

**BREAKING BARRIERS**

**Tax and Legal Strategies for Family Farm Transitions**

Polly Dobbs, Attorney  
Paul Neiffer, CPA

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**BREAKING BARRIERS**

**Speaker Introduction**

**Polly Dobbs, Esq. Owner,**  
**Dobbs Legal Group LLC (Peru, IN)**

- Estate planning attorney passionate about helping farm families create holistic plans
- Raised on a farm, left to do the city thing, thrilled to be back home raising the next generation on my family's farm
- Conducts regular seminars and publishes written materials about succession of the family farm
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**BREAKING BARRIERS**



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**BREAKING BARRIERS**

## Speaker Introduction

**Paul Neiffer, Principal,  
CliftonLarsonAllen**



- Frequent national speaker on taxation, agricultural, and estate tax topics
- Chair of the AICPA National Agriculture Conference committee
- Past-President of Farm Financial Standards Council
- Author of the "FarmCPA" Top Producer column
- Author of the "FarmCPA" blog on [www.farmcpatoday.com](http://www.farmcpatoday.com)
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**BREAKING BARRIERS**



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**BREAKING BARRIERS**

## Family Farm Transitions Agenda

- Understanding Estate & Gift taxes
- Structures for farmland transitions:
  - Part gift/part sale on direct land transfers
  - Use of entity for land: Farm successor
  - Use of entity for land: No heirs
- Governing Documents & Buy-Sell Agreements
- Structures for operating assets
  - No heir
  - On farm heirs

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**BREAKING BARRIERS** **Let's Talk Taxes**

- How Much Can You Give Away Tax Free
  - During life
  - At death
  - Each year
- Can We Reduce The Value of Our Farmland

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**BREAKING BARRIERS** **LET'S TALK TAXES**

- Upon death, up to \$11.4 million (as of 1/1/2019) will pass exempt from Federal Estate Tax. A married couple can pass \$22.8 million.
- During lifetime, you may give away up to \$11.4M of your assets exempt from Federal Gift Tax, which would reduce the amount of your exemption remaining at death.
- For estates or gifts in excess of this exemption, the maximum tax rate is 40%.

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**BREAKING BARRIERS** **Let's Talk Taxes, Portability Election**

- A surviving spouse can make a portability election in order to "port" over any unused federal gift/estate tax exclusion amount from the first spouse, if he/she died on or after January 1, 2011.
- Election must be made by the estate of the first spouse to die, which requires filing of a Form 706 Federal Estate Tax Return, even if no tax is owed.
- Could be a \$11.4M mistake is not elected – get it in writing if surviving spouse declines to elect.

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**BREAKING BARRIERS** **Let's Talk Taxes, Annual Exclusions & State Taxes**

- Annual gift tax exclusion is \$15,000 - to as many individuals as donor wishes, without reducing donor's \$11.4 million estate tax exemption or triggering Gift Tax.
- State inheritance or estate taxes deserve special attention: Connecticut, District of Columbia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oregon, Rhode Island, Vermont, Washington, Iowa, Kentucky, Nebraska, and Pennsylvania.

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**BREAKING BARRIERS** **Let's Talk Taxes, tick tock**

- Tax Reform under Tax Cuts and Jobs Act of 2017 ("TCJA"), made major changes to succession planning for farmers.
- Temporary doubling of the transfer tax exemption is set to expire January 1, 2026, reverting back towards the \$5.6 million per person, \$11.2 million per married couple level.
- Now is the time to act.

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**BREAKING BARRIERS** **Special Use Valuation**

- Estate Tax Special Use Valuation (Sec. 2032A)
  - ≥ 50% of estate consists of farming assets
  - Actively farmed prior to death or retirement
  - An heir continues to actively farm ≥ 10 yrs. post-death
- Value land at lower 5-year average capitalized rent value
  - Valuation reduction limited to \$1.16M (2019)

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**BREAKING BARRIERS** Special Use Valuation Example

Fair market value of land (per acre)	\$8,500
Average cash rents for comparable land	\$200
Current real estate taxes	\$10
Net cash rents	\$190
Farm Credit System current interest rate	5.50%
Special use value	\$3,455
Approximate maximum reduction in value	\$5,045

Maximum Reduction is \$1.14 Million (2019)

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**BREAKING BARRIERS** Common Mistake

"I'm doing nothing because I'm worth less than \$11.4 million," or the similar reasoning: "Because my wife and I are worth less than \$22.8 Million."

