to pay for long term care?
 - Will we lose land in paying for care?

ISSUES and ANXIETIES

- Feasibility
 - Will we have to buy out other heirs?
 - Price? Terms?
 - Will we be paying rent to other heirs?
 - Can we afford to keep going?
 - Do I want to take on debt at my age?

ISSUES and ANXIETIES

- Independence
 - Am I going to be in business with off-ranch heirs?
 - Who will call the shots?
 - Will I be able to plan my own retirement?
 - Will I be able to plan for succession to my kids?

ISSUES and ANXIETIES

- Uncertainty
 - What if parents change plan?
 - What if parents become incapacitated?
 - POAs, successor trustee
- Contests and disputes
 - Will there be fighting among the heirs?

Background Basics: Planning

- Tax considerations
 - What are they?
- Dispositive wishes
 - What becomes of the assets?
 - The heart of the matter
- Tools to accomplish wishes
 - Gifts, Sales, Wills, Trusts, Titling

Background Basics: Taxes

- Federal Transfer Taxes
 - Estate Tax – 40% - on time of death transfers
 - Gift Tax – 40% - on gifts made during life
- Unified Credit: Exemption is \$5 million per person
 - portability
- Basis Adjustment
 - Available for time-of death transfers only
- Nebraska Inheritance Tax
 - 1%: children, siblings, grandkids, parents (\$40k)
 - 13%: niece, nephew, uncle, aunt (lineal descendants thereof) (\$15K)
 - 18%: others (\$10K)

**Background Basics:
Dispositive Wishes**

- Three basic options
 - Direct ownership
 - Heirs own property separately
 - Heirs own property together
 - Indirect Ownership
 - Heirs own property entity or trust

Background Basics:
Separate Ownership

- Each heir gets their own
 - Virtue of simplicity
 - Heirs not “in business” together
 - No asset protection
- Need to decide who gets what
 - Can this be done and satisfy sense of fairness?
 - What about feasibility?
 - Can property be physically divided?

Background Basics:
Co-ownership

- Tenancy-in-common: undivided interests
 - No management structure
 - Right of partition
 - No asset protection
- Joint tenancy
 - “last person standing...”

Background Basics: Indirect
Ownership

- Property is held in trust or owned by an entity, e.g. LLC
 - Heirs own the entity
 - Entity provides
 - structure for management/control
 - restrictions on ownership
 - asset protection
 - buy-sell possibilities

**Background Basics:
The Transfer**

- How will owners transfer property?
 - During life
 - By gift or sale
 - At time of death: three basic ways
 - Will
 - Titling
 - Trust

Some Common Tensions

- Equality v. Succession
 - How do owners feel?
- Separate ownership v. shared ownership
 - Separate is cleaner (not in business together) but will the ranch continue?
- Fair market value v. discounted value
 - Feasibility
 - Values
- Cardinal principle v. Sandwich Generation
 - Present interest v. time-of-death transfer

**What can
Sandwich Generation do?**

- Start the conversation
- Help owners to think about these issues
 - Inform them of resources for succession planning
 - Provide written information
- Inform owners of the risks of failure to plan
 - Common triggers: taxes, long term care costs
- Discuss values
 - Are there shared values of succession
 - Do owners want to see the ranch survive under family ownership and active operation
- Acquire present interests, rights, property

Forks in the Road

- Do heirs receive separate property or do they share property?
- If separate
 - Who gets what?
 - Is the division fair?
 - Can the successor keep going?
 - If the successor gets more, what conditions come with it?

Forks in the Road

- If they share, what do they share?
 - Ownership
 - What rights do they have: buy outs, first refusals?
 - Management
 - What decisions can successor make alone?
 - Which decisions require agreement?
 - Income
 - Rental income, or
 - Business profit

Forks in the Road

- Whether they share or separately own, what rights govern their relationships as owners?
 - Can the successor buy out the other heirs?
 - Can the successor force the others to sell?
 - Can the others force the successor to buy?
 - Can no one force anyone else, but if someone wants to sell, the others get first shot at buying?

WILL CONTESTS

Grounds for will contests include

- Most common
 - Lack of testamentary capacity
 - Undue influence by one benefitting under the will
- Less common
 - Fraud
 - Mistake
 - Revocation
 - Duress

PART II Tools to Know About



TOOLS

- Gifting
- Incomplete Gifting
- Installment Sale
- Lease Rights
- Option to Own
- Preemptive Rights
- Life insurance
- Entities
- Buy-Sell Provisions

GIFTING

Parents gift property to SG

- Advantages
 - SG become owners
 - No feasibility issues
 - 5 year Medicaid look-back starts running
 - 3 year Neb. Inheritance Tax starts running
- Disadvantages
 - No step up in basis
 - Parents lose control and income
 - Need to file federal gift tax return

