
# Planning for the Future of Your Farm

**TAX IMPLICATIONS OF FARM TRANSFERS**

YANKEE FARM CREDIT
Building Relationships That Last Generations

**Did some financial planning and it looks like I can retire at 62 and live comfortably for eleven minutes.**

# Estate Planning

**FORMAL DEFINITION: PROCESS OF ANTICIPATING AND ARRANGING FOR THE DISPOSAL OF AN ESTATE**

- Typically maximizes value of estate by reducing taxes and other expenses
- Guardians often designated for minor children and beneficiaries in incapacity

**SIMPLE DEFINITION: HELPING CLIENTS ACHIEVE THEIR OBJECTIVES WHICH ALWAYS INCLUDES MINIMIZING TAXES AND BEING "FAIR" TO THEIR HEIRS**

- Equal vs. Equitable


# There is more to estate planning than having a will.

A good plan should:

- Minimize taxes
- Protect assets (long term care facility)
- Avoid probate
- Appoint someone if you become disabled


# There are a few different potential tax events for a farm transfer.

- Estate or “Death” Tax
- Tax on sale of assets
- Tax on retirement income


# Choose the best business arrangement.

- Growing-in plan for increased responsibilities
- Start or take over an enterprise
- Start a mini-business within the main operation
- Percent interest in a new business entity

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# Many different facets to consider in business succession.

- Older generation ready to begin transferring management, control, ownership and income?
- Do you have a common vision for the farm?
- Can all parties live and work together?
- Is the spouse of young farmer committed to the farm?
- Can the farm support multiple families?
- How should the farm business be structured?
- What about a buy-sell agreement?
- How will non-farming children be treated?

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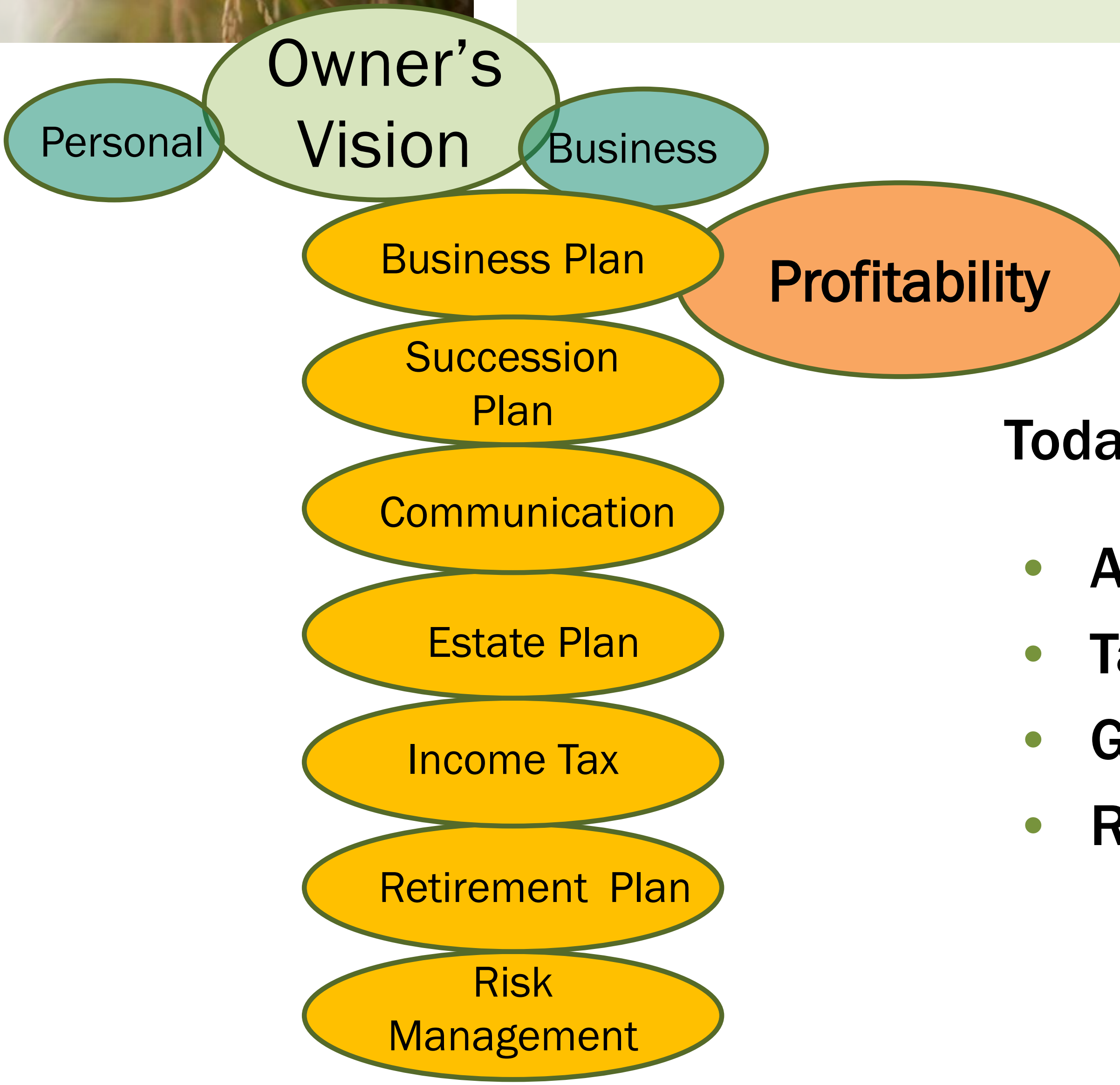
# "Start with the End in Mind" -Steven J. Covey

