Sentinel

Personal Financial Management Ideas

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Deathbed Financial Planning Tips

By Benjamin C. Sullivan, EA, CFP®

A terminal diagnosis for you or a loved one can make it seem as though your world is falling apart. While there may be nothing you can do about the illness, you may find solace in addressing issues that you can control.

I am not a doctor, so I can't recommend any course of treatment. But as a financial adviser, I can suggest items you should address if you know death is likely imminent. While the list below assumes you are the patient, most of these tips also apply if the terminal patient is a loved one. Many of these recommendations are hallmarks of traditional financial planning, but they become urgently essential when your life expectancy is short. As with any financial planning advice, the appropriate course of action will depend on your individual circumstances.

Remember to prioritize. When time is limited, you may not be able to check off all of the items on your to-do list, even when all of them seem important. Take care of the items that have the highest emotional or monetary impact first. Focus on fundamentals. This list assumes that you have already covered the basics, such as writing a will, but if you have not, act on such items immediately.

Communicate. Be proactive. While this is understandably easier said than done, it is critical to have the uncomfortable conversations that you might have been putting off. For example, you may need to tell your beneficiaries why they have been named (or tell other loved ones why they were omitted). Starting financial conversations can be hard even in good times; my colleague Anthony Criscuolo recently wrote about initiating family meetings ("Talking About Money: The Family Meeting" appeared July 2015 online, October 2015 in our print edition), and much of his advice can be helpful in this situation, too.

Make sure all beneficiary designations on your retirement accounts and insurance policies are correct. Many assets move "by operation of law" based on named beneficiaries on an account or policy. In other words, it doesn't matter what you specify in your will if your named beneficiary is different for certain assets. These include retirement accounts, annuities, joint accounts, life insurance policies and transfer-on-death accounts. Outdated or unnamed beneficiaries can wreak havoc on an otherwise well-planned estate.

Revisit your estate-planning documents. Make sure your will and any trusts still reflect your wishes based on current law in the state where you live. This includes naming guardians for your children if you have any who are still minors. Consider what would happen if the estate tax is eliminated or the rules change in the near term if such taxes are a concern for you. Make sure that any changes to your estate-planning documents are made while you are demonstrably of sound mind. Confirm that powers of attorney for medical and health care purposes, as well as living wills or advance directives for medical decisions, are up to date and available to those who will need access to such documents.

Discuss your final wishes for nonfinancial items. Consider writing a separate memorandum for how to dispose of

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Tax Planning For Part-Time Farmers

By David Walters, CPA, CFP®

The farmer looms large in the American imagination, but many Americans who have not experienced modern farming firsthand have a skewed perception of what the activity actually entails.

The Internal Revenue Service is not so small-minded.

The IRS casts a wide net when it comes to the definition of farming. In Publication 225, the "Farmer's Tax Guide," the agency takes the position that "You are in the business of farming if you cultivate, operate, or manage a farm for profit, either as owner or tenant." Farmers are not only those who grow food crops, but also those who produce livestock, dairy, poultry, fish and fruit. Truck farms, ranches and orchards are all farms, too, as far as the IRS is concerned.

But what about part-time farmers? According to the 2012 Census of Agriculture, 38 percent of all U.S. farms were operated by individuals who had primary occupations other than farming. And many American farms, whether part time or full time, are also small; 88 percent of all farms had less than $350,000 in gross cash farm income, according to the same survey.

For tax purposes, the main question is not the size of your operation or how many hours you work, at least not in isolation. The most pertinent question is whether your farm is a business or a hobby.

Section 183 of the tax code details the rules on activities "not engaged in for profit." The determination, often referred to as the "hobby-loss rule," can make a big difference in how you handle your taxes. And part-time farmers are especially prone to IRS scrutiny because for-profit farms have access to a variety of helpful tax rules.