1. Taxes are probably not your biggest problem! Family farms are destroyed more often by feuding families than by taxes.
2. You may have a false sense of security that your total assets are worth less than \$22.8 million. What's your farm ground really worth today? What are your neighbors selling for? Maybe you have a lurking tax problem.
3. Who knows what will happen after 2025?

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**BREAKING BARRIERS** Irrevocable Life Insurance Trusts ("ILIT")

- Face Value of life insurance "counts" toward the \$11.4M (\$22.8M) estate tax exemption
- Transfer existing insurance to an ILIT – 3 year lookback for estate inclusion
- Apply for and own new insurance in ILIT – no risk of inclusion
- Don't be your own trustee (no control)
- Terms of ILIT should complement estate plan – facilitate loaning/buying assets from estate to inject liquidity to pay the estate tax, fund philanthropy, or achieve other goals

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**BREAKING BARRIERS**

### ILIT Details

- ✓ Funding the ILIT is treated as a gift to the beneficiaries
- ✓ Contribute income producing assets, to pay premium on the insurance policy from income earned
- ✓ Contribute \$ annually so the Trustee of the ILIT can pay the premium
  - ✓ *Crummey* withdrawal rights – track lapsing rights
  - ✓ Utilize annual gift tax exclusions, now \$15,000 per donor per donee
  - ✓ Premium financing? Get good advice.

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### ILIT – Do I still need it?

- ✓ Many had ILITs when estate tax exemption was \$5M (or \$3.5M, \$2M, \$1M, or \$600k) to provide liquidity to pay tax on value of farm in excess of this exemption
- ✓ Now farm value may be under the new exemption \$11.4M each (\$22.8M married couple) – now what
- ✓ Unknown future after sunset 12/31/2025. Exemption could be lower
- ✓ “Family Cash Island” can be used for other things
  - ✓ Pay down debt to improve cash flow at the next generation
  - ✓ Provide cash for 2<sup>nd</sup> wife or step kids
  - ✓ Allow next generation to expand operations and land base
- ✓ This is an Investment Decision!

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**BREAKING BARRIERS**

### PLANNING FOR THE FAMILY FARM:

“Fair” does **not** necessarily mean “equal” ownership of all assets among kids

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**BREAKING BARRIERS** **Communication is Key**

- Planning in secrecy is a bad idea. Entitlement may be brewing at the next generation.
- Take a poll – not a vote -It's not a democracy.
- Once you decide what's fair – tell everyone – no surprises!
- "No Contest" clauses are a cop out
- "It's easier to talk to your kids about sex than about the farm transition" ... said one Iowa farmer.

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**BREAKING BARRIERS** **Is Co-Ownership at Next Generation Best?**

- Should your children be in business together?
- Can they get along well enough to split the cash rent?
- Could they get along if a professional farm manager was involved?
- If not – pursue a different plan!
  - Different assets to different children
  - Define specific terms for one child to buy certain assets at death

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**BREAKING BARRIERS** **Separate Land and Operations**

- ✓ Treat assets differently during lifetime to make them easier to pass at death
- ✓ Survey and split off operations from bare land: machinery, equipment, trucks, bins, dryer, shop, barns, pasture
- ✓ Direct who gets these assets through lifetime sales or gifts, or at death:
  - ✓ Include operations in share of farm successor child - either "off the top," or so farm kid gets less of other stuff
  - ✓ Offer operations for sale to non-related successor
  - ✓ Hold land in trust to be available to a farm successor until retirement, then distribute to grandchildren?
  - ✓ Have land in entity, which all kids inherit with rules attached, keeping land available to successor ?

