ESTATE PLANNING
Liquidity in Estate Planning

by Al Lundstrom

Availability of cash is a problem most of us are familiar with. The problem of cash liquidity exists in our normal day-to-day operations during life and in almost every case is a problem in an estate at the time of death.

The rancher-farmer as a businessman is concerned with projecting his cash flow and cash requirements throughout the year. Unlike most businessmen, the rancher-farmer's requirements and ability to generate cash depend a lot on weather and natural resources. Most expenses are fixed by a third party—the supplier of seed, fertilizer and fuel. Likewise, when he sells grain or cattle, he becomes victim of a "buyer's market."

The situations under which you work from day to day are not unlike those of the administrator and executor of your estate. There will be expenses imposed on your estate over which they have no control—such things as federal estate taxes and any outstanding liabilities.

What type, if any, liquid assets will be available to pay those debts and taxes?

Estate Plan

Everyone has an estate plan. You have the opportunity to design your own plan now or be victim of a plan currently provided for you by your state and federal government and implemented by probate court.

Let's take a look at Mr. Frank Farmer. He is a man in his mid-40s, married, with four children. The oldest, a boy, is married and working on the farm. Next is a girl still in college; and the youngest two, an eleventh grader and a ninth grader, are boys in high school. Mr. & Mrs. Farmer have been married for some 23 years, all of which have been spent farming. They have seen good years and lean years not only due to weather conditions but also due to prices received for their products. All Farmer family members are apparently in good health.

The Farmers currently operate 1,700 acres in the midwest, having almost 1,200 acres under cultivation, the rest in grassland, with a few wooded acres. Their total assets consist of land valued at $1.45 million, 100 brood cows worth $100,000, machinery and equipment worth $300,000, all totaling about $1.85 million. Their operating loan at the PCA is for $300,000 and their mortgage on the land is $320,000.

Taxable Estate

When Mr. Farmer dies, outstanding loans such as the PCA and mortgage and any other debts will be subtracted from the gross estate. In this case, there would be a net balance of $1.23 million. If ownership is held in such a way that half goes to the husband and the other half goes to the wife, Mr. Farmer's taxable estate would be $615,000—on which federal estate tax alone would be approximately $192,000. Other expenses would include administration costs of approximately $36,000 plus other miscellaneous expenses.

Consider the facts. The oldest son is currently operating the farm with his father, the youngest sons are also very interested in farming, and it is the intent of both Mr. & Mrs. Farmer to have the farm stay in the family.

Several problems exist. First, the family does need cash flow for the next four to six years to support the daughter through college and the younger boys in school plus college. Sufficient income is also necessary to support and care for Mrs. Farmer, the oldest son and his family. Another problem is the PCA loan on which the father has signed personally. They always have considered him to be manager and key person on the farm. They will, no doubt, want that loan paid.

Source of Cash

The administrator is faced with paying off the PCA loan plus federal estate tax, state inheritance tax (if applicable), administsration fees and court costs. All these expenses certainly would be in excess of $500,000. Where will this money come from?

Cash liquidity can be found or created from several sources. Assets such as cows or possibly the machinery or equipment could be sold. If that is done, will they sell at true market value or at auction or depressed prices?

If assets are sold that already have been depreciated, they sell on an ordinary income basis. Selling $500,000 worth of cattle, machinery or equipment would mean paying ordinary income tax at the rate of 50%. The net result would provide only $250,000 cash less any sales expenses.

Another option available is to borrow money from a commercial lender, possibly the PCA or a bank. Borrowing $500,000 from the local bank at the going rate of 12% interest means payments of $72,000 per year for 15 years. The amount of money paid back during that period would be $1.08 million—more than twice the original needed.

The possibility exists of selling part of the farmland. More than $750,000 of land would have to be sold to create $500,000 of net cash after sales commissions, state and

The sixth in a series of articles in ANGUS JOURNAL offering readers a systematic procedure they can use in designing their own estate plans.

federal income taxes had been paid.

Saving for Crisis

Saving for the eventual crisis is another way. Figuring that $500,000 is needed in 15 years at a net return of 7%, required deposits would be $18,600 per year. What happens if the cash is needed next year, not 15 years from now?

The federal estate tax also can be paid on an installment basis under Internal Revenue Code 6166 or 6166A. This provides interest only at 4% for the first five years and then 10 years to pay the principal at a current 12% interest rate. Remember that this is only applicable to federal estate tax, and there are other limitations and restrictions. Please refer to the Internal Revenue Code for details.

Depending on your ability to acquire it, life insurance also can provide necessary cash. Life insurance dollars generally will not cost more than 50¢ each and in some cases as little as 3¢ for each dollar paid to the estate. This is one way to pay expenses and taxes with low-cost dollars.

Steps should be taken to minimize these losses and obligations to your estate. A satisfactory solution and estate plan can be implemented that will represent your personality and ideas as well as accomplish the goals for you and your family. Serious consideration should be given to all the different ways of providing liquidity. A true comparison of alternatives is a necessary step in making an intelligent decision. Discussing these ideas with your attorney, accountant or estate planner can be very valuable in providing you with information.

Money Market

When borrowing is the only alternative, remember that money borrowed depends on the money market at the time it is needed. Lenders might not look favorably at lending when the manager and prime force of the business is lost.

When considering sale of capital gains assets to pay these expenses, remember that forced sales usually result in a 40-90% loss in value. The true cost of these dollars is the loss of a cash-producing asset. How much will this decrease income-producing ability of on-farm heirs to maintain the family?

The need for liquidity to pay expenses and taxes can be altered or reduced and the estate preserved if due consideration is given to the owership of assets and the form under which you do business, such as a partnership, limited partnership, corporation or trusts.

Next month's article will deal with alternate ways of operating and owning your farm. Who will have control? Who will make the decisions? Answers to these and other questions will be covered in detail.

We welcome your questions and comments. Please send them to Lundstrom & Associates, P.O. Box 1077, Janesville, Wis. 53545, or to ANGUS JOURNAL.