The simplest way to prove that your farm is a for-profit venture is to turn a profit. In most cases, the law creates the presumption that if an activity shows a profit in three out of the five most recent tax years, the taxpayer intends to make a profit from the activity. For horse-related activities, you need only show a profit every two out of seven years. Once you have established a profit motive, the burden of proof shifts to the IRS if it wishes to allege that your farm is not run with a profit motive.

Regrettably, farming can prove economically challenging, which is part of the reason so many small farmers have other primary occupations in the first place. This does not mean, however, that you cannot demonstrate a profit motive without meeting the profitability test. The facts and circumstances of your situation can also demonstrate to an IRS examiner that your farm is not simply meant for your own pleasure, but is truly intended as a business.

Some of the conditions you can indicate include:

You operate your farm like a business. You should be able to produce evidence to prove you are treating your farming in a businesslike way. Such evidence could include a realistic and concrete business plan, a separate checking account for farming activity, and clean and accurate accounting records. If you sell your products directly to the end consumer, spending time and money on marketing materials can also show profit motive.

You put a reasonable amount of time and effort into your farming activities. Even if you farm part time, keeping records of the hours you work will show that you treat it as a consistent business venture, not simply a leisure-time activity. In addition to the time you spend actually farming, you should also keep track of time you spend reading relevant publications, attending classes or seminars, and participating in any other activities meant to improve your skills. Many state cooperative extension services even offer workshops in partnership with the IRS specifically on farm taxation.

You demonstrate expertise or have consulted experts about your farm. How much experience do you have in your area of agriculture? If you are new to farming, have you discussed your plan with more experienced farmers and implemented their advice? A farmer who has spent decades in agriculture but chooses to work part time as she gets older is likely to have an easier time demonstrating profit motive than is a banker who takes up farming on a whim after retiring from his primary career.

You reasonably expect to turn a profit in the future. Have you been successful in similar ventures before? Is your "day job" related to your farming activity? Have you had your property appraised more than once, and if so, has

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INVESTMENT FOCUS

Reporting Requirements For Foreign Assets

By Melinda Kibler, EA, CFP®

The term "offshore accounts" is often used as shorthand to suggest that such account holders are trying to dodge tax responsibilities. Especially after the Panama Papers, many observers are quick to assume the worst when someone holds assets outside of the United States.

In reality, many, if not most, taxpayers who hold foreign assets do so in good faith for a variety of legitimate reasons. However, depending on the type of property in question and the taxpayer's overall situation, keeping the Internal Revenue Service adequately informed can prove challenging. Foreign accounts are a popular target for legislation and regulation, so taxpayers should make an effort to stay abreast of new developments.

Given the often steep penalties for failing to report foreign assets or reporting them incorrectly, many taxpayers may want to seek professional guidance on when and how to report their holdings. Never hesitate to ask a potential adviser or accountant about his firm's experience with international tax issues. Lawmakers have taken a keen interest in tracking down tax dodgers, and untangling oneself from filing mistakes can be difficult.

Clearing The FBAR

If you are a U.S. citizen or resident and you have a financial interest in, or signature authority over, a non-U.S. bank or securities account, you must report it on FinCEN Form 114, more often known as the FBAR. The only major exception is if the aggregate value of your foreign accounts never exceeds $10,000 during the calendar year. This rule also applies to U.S. entities, so corporations, partnerships, limited liability companies, estates and trusts also should file if the entity owns or has signature authority over such accounts. In addition to filing an FBAR if you maintained foreign financial accounts that totaled more than $10,000 at any point in the calendar year, you must indicate this fact on Form 1040, Schedule B of your income tax return.

Signature authority, for the IRS, means that you can control the disposition of assets in the account directly. For instance, a financial adviser who can buy and sell investments within the account but who cannot distribute assets does not have signature authority. Nor does approving a disbursement that a subordinate employee actually orders count toward signature authority. If this seems unclear to you, you are not alone. The Treasury Regulations are often opaque, and it generally pays to err on the side of caution.