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**BREAKING BARRIERS** **Transitioning the Land**

- Gift
- Sale
  - Outright
  - Seller-financed (installment sale)
- Combination gift-sale

[Same choices, whether transferring acres or entity shares]

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**BREAKING BARRIERS** **Part gift/part sale – Strategy for one heir**



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**BREAKING BARRIERS** **Part Gift – Part Sale Strategy**

Example

- Low basis (i.e., tax cost) in land
- Objective: Sell to a family member at a price that can be paid in an installment sale using annual cash rents
- Bargain element (full FMV less sale price) = gift

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**BREAKING BARRIERS** **Part Gift – Part Sale Strategy**

<u>Example</u>		<u>Per acre</u>
• Full appraised FMV	\$9,500	} \$4,500 gift
• Sale price (to family)	\$5,000	
• Tax basis (cost)	\$1,000	} \$4,000 gain

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**BREAKING BARRIERS** **Part Gift – Part Sale Strategy**

Planning tips

- Importance of a qualified appraisal to prevent IRS attack on amount of gift
- Opportunity: Lock in low interest rate on installment note to family member
  - Based on IRS AFR% for month of sale
  - January 2019 rate: Over 9 yr. term: 3.15%
  - January 2019 rate: Over 3 yr. & ≤ 9yr.: 2.89%
- Long-term IRS AFR rates are still relatively low

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**BREAKING BARRIERS** **Why Use an Entity?**

- Reduce liability exposure
- Payroll & income tax savings
- Take advantage of tax-free fringe benefits
- Take advantage of entity valuation discounts (*note proposed IRS Sec. 2704 Regulations*)
- Ease of transfer of ownership to next generation(s)

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**BREAKING BARRIERS** **Liability Reasons for Entity Selection**

- Sole proprietors are subject to unlimited liability exposure
- Partnerships are even worse
  - Exposed to other partner issues
- Corporations limit exposure to investment
- LLC, LLP and LLLP are essentially the same as corporations
- LP are hybrid of each
- Trusts may or may not provide protection

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**BREAKING BARRIERS** **Which Entity? IT DEPENDS...**

- Either a corporation or a Limited Liability Entity ("LLE") is appropriate to limit liability to the owners
  - Needs bank account
  - Needs to be run like a business
  - Should have annual meetings and documentation
  - If not, then piercing the entity shield can and will occur

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**BREAKING BARRIERS** **Does a Limited Liability Land Holding Entity Make Sense?**



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**BREAKING BARRIERS**

### No Use of Entity = Disaster in Future

- Outright parcels to each child?
  - Difficult to equalize values (quality of parcels)
  - Greater production risks with fewer acres
  - Centralized management impeded
  - Spendthrift sale
- Undivided 1/3 tenant in common interest to each child in each parcel?
  - No mechanism for agreeing on lease terms
  - No mechanism for agreeing on sale terms
  - Possible partition issues. Partition actions allow one tenant in common to trigger a court ordered auction, no matter how small an interest he owns

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**BREAKING BARRIERS**

### Limited Liability Entity (LLE) Illustration

```
graph TD; H((H)) --- LLE[LLE (land)]; W((W)) --- LLE;
```

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**BREAKING BARRIERS**

### Limited Liability Entity (LLE) Illustration

```
graph TD; H((H)) --- LLE[LLE (land)]; W((W)) --- LLE; LLE -- Gifts --> C1((C-1)); LLE -- Inheritance --> C2((C-2)); LLE -- Inheritance --> C3((C-3));
```

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**BREAKING BARRIERS**

### LLE Advantages

- Centralized Management
- Provides structure around farm ownership lacking in tenancy in common & Prevents partition action!
- Facilitates gifts (easier than multiple deeds)
- Design of LLE document forces family communication pre-death
  - Require each child to invest cash at formation to force legal and emotional buy-in to the operating agreement
- Include binding mediation/arbitration language if disputes arise

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**BREAKING BARRIERS**

### LLE Disadvantages

- Fees
  - Legal costs of document drafting/planning
  - Appraisal fee for land valuation
  - Appraisal fee for discount valuation
- IRS valuation disputes
- Annual partnership tax return
  - Separate checking account
- Proper allocations of any cash distributions each year

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**BREAKING BARRIERS**

- A practical guide to what your documents should contain



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**BREAKING BARRIERS** **Limited Liability Entity**

Ownership and Control:

- Entity can (should) be structured with voting and non-voting interests
- Lifetime gifting or a coordinated estate plan provides control to farming successor through voting interests
- Off-farm heirs receiving non-voting interests
- "Fair" does not necessarily mean "equal" ownership among kids

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**BREAKING BARRIERS** **Decision Making in the Landholding Entity**

- The holder of the voting interests controls the entity unless you provide otherwise
- Include specific details:
  - Must the land be offered to lease to a certain tenant? (hand picked successor) If so on what terms?
  - Can interests be owned by "non-blood" relatives? Transfer restrictions are crucial! Think about a put option.
  - If a buy-back happens because of a default, do "good owners" get to pay "bad owners" a discounted price?