Today → 1 Year → 5 Years → Business succession / Exit strategy

*If you don't know where you're going,*
*any road will take you there!*

# Many dynamic pieces to the plans.




**Today → 5 Years**

- **Always evolving**
- **Tax laws changing**
- **Gov't regulation**
- **Relationships change**

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# Two basic types of transfers:

**SET UP NEXT GENERATION IN BUSINESS**

**OR**

**BOTH GENERATIONS WORKING TOGETHER**

# Set next generation up in business

**SENIOR GENERATION READY TO SLOW DOWN**

- Reduce workload
- Reduce management responsibilities
- Collect Social Security
- Collect rents

**JUNIOR GENERATION READY TO TAKE CONTROL**

- Ready & capable of management
- May have expansion plans
- Experienced & confident


# Four Ways to Transfer

1. **Sell:** Use bank or family becomes banker
2. **Grow:** Form a new business
3. **Gift:** Play Santa Claus
4. **Inherit:** Wait & wait & wait…
   & wait


# Taxed on GAIN of sale

- Gain on sale of property:

**(Sale $ - Cost of Sale - Basis)**

- Ordinary income taxed at ordinary rates
  - Non-capital assets
  - Inventory
  - Depreciation recapture


# New 2018 law leaves Capital Gains generally unchanged

| Filing Status | 0% | 15% | 20% |
|---|---|---|---|
| MFJ or Surviving Spouse | 0-$77,200 | $77,201-$479,000 | Over $479,000 |
| Head of Household | 0-51,700 | 51,701-452,400 | Over 452,400 |
| MFS | 0-38,600 | 38,601-239,500 | Over 239,500 |
| All other Ind. | 0-38,600 | 38,601-425,500 | Over 425,500 |

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# Gifting – Annual exclusion mechanics

**2019 ANNUAL EXCLUSION = $15,000**

**CAN MAKE LIFETIME GIFTS OF LARGER AMOUNTS, UP TO $11,400,000**

  – Amount is deducted from the Estate Tax Lifetime Exclusion available

- Unlimited number of exclusions available per taxpayer each year
- Husband and wife can combine their exclusions (spousal election)

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# There are many pros to gifting

**PROS:**

- Gifts are generally valued at FMV
- Provides Certainty of Ownership
- Can reduce estate taxes
- Reduce estate settlement costs
- Transfer a going business to successors
- Benefit family members and charitable organizations

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# Gifts aren't always great

**CONS:**

- Assets no longer available to provide income
- Control over gift property is given up

- Tax basis of gift transfers to recipient

Vs.