Such caution is necessary because improperly filing the FBAR can trigger civil fines of up to $10,000 per violation. The penalty for willfully failing to file is the greater of $100,000 or 50 percent of the account balance, with the potential for criminal penalties as well. These harsh penalties make clear that federal tax authorities take the potential of tax evasion through foreign accounts very seriously.

However, while you should be careful with your FBAR filing, do not let the process intimidate you. Consider consulting a tax expert, especially one with experience in international tax compliance. He or she will be able to assist you in preparing and filing your FBAR electronically; unlike most of the forms discussed below, the FBAR must be filed from FinCEN's online system with the Department of the Treasury, rather than attached to the taxpayer's annual return. It is also worth noting that the due date for the FBAR recently changed. It is now due at the same time as Form 1040 (usually April 15).

Specified Foreign Assets

U.S. citizens and residents who own "specified" foreign assets must report them to the IRS on Form 8938, which is attached to their annual tax returns (and due at the same time). Nonresident aliens who elect to be treated as resident aliens on a joint tax return must also file Form 8938 if they

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own specified foreign assets. The term "specified" covers any financial account maintained by a foreign financial institution, but also a few other particular types of foreign assets:

- Stock or securities issued by a non-U.S. person;
- Interest in a foreign entity;
- Financial instruments or contracts in which the issuer or the counterparty is not a U.S. person.

Specified foreign assets do not include foreign real estate unless it is held through a foreign trust, partnership or other entity, in which case the interest in the foreign entity itself is reportable. Foreign currency is also excluded, as are U.S. financial accounts that hold foreign securities. For example, if you own shares in a U.S. mutual fund that holds foreign stock, you do not need to report it on Form 8938.

Like the FBAR, Form 8938 has a value threshold for filing. For unmarried taxpayers living in the United States (or married taxpayers filing separately), the total value of specified foreign assets must be more than $50,000 on the last day of the tax year or more than $75,000 at any time during the tax year; for married taxpayers filing jointly, these thresholds are $100,000 and $150,000, respectively. Taxpayers living abroad have higher thresholds: $200,000 and $300,000 for single filers, and $400,000 and $600,000 for joint filers. Note, however, that you must be a bona fide resident or physically present in the foreign country for at least 330 days in the year to qualify.

Most important, filing an FBAR does not relieve you of the responsibility of filing Form 8938 and vice versa. Many taxpayers will file both.

Transfers And Transactions

The FBAR and Form 8938 cover many of the foreign accounts and assets U.S. taxpayers tend to hold. But the IRS also wants to know about property that U.S. taxpayers and entities give to or receive from foreign corporations, foreign trusts and foreign individuals.

If a U.S. person or entity transfers property to a foreign corporation, including, but not limited to, cash and securities, the transferor must file Form 926, "Return by a U.S. Transferor of Property to a Foreign Corporation." The form will ask for details including the date of transfer, the transferee's information, the property's fair market value at the time of transfer and any applicable basis. If the transaction is an exchange, you will also need to report details on the transfer and amount of gain recognized. Forgetting to file is costly; the penalty for failing to file is 10 percent of the fair market value of the property. While the penalty is capped at $100,000, this limit does not apply if the taxpayer intentionally disregarded the requirement. Like Form 8938, this form is attached to the taxpayer's annual tax return and is due at the same time.

Forgetting to file is costly; the penalty for failing to file is 10 percent of the fair market value of the property.

If the transaction is with a foreign trust, rather than a foreign corporation, you must report any transfers, whether you are the donor or the recipient. In this case, you will use Form 3520, "Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts." This form also covers certain large gifts from foreign persons to U.S. taxpayers. For transactions with foreign trusts, any amount is reportable. Bequests from foreign estates or gifts from nonresident alien individuals must be reported if they exceed $100,000, as must gifts exceeding an annually adjusted threshold ($15,671 in tax year 2016) that come from a foreign corporation or partnership. Form 3520 is also due along with your income tax return, including any extensions.