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**BREAKING BARRIERS** **Decision Making in the Landholding Entity**

- Non-voting owners need not be excluded from all management
- Define "Big" decisions that may require majority, supermajority or unanimous approval of all non-voting interests, so everyone feels involved

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**BREAKING BARRIERS** Examples of "Big" Decisions In a Landholding Entity

- Sell land
- Mortgage Land
- Drastically change use of land
- Setting cash rent rates if one owner is the tenant (checks and balances) (include provision for alternative method to set rent if/when can't agree)
- CAFO, Wind Farm, other "hot button" issues...

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**BREAKING BARRIERS** Use of a Limited Liability Entity to Transfer Farm Land

With Farming Successor

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**BREAKING BARRIERS** Example 1: Farming Successor

Facts:

- Dad and Mom ages 75 and 73; 2,400 acres of land
- Net worth about \$24M (\$21M land + \$3M investments)
- 3 adult children, all married with children

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**BREAKING BARRIERS** **Example 1: Farming Successor (cont.)**

Facts:

- Active farm assets (inventory & machinery) owned by Jr.
- Dad and Mom are retired landlords
- Land is cash-leased to Jr.
- Objectives: Hold land together and assure Jr. has access to lease and buy land

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**BREAKING BARRIERS** **Example 1: Limited Liability Entity**

```

graph TD
    H((H)) ---|97%| LLE[LLE (Land)]
    W((W)) ---|1%| LLE
    Jr1((Jr.)) ---|1%| LLE
    C2((C-2)) ---|1%| LLE
    C3((C-3)) ---|1%| LLE
    Jr2((Jr.)) --- Farming[Farming Entity]
    Farming -- "$ Rent" --> LLE
  
```

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**BREAKING BARRIERS** **Example 1: Limited Liability Entity**

Additional LLE document issues if tenant-successor:

- Define Jr. as having first right to lease and define terms. Example:
  - 95% of county extension average lease rates
  - Average soil quality rate most recently published by a University.
- Define right of Jr. to purchase land parcels from partnership (e.g., appraisal mechanism; seller-financed terms)
  - Don't just give him 1<sup>st</sup> right of refusal

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**BREAKING BARRIERS** **Example 1: Limited Liability Entity**

Additional LLE document issues if tenant-successor:

- Consider specific designation of voting units
  - Example: 3 voting units: Dad, Mom and Jr.
  - At second parent's death, 1 unit to Jr. & 1 to non-farm child
  - Jr. has control (2 of 3 votes), but one child to monitor compliance with LLE document

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**BREAKING BARRIERS** **Limited Liability Entity**

Avoiding family conflict:

- Thorough communication at formation about Dad & Mom's objectives
- Emotional and financial buy-in by each child
- Consider use of consultant to sort out conflicting objectives of children/misconceptions/hidden heartburn
  - Private interviews; feedback to Dad & Mom

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**BREAKING BARRIERS**

**Use of Entity For Transfer of Land with No Farming Successor**

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**BREAKING BARRIERS**

### Example 2: No Related Farming Successor

Facts:

- Same dollar facts as previous example
- 3 adult children, all married, none farming
- Land has been cash rented to unrelated tenant
- Objectives: Hold land together for children / grandchildren
  - Concerned about spendthrift lifestyle of Child 3 and husband

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**BREAKING BARRIERS**

### Limited Liability Entity (LLE) Illustration

```
graph TD; H((H)) -- Gifts --> C1((C-1)); W((W)) -- Gifts --> C2((C-2)); W -- Gifts --> C3((C-3)); C1 --- LLE[LLE]; C2 --- LLE; C3 --- LLE; Land[Land] --> LLE;
```

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**BREAKING BARRIERS**

### Example 2: Limited Liability Entity

```
graph TD; H((H)) --- LLE["LLE (Land)"]; W((W)) --- LLE; C1((C-1)) --- LLE; C2((C-2)) --- LLE; C3((C-3)) --- LLE; Rent["$ Rent"] --> LLE;
```

Cash distributions out of LLE allocated 70-10-10-10

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**BREAKING BARRIERS**

## Buy-Sell Provisions

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**BREAKING BARRIERS**

## WHAT IF YOU DIE TOMORROW?

- How does ownership of the farm pass under the existing buy-sell agreement, estate plan, or lack of plan?
- Is this OK with all interested parties?
- If not - fix it!