INCOMPLETE GIFTS

Parents give property to SG; keep life estate

- Advantages
 - SG interest is vested – certain to be owners
 - Preserves step-up in basis
 - Parents retain income and control for life
 - 5 year Medicaid look-back starts running
- Disadvantages
 - Irrevocable
 - Parents cannot sell or mortgage w/o consent

INSTALLMENT SALES

- Parents sell assets to SG in installment sale
- Price and term are fixed
- Title is transferred or held in escrow
- Two structures
 - Land contract
 - Title typically held in escrow pending payment
 - Note and deed of trust
 - Title transfers; SG signs note and DOT

INSTALLMENT SALES

- Advantages
 - Gives SG legal rights in property, if not outright ownership
 - Less susceptible to contest by other heirs
 - Fixes obligation – removes uncertainty
 - Can create larger income stream for parents
- Disadvantages
 - Income taxes
 - Capital gain or recaptured depreciation
 - Related party rules
 - No step up in basis; purchase price is basis

LEASE & OPTION TO LEASE

- Long term leases are possible in Nebraska
 - Notice of lease recorded against title to real estate
 - Prevents sale of land out from under the lessee
- An option to lease land can be recorded against title to the land
 - Goes with the land
- Lease rights in general survive death of lessor/owner
 - continuity

LEASE & OPTION TO LEASE

- Issues include
 - Mechanism for determining rent
 - “Customary & reasonable for like property”
 - How to resolve dispute over rents?
 - Can the lessee/option holder assign the lease or lease option?
 - If so, to whom? And for how long?
 - Lineal descendants of parents only
 - Only those actively engaged in ranching
- Disadvantages
 - A lease right is not ownership, only access

OPTIONS TO OWN

- Parents give SG an option to own property
- Option can be recorded against title, e.g. to real estate
 - Option can be recorded in time-of-death transfer, e.g. by PR in probate or successor trustee
 - Option can be recorded while parents still alive
 - Need to recite consideration
- What are the terms?
- Option typically gives holder right to force owner to sell

OPTION TO OWN

- Typical terms
 - What property is option for?
 - How long does option last? (“the term”)
 - What is the purchase price for the option?
 - How is the purchase price paid?
 - e.g. lump sum or over time
 - How is option exercised?
 - What exactly does holder have to do to buy the property? Notices, timeframes, etc.
 - Can option be assigned?

PREEMPTIVE RIGHT

- Gives the holder an opportunity to purchase property from owner before owner sells to someone else
 - Only effective if owner wants to sell
 - Holder cannot force owner to sell
- Two kinds
 - Right of first refusal (“ROFR”)
 - Right of first offer (“ROFO”)

PREEMPTIVE RIGHT

- Right of first refusal (“ROFR”)
 - Holder has right to match any offer received by owner
 - Owner must sell to holder if he matches the offer price
- Right of first offer (“ROFO”)
 - Holder has right to buy, if owner decides to sell
 - Can work in couple of ways:
 - Owner first offers to sell to holder at a price owner is willing to accept. If holder doesn’t accept offer, owner can sell to someone else.
 - Owner notifies holder of desire to sell and holder makes an offer. If owner doesn’t like offer, can sell it to someone else, though often not for less than holder’s offer.

PREEMPTIVE RIGHT

- ROFO combined with ROFR
 - Owner notifies holder of desire to sell
 - Holder offers \$5000 per acre
 - Owner doesn’t like (does not accept) offer
 - Owner free to sell to someone else.
 - If owner gets an offer from someone else, holder has right to match it.
 - Basically gives holder two shots at buying

A HYBRID RIGHT

- Preemptive right that works like an option
 - If owner wants to sell
 - Then must first offer to sell to holder of right
 - For a stated (and perhaps discounted) price
- How long does this right last
 - Probably only a lifetime

Life Insurance

- Life insurance
 - Mom & Dad purchase life insurance for off-farm heirs, successor gets the farm
 - Successor purchases life insurance on Mom & Dad to buy out siblings
 - May be prohibitively expensive
 - Off-farm heirs may want to own part of family land

Promissory Note & DOT

- Parents leave land to Successor through a Will or Trust
- Successor, before receiving title to land, signs promissory note to pay Off-Farm Heirs \$X over Y years at Z % interest
- The promissory note is secured by deed of trust against (some of) land Successor is inheriting

Promissory Note & DOT

- Opportunity to fix the Successor's obligation
 - Weigh obligation against cash flow
- Build in protections
 - Right to defer one (or more) annual payment (disaster set aside)
- Prepayments allowed

ENTITY

- If parents wish to consider the following, then an entity is likely needed:
 - Provide for co-ownership of assets (off-ranch and successor)
 - No off-ranch heirs involved in decision making
 - Protecting ranch from heirs' troubles, i.e. divorce, medical & financial problems?
 - Provide management structure
 - Avoid partition and forced sale of land
 - Make certain it stays in family