Unlike some of the other forms discussed, Form 3520 comes with a relatively complex formula for determining penalties. If you fail to timely file the form, or file it with incorrect or incomplete information, the penalty is the greater of $10,000 or the following, as applicable:

- 35 percent of the gross value of property transferred to a foreign trust or
- 35 percent of the gross value of distributions received from a foreign trust or
- 5 percent of the gross value of the portion of trust assets treated as owned by a U.S. person under the grantor trust.

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For a gift from a foreign individual, the penalty is 5 percent of the gift amount for each month you fail to report, capped at 25 percent total.

Passive Foreign Investment Companies

Owning shares of a passive foreign investment company, or PFIC, subjects U.S. taxpayers to a complicated set of rules enacted in the 1980s in order to eliminate beneficial tax treatment for certain offshore investments. Under the current rules, in most cases PFIC distributions are taxed as ordinary income, rather than as long-term capital gains or dividends.

This raises the question: What counts as a PFIC? According to the law, a corporation fits the definition if it meets either the income test or the asset test. In the first instance, if 75 percent or more of the corporation's gross income for the taxable year is passive, the entity qualifies as a PFIC. Alternately, a PFIC may be a corporation in which at least 50 percent of the corporation's assets produce passive income or are held for that purpose.

PFIC shareholders must file Form 8621, "Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund," if they receive direct or indirect distributions from the company in a given tax year. They must also file, however, if they: recognize a gain on disposing of PFIC stock; make an election reportable in Part II of the form; or meet several other reporting requirements. Since PFIC reporting can become relatively complicated, most taxpayers to whom the rules apply will want to involve professionals to ensure that they meet their responsibilities where such assets are concerned.

U.S. Transfer Taxes

Gift, estate and generation-skipping transfer (or GST) taxes occasionally involve foreign property. These taxes may change or vanish under the new administration, but as of this writing, gross estates valued above $5.49 million and annual gifts above $14,000 are still subject to federal gift and estate tax. It is important to note that these totals include assets and real property held outside of the United States. There is no separate form for reporting foreign assets in these cases, but all such property must be included on Form 706 for estates and Form 709 for taxpayers who have made gifts in excess of the threshold.

U.S. taxpayers may own foreign assets or accounts for a variety of reasons ranging from investment opportunities to the convenience of local banking when living abroad. Because regulators have developed rigorous reporting requirements for many kinds of foreign assets, approaching such accounts with careful attention will ensure that you can meet your obligations and demonstrate that you are not ignoring Uncle Sam.

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...Tips

tangible property. If you do, make a note of this document in your will.

Gather a list of all accounts, insurance policies and passwords. You don't want your executor or beneficiaries to overlook any financial accounts or insurance policies, so getting a list together in advance of death is a best practice. Rules vary for who can legally access accounts of a deceased individual, so it may be to your advantage to share your website login information with a trusted individual.

Identify property owned outright in other states. Probate in other states can be costly and an administrative burden for your executor. Retitling these assets into a trust should eliminate the need to initiate probate proceedings in nonresident states.

Understand what will be subject to probate. Probate can be expensive and time consuming. It also exposes your personal information to the public. Consider moving assets into a revocable trust or into an account that would move by operation of law.

Consider making annual exclusion gifts. Each individual can give up to $14,000 per year to as many people as she wants without gift or estate tax consequences. Such gifts can be helpful if you're concerned about reducing your taxable estate or if you want to redistribute smaller sums of money to certain people.

Consider whether the mix of assets in your portfolio is still appropriate. Is there enough liquidity for short-term needs, including taxes? An imminent death changes the time frame for planned withdrawals from your portfolio. Funeral expenses, estate taxes and loss of a salary may accelerate withdrawals; on the other hand, most of your money will likely be destined for a beneficiary with different needs and perhaps a different planning time horizon. Consider adjusting the portfolio now, while being mindful of the tax consequences.