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**BREAKING BARRIERS**

## Buy/Sell Agreements

- Results from negotiation with all owners of a business to create a contract that achieves goals and transitions the business after an owners' retirement, disability, or death
- Often incorporated into the entity's governing document, such as the Operating Agreement (for an LLC), Partnership Agreement (for an LLP) (or By-Laws (for a Corporation)
- If ignored upon formation, then in a subsequent free-standing agreement - watch for conflict!

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**BREAKING BARRIERS** Buy/Sell Agreements

- An owner may be contractually obligated to offer to “sell” the business interest to the entity or other owners upon certain triggers
- Entity or other owners has the option to “buy” that owner’s interest (“first right of refusal”)
- An owner may have the right to require the entity to buy that owner’s interest (“put option”)

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**BREAKING BARRIERS** Buy/Sell Agreements- Transfer Restrictions

- Must be reasonable - no absolute restrictions
- Permitted transferees may include:
  - Revocable Trust of current owner
  - Spouse of current owner
  - QTIP Trust FBO spouse of current owner
  - Descendants of current owner
  - Trust FBO descendants of current owner

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**BREAKING BARRIERS** Buy/Sell Agreements - Transfer Restrictions

- Permitted transferees may also include:
  - o Spouses of descendants
  - o QTIP Trust FBO spouse of a descendant
  - o Charities
  - o Qualified Charitable Trusts
- Transfer to non-permitted transferee would trigger First Right of Refusal in company or other owners

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**BREAKING BARRIERS** Buy/Sell Agreements - Triggering Events

- Divorce
- Bankruptcy
- Attempt to sell interest to outsider
- Pledging ownership interest as collateral
- Competing against the business
- Involuntary termination of employment
- Death
- Permanent disability
- Retirement
- Voluntary termination of employment

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**BREAKING BARRIERS** Buy/Sell Agreements – Details Matter

- Purchase might be accomplished with a lump sum cash payment
- Purchase might be made with a % down payment and a promissory note for the balance, to ease the burden on the purchaser
  - How many years? At what interest rate?
- Life insurance can provide liquidity to accomplish the purchase
  - buy the right insurance (2<sup>nd</sup> to die?)
  - consider a separate entity to own insurance or an Irrevocable Life Insurance Trust (“ILIT”)

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**BREAKING BARRIERS** Buy/Sell Agreements – Purchase Price

- What will be the Purchase Price?
  - Agreement by the owners on a regular basis
  - Formula approach
  - Appraisal approach
  - Any of the above may include valuation discounts for lack of control and lack of marketability
- Fair Market Value is:
  - Price at which ownership interest would change hands between a willing seller and a willing buyer, neither being under any compulsion to sell and buy, and both having reasonable knowledge or all relevant factors concerning the ownership interest

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**BREAKING BARRIERS**

### Purchase Price can be different depending on trigger

- Purchase price may (should) be lower if an event of default triggered the sale
- Lack of control discount may not be appropriate when valuing shares of deceased majority shareholder
- Remember: Price set in a buy/sell is not necessarily binding on the IRS for valuation purposes

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**BREAKING BARRIERS**

### Valuation issues

- A farm owned by an entity will need two values:
  - appraisal of the farm land, improvements, equipment and assets
  - business valuation to determine the value of an interest in the entity with appropriate discounts.
- Appraisals and business valuations satisfy the adequate disclosure rules triggering the running of the status of limitations for transfers reported on a gift tax return.
- No Guarantee the IRS will accept a valuation, best practice is rely on independent professional business valuation, no shortcuts!