ENTITY – Closely Held

- LLC is the generally preferred business entity, these days
 - Tax and management flexibility
 - Asset protection
 - Limited liability for owners
 - Owners can be managers
 - Retain control while also transferring ownership

ENTITIES

- Tax considerations play a big role in choosing which entity to use
 - Income tax
 - Basis issues
 - Self-employment taxes
 - Medicare and NIIT taxes
- Limited liability entities are restricted to single payment limitation under FSA rules

ENTITIES

- A trust is not commonly a business entity
 - Separate management from enjoyment
 - Best asset protection
 - Less flexibility in general and for taxes
 - Difficult to retain control while also transferring ownership
 - Tax planning tool

Buy-Sell

- An agreement among owners of a closely held company restricting the purchase and sale of interests in the company
 - Buy-sell provisions often come as a condition of ownership
- What it does in a nutshell:
 - If an owner a) wants to sell, b) dies, c) retires, d) becomes incapacitated, or e) gets in financial trouble, (“triggering events”) how is that owner bought out?
- Buy-sell provisions can also be used in trusts

Buy-Sell

- Main purpose is a balancing act:
 - How to protect viability of business, i.e. keep it going WHILE
 - Creating a market/value for ownership interests
- Other purposes
 - Prevent oppression by those in control
 - Keep business in the family
 - Protect business from owners’ creditors
 - Protect business from spousal claims

Buy-Sell

- Requires an owner to sell ownership interests a) to the company or b) to the other owners, before selling to an outsider
- Terms include
 - Price
 - Fixed price, formula price, appraisal
 - discounts
 - How price is paid (lump sum, overtime, etc.)

OTHER TOOLS

- SG is making improvements to property that is owned by parents or entity
- How to protect SG's investment?
 - Owner of property can give SG a lien against the property for value of the improvements
 - Owner can have improvements reflected in estate documents
 - Entity can increase share of SG in the entity for value of improvements
 - Long term lease may be given in the property

Will Contests Additional Information



WILL CONTESTS

Capacity is:

- (a) knowing the nature of their acts in making and executing a will; (b) knowing the nature and extent of their property; (c) knowing the proposed disposition of their property; and (d) knowing the natural objects of their bounty
- Testamentary capacity is not necessarily the same as medical soundness of mind. People may be rational upon one or more subjects and still not have testamentary capacity. And they may have testamentary capacity even though they are ill, are unable to transact some business affairs, have peculiar habits, or are subject to delusions or other mental or physical infirmities

WILL CONTESTS

A few unsuccessful challenges to capacity

- A person possessing the requisites of testamentary capacity is not incapacitated by failing memory, vacillating judgment, childishness, slovenliness in dress, eccentricities or peculiarities in habit or speech, or even delusions or hallucinations (unless such delusions control his actions and render testator insensible to the ties of blood or kindred).
- senile dementia case; validity of will depends on actual impact of the disease on testator, not the disease's pathology
- a drinking problem will not vitiate a will, unless it can be shown that the testator was drunk on the day and at the time the will was executed
- Old age and infirmity are not sufficient grounds for invalidating a will

WILL CONTESTS

• Undue Influence

- Manipulation that destroys the free agency of the testator
- prove by a preponderance of the evidence that (a) the testator was subject to undue influence, (b) there was an opportunity to exercise such influence, (c) there was a disposition to exercise such influence, and (d) the result was clearly the effect of such influence

WILL CONTESTS

- Undue Influence: failure to prove
 - mother disinherited four out of six children expressly because they successfully had a conservator appointed, and had a lease of farm ground set aside because the offspring wanted to lease the ground
 - mother validly changed will after stroke and shortly before death, bequeathing all of her livestock and farm to offspring with whom she had special business relationship for prior 17 years; son had stayed home and worked family ranching operations after death of father

WILL CONTESTS

Successful challenges

- Bank that got the money: will naming trust company in lieu of family members as beneficiaries overturned; testator evinced unnatural hostility/paranoia toward family indicative of mental disorder and confusion in later years
- Blushing bride: the motives that prompted marriage on the part of proponent to testator, the sickness and helpless condition of testator at the time, the fact that the testator was an elderly man while the proponent was very much younger, the efforts of the proponent and of her parents and relatives to bring about the marriage, poverty of the wife and the wealth of the testator could be considered on issue of undue influence by wife

WILL CONTESTS

Successful challenges

- Snake in the grass sibling: son borrows legal form book; generates will; and props up dying father so he can sign it, without the will being read by father, or even being read to father
- Attorney gets the loot: Attorney, who was sole beneficiary and personal representative named in will, filed application for informal probate. Friend of decedent filed application for formal probate alleging undue influence on part of attorney in preparation of will. Eventually, Supreme Court held that evidence established many suspicious circumstances which, combined with confidential and fiduciary relationship between elderly testatrix and attorney, were sufficient to raise presumption of undue influence