Manipulate cost basis in your favor by repositioning, selling, holding or gifting specific assets. Under current law, the cost basis of assets held in an estate is adjusted to their fair market value on the date of the owner's death. Therefore, it's helpful to continue to hold assets that have unrealized gains and to sell or transfer to a spouse assets that have depreciated. Keep in mind that transfers within one year of death do not receive a basis adjustment if they were gifted to the decedent and then returned to that same beneficiary upon the owner's death. This stipulation can be avoided in many cases by moving the assets to a trust. Remember that the decedent's accumulated capital loss carryover, if any, is lost upon death. Therefore, it may make sense to sell appreciated assets in a spouse's name in order to use up any carryover loss.

Consider making lifetime charitable gifts. Charitable gifts that you make during life give you an income tax and estate tax benefit, while transfers at death only provide the estate tax benefit. Getting both allows you to give more. It also simplifies trust and estate administration to avoid charitable beneficiaries.

Evaluate your life insurance situation. It is too late to purchase more life insurance, but make sure that all of your existing policies remain in force. Typically, you should make all life insurance premium payments. However, if you have permanent insurance policies such as universal life, consider stopping payments if the accumulated cash value is sufficient to allow the policy to remain in force.

Plan for the expected, but prepare for the unexpected. While a terminal illness can lead to more certainty about the timing and order of deaths among individuals listed in a will or trust, remember that life continues to be uncertain. Realize that you may live longer than a doctor's estimate, and plan accordingly.

Make sure someone knows how to run the show when you're gone. Succession planning is essential for those who run their own businesses. But we all have responsibilities that others will need to handle once we are unable to do so. Whether it's a surviving spouse, relative, close friend or trusted adviser, you should ensure that someone is ready to take over your responsibilities when you can no longer manage them.

This list is by no means exhaustive, but it includes many of the top priorities that those facing imminent death should consider. Taking care of these items as thoroughly as you're able can leave you knowing that you did your best to help your heirs deal with the practical side of your loss.

...Farmers

its value increased over time? Even if you don't meet the IRS' profitability test, have you earned profits in the past? Proof of even occasional profitability will help your case.

Your financial status rests, at least in part, on the farm's success. If you earn sufficient income at your primary occupation or have substantial financial resources independent of the farm, it may be harder to demonstrate the farm's profit motive.

While none of these circumstances is indispensable on its own, the more of them you can document and demonstrate, the more likely the IRS will accept your position that your farm is a true business. It is also worth noting that when establishing a new farm, a taxpayer can put off the determination of whether the business is a for-profit venture. If it looks as though your farm will eventually turn a profit, you can postpone the determination until the end of the fourth tax year of farm operations.

Farmers who run their farms as a hobby simply report the income as they would income from any other hobby activity. Assuming that the taxpayer itemizes deductions, he or she can itemize miscellaneous hobby-related deductions on Schedule A, but not in excess of the gross hobby-related income. These deductions are also subject to the general 2 percent floor relative to adjusted gross income.

Farmers who run their farms as a business, in contrast, can deduct all allowable expenses. They will report their income from farming on Schedule F. (This form is also used to report a variety of other farm-related income, such as crop insurance proceeds or rent earned from farms.) This form is also where farmers will report deductible expenses. Many of these are the same as those available to any other business, but farmers have access to additional specific deductions on things such as seed, chemicals and fertilizer. Farmers will also often benefit from depreciating property such as machinery and other technological improvements to their operations.

Since many farmers live on their farms, it is also important to keep excellent records of deductible expenses that may be partly personal and partly business related. For instance, water, rent, insurance and gasoline all may need to be allocated between business and personal use, since the portion for personal use is generally not deductible. You may wish to involve a tax professional in making this determination, but either way, it will be important to document how you divided expenses in case the IRS audits your return.

For farms that are organized as sole proprietorships, partnerships or S corporations, farmers may have the option to engage in "farm income averaging." This method allows you to average all or some of the current year's farm income by allocating it to the three prior tax years. This option is not open to farmers whose enterprise is organized as a C corporation, however.