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**BREAKING BARRIERS**

### COMMON MISTAKE: WE ALREADY HAVE A BUY-SELL; WE'RE FINE!

- An old/outdated buy-sell can be worse than no agreement at all.
- How will assets be valued?
- What liabilities will be considered?
  - \*If C Corp. will Built In Gains Tax Liability be reflected?
- Will discounts be applied?
- CPA should walk all owners through the formula showing the current value per share, and have everyone sign off agreeing
  - in minutes
  - as an exhibit to the Buy-Sell

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**BREAKING BARRIERS**

## Use a Charitable Remainder Trust to Dispose of Grain At Retirement

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**BREAKING BARRIERS**

## Charitable Remainder Trusts

```
graph LR; Donor -- "Asset" --> CRT[Char. Rmndr. Trust]; CRT -- "Income" --> Donor; CRT -- "Rmndr. After Term" --> Charity; Note["(No Tax On Asset Sale)"]
```

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**BREAKING BARRIERS**

## Charitable Remainder Trusts

Advantages

- Defer income up to a 20-year term
  - Lower federal income tax rates
  - No SE Soc. Sec. Tax
- Commodity can be sold by Trust with no tax
- Less federal tax; trades off with residual to charity
  - 10% minimum net present value to charity

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**BREAKING BARRIERS**

### CRT Examples

- 10 year term, annual payout
- \$500,000 funding
- Annual payout @ year-end

	IRS Interest Rate	
	2.0%	4.0%
• Payout amount	\$50,095	\$55,400
• Charitable remainder	10.01%	10.13%

[Current IRS rate: About 3.4%!]

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**BREAKING BARRIERS**

### Dealing With Land Trapped in a Corporation



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**BREAKING BARRIERS**

### C Corp. with Land Inside: No Successor

- Liquidate grain/livestock inventory and M&E as a C corp.
  - Use C corp. lower tax rates – 21%
  - Possible offsetting deductions for past underpaid services to employee-shareholders?
- Convert to S corporate status after disposition of all operating assets
  - S corp. holds land only; becomes landlord entity
  - Net rent income flows through to corp. owners
  - But S corp. must be "active" (crop share rents) or pay out its prior C corp. earnings as a dividend

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**BREAKING BARRIERS** **C Corp. with Land Inside: No Successor**

- Be mindful of Built In Gains ("BIG") recognition period
  - 5 years (used to be 10)
- After death of owner, stock gets step-up in basis
- Heirs sell land
  - Creates additional gain to add to stock basis
- Heirs then liquidate in year of sale
- Result equals no capital gains tax due (or even a small loss)

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**BREAKING BARRIERS**

**Transitioning Operating Assets to a Successor**

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**BREAKING BARRIERS** **Who's Your Successor?**

If you don't have a successor, do you want to find one, or is a machinery auction your plan for retirement or after death, with spouse and kids splitting the net after taxes?



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**BREAKING BARRIERS** **Sale to Non Related Successor**

- Through estate plan, at death an option to buy machinery, or “operating” assets could be given to non related successor, for ex: long time employee, young farmer who won’t be inheriting an operation.
- During lifetime, sell operating assets to identified successor, perhaps using corporation and selling stock
- Hand picked successor gets a chance to buy operating assets, perhaps at a discounted price, on installment over time.

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**BREAKING BARRIERS** **Sale to Non Related Successor**

- Kids become landlords, with stream of income
- Take steps to ensure successor to operations has access to farm land, outline formula to set lease terms, and consider giving successor operator ROFR over land.

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**BREAKING BARRIERS** **Case Study: Active Operations to Successor**

**Facts:**

- John, age 65, operates as Schedule F proprietor
  - Owns grain, machinery, and land
  - Objectives: Retire in several years, liquidate grain, and sell machinery to Sam
  - Est. grain value: \$800,000; machinery \$500,000
- Sam, age 34, who may or may not be related, farms with John, but also files as proprietor
  - Owns his share of grain, some machinery (total value \$200K)
  - Buying 160 acres on contract from neighbor

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**BREAKING BARRIERS** Case Study: Active Operations to Successor

Plan A: Liquidate grain/lease & sell machinery to Sam

Asset	Federal Income & SE Taxes		Total
	Income Tax (35% blended)	Soc. Sec. Tax (9% blended)	
\$800K grain	\$280K	\$72K	\$352K
\$500K machinery	\$175K	\$ -	\$175K
\$1.3M	\$455K	\$72K	\$527K

Combined Tax 41%

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**BREAKING BARRIERS** Case Study: Active Operations to Successor