In addition to filing Schedule F, farmers who treat their farms as a business will need to be aware of their other tax obligations. Even part-time farmers who operate for-profit farms will generally need to stay mindful of self-employment taxes. If they hire employees, they must withhold Social Security and Medicare taxes for them as well; on the other hand, employees' wages are usually a deductible expense.

Given the wide range of activities the IRS includes under the umbrella of "farming," it is important to note that the tax code sometimes has special rules for certain agricultural pursuits. For instance, many of the rules discussed in this article are slightly different for those raising horses or for farmers primarily producing timber. When in doubt, it is wise to consult an expert with experience in your particular area.

Farmers should also stay aware of their state tax obligations. For most farmers, property tax will represent a major portion of their overall tax burdens. However, sales tax and state-specific permits and fees may also come into play. Some states, too, exempt specific agriculture-related sales from tax. Therefore, it is important to fully understand the rules in your state in order to meet your obligations and to take advantage of any available benefits.

Many farms are family affairs, and some part-time farmers are former full-time farmers who have scaled back their involvement as they approach retirement. Like any small business, if you plan for your farm to survive after you are gone, it is important to create a formal succession plan as part of your wider estate plan. While many, if not most, part-time farms will fall below the threshold for federal estate tax, careful planning ahead of time can reduce the likelihood that your heirs will need to sell some of your property to meet such tax obligations.

Part-time farming can be a rewarding pursuit, whether it has been a longstanding part of your family's lifestyle or is a new endeavor. Taking the time to fully understand the nature of your farming activity, as well as the tax obligations and benefits it presents, can make it a rewarding part of your financial life, too.

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Duly Noted

Court Says Relief For Wrongfully Incarcerated Prisoners Doesn't Apply To Relatives. The son and former wife of a man who spent six years in prison for a murder he didn't commit cannot benefit from tax relief that Congress granted wrongfully incarcerated individuals, a federal court in Ohio ruled. Melinda Dawkins and Clarence Elkins II sought to reopen their bankruptcy cases to try to recover income taxes on their shares of $6 million in settlements that Clarence Elkins received after his release in 2005. But Bankruptcy Judge Russ Kendig refused on grounds that the law Congress passed in 2015 exempting such settlements from tax applies only to the convicted individual. On Dec. 16, 2016 — three days before the deadline for filing a refund claim — U.S. District Judge Benita Pearson affirmed Kendig's ruling, preventing Dawkins and Elkins II from even asking the Internal Revenue Service whether it deemed them eligible for relief. *In Re Melinda Louise Elkins et. al. vs. United States, 2016 TNT 244-17.*

Account Transcripts Can Substitute For Estate Tax Closing Letters. In mid-2015, the Internal Revenue Service stopped routinely issuing "closing letters" to executors stating that the examination of the estate's return is concluded. The letters were customarily required for many bank and real estate transactions needed to wind up an estate. In a new notice, the IRS pointed out that executors can still request a transcript of the estate's tax account. According to the IRS, if the transcript includes the code 421, it denotes that the estate's return has been accepted, making the transcript the "functional equivalent" of a closing letter. *Notice 2017-12.*

What Took So Long? A Pennsylvania man who was convicted of obstructing the Internal Revenue Service and willfully failing to file tax returns for more than 20 years had an unsurprisingly long history of tax protester litigation. James K. Schlosser of Bird-in-Hand, Pennsylvania, faces up to five years imprisonment and $450,000 in fines at a sentencing scheduled for June 10. According to a post-trial statement from the Justice Department, Schlosser testified that he stopped filing tax returns in 1994 because a Social Security number represented a biblical "mark of the beast." In previous civil litigation stretching back more than a decade, Schlosser had raised a variety of other arguments deemed legally frivolous, including that income taxes are voluntary self-assessments and that as a resident of Pennsylvania, he is not subject to United States jurisdiction. *2017 TNT 47-8.*

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