Plan B: Use an Entity to Transition Operating Assets

```

    graph TD
      John((John)) -- "87% stock" --> SCorp[S Corp.]
      Sam((Sam)) -- "13% stock" --> SCorp
      John --- JAssets["Grain & machinery $1.3M"]
      Sam --- SAssets["Grain & machinery $200K"]
  
```

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**BREAKING BARRIERS** Case Study: Active Operations to Successor

```

    graph TD
      John((John)) -- "87%" --> SCorp[S Corp.]
      Sam((Sam)) -- "13%" --> SCorp
      SCorp --- Assets["$1.5M grain & machinery"]
      Sam -- "NOTE" --> John
      John -- "STOCK" --> Sam
  
```

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**BREAKING BARRIERS**  
**Case Study: Active Operations to Successor**

Strategies with corporate entity:

- Capital gain & no SE tax to John on stock sale
  - Cuts effective tax rate from 40% to 20%
  - Spread gain over term of note (e.g., 10 yrs.)
- Sell stock in minority increments with discounts
- Consider reorganizing into voting & non-voting shares
  - John can dispose of most stock, but retain control if desired

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**BREAKING BARRIERS**  
**Case Study: Active Operations to Successor**

John ← \$ Note Pmt. ← Sam

10% 90%

S Corp. → \$ 90% of cash distributions

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**BREAKING BARRIERS**  
**Case Study: Active Operations to Successor**

	Plan A Sale	Plan B (Entity)
Value of grain/machinery	\$1,300K	\$1,300K
Less stock discount (25%)		(300K)
Less tax cost: A @ 40%	(520K)	
B @ 20%		(200K)
Net to John after taxes	<u>\$780K</u>	<u>\$800K</u>

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**BREAKING BARRIERS**

### Case Study: Summary

- Entity sells John's grain, but offsets income with ongoing farm input expenses & prepaids
- Sam does not get fresh depreciation on machinery
  - Bought nondeductible stock, but at a discount
  - Sam gets favorable long-term financing from John
  - Sam has cash method farm expenses to continue tax deferral
- S corp. distinguishes salaries vs. rent vs. owner distributions

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**BREAKING BARRIERS**

### Rent the Land to Non Related Successor

```
graph TD; John((John)) --- LLE[LLE (Land)]; W((W)) --- LLE; C1((C-1)) --- LLE; C2((C-2)) --- LLE; C3((C-3)) --- LLE; LLE -- "$ Rent" --> FE[Farming Entity]; FE --- Sam((Successor Sam.));
```

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**BREAKING BARRIERS**

### Audience Participation Case Study

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**BREAKING BARRIERS**

### FACTS

- Jack, age 68, Jill age 65 currently own 12,000 acres worth \$24 million
- They own equipment worth about \$1.5 million with little or no tax basis
- They have about \$1 million of carryover grain with no tax basis
- They have life insurance on each other with a face value of \$2 million each
- They have 4 children, Sam farms with dad but has his own operation
- The other three children live out of state
- Jack would like to retire around age 75 since his health is good

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**BREAKING BARRIERS**

### OBJECTIVES

- Wants to minimize the tax costs of transferring/disposing of the grain and machinery when Jack finally retires
- Wants to make sure that Sam can farm the ground and has the right to purchase the ground after they pass away
- Wants to maintain harmony in the family
- Wants to eliminate the estate tax if possible

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**BREAKING BARRIERS**

### QUESTIONS

- What entity would you use for the transfer of the equipment to Sam?
- How would you dispose of the excess grain?
- What would you do with the life insurance?
- How would you structure the farm land holdings?
- Other questions that arise?

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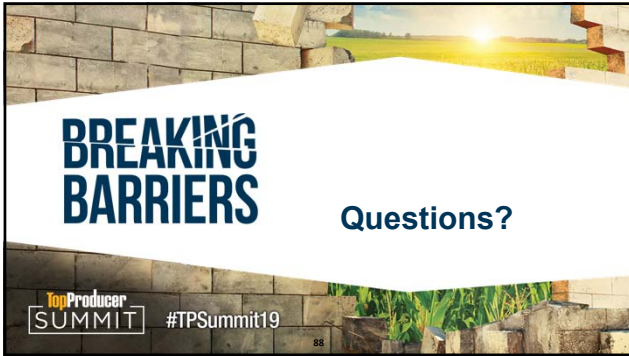
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