- Holding asset through estate then heirs receive a stepped up basis equal to FMV

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# Federal estate taxes lead up to 40% tax

| Taxable Estate Range | Pay this Amount | Plus this Rate on Excess Over Low End |
|---|---|---|
| $0 to $10,000 | $0 | 18% |
| $10,000 to $20,000 | $1,800 | 20% |
| $20,000 to $40,000 | $3,800 | 22% |
| $40,000 to $60,000 | $8,200 | 24% |
| $60,000 to $80,000 | $13,000 | 26% |
| $80,000 to $100,000 | $18,200 | 28% |
| $100,000 to $150,000 | $23,800 | 30% |
| $150,000 to $250,000 | $38,800 | 32% |
| $250,000 to $500,000 | $70,800 | 34% |
| $500,000 to $750,000 | $155,800 | 37% |
| $750,000 to $1 million | $248,300 | 39% |
| $1 million and up | $345,800 | 40% |


# Gross estate includes value of all property, including certain transfers

**YOUR GROSS ESTATE INCLUDES THE VALUE OF ALL PROPERTY IN WHICH YOU HAD AN INTEREST AT THE TIME OF DEATH INCLUDING:**

- Life Insurance Proceeds
- In certain instances, property transferred w/in 3 (life insurance) or 5 years of death (other gifts)

**ASSET VALUATION**

- Fair market value (FMV) as of date of death (DOD) of all assets owned by the decedent.
- Optional valuation method for farm real estate
  – Must qualify for special use valuation

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# Taxable estate definition

**GROSS ESTATE MINUS ALLOWABLE DEDUCTIONS INCLUDING:**

- Funeral expenses
- Debts
- Marital Deduction
- Charitable Deduction
- State Death Tax Deduction

**MARITAL DEDUCTION: UNLIMITED VALUE OF ASSETS MAY PASS TO SPOUSE AND NOT BE SUBJECT TO ESTATE TAXATION**

Portable under current law

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# Federal estate taxes have exemptions

Lifetime Estate and Gift Tax Exemption:
- $11.4 million per person

Annual Gift Tax Exemption
- $15,000 per person
- For > $15,000 need gift tax return

Gifts to spouse or charity generally tax-free

Portability for married couples
- Executor of estate of first spouse to die MUST file an estate tax return
- Combined exclusion $22.8 million

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# Vermont estate tax is flat

- Estates taxed at a flat 16%
- Estate tax exemption is $2.75 million
- No gift tax in Vermont
- No portability for Vermont estate exemption


# Both Generations Working Together

**SENIOR GENERATION NOT READY TO SLOW DOWN**

- Not ready to Gift or Sell Business
- Too young to retire
- Want to remain active

**JUNIOR GENERATION READY TO TAKE ON MORE RESPONSIBILITY**

- Ready & capable of managing the entire business
- May have expansion plans
- No capital to contribute to business

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# Business Entities: Match the right entity to your need

Limited Partnership

General Partnership

Sole Proprietorship

Trusts

Regular Corporation

Sub S Corporation

Limited Liability Company

Limited Liability Partnership

# Important factors in entity formation

- **ESTATE PLANNING**
- **LIABILITY PROTECTION**
- **MANAGING PROFITS**
- **EASE OF FORMATION**
- **EASE OF MAINTAINING YOUR BUSINESS ENTITY**
- **FRINGE BENEFITS**
- **CONTROL**


# Generations working together requires more people working together

## KEEPING EVERYONE INFORMED IS CRITICAL

### SUGGESTIONS ON NURTURING YOUR FAMILY BUSINESS STRUCTURE:

1. Operate in a business-like manner
2. Define roles & responsibilities
3. Be clear on compensation & benefits
4. Have a written business plan with measurable goals that all agree on
5. Keep family disagreements private


# Importance of written agreements shouldn't be underemphasized

Operating Agreements, Shareholders Agreements, Leases

- Fall back position if can't agree
- Communication tool
- Agreeing before you begin takes the uncertainty out of future
- Covers catastrophe: what if die, disabled, leave


# Different types of taxable retirement income to cover living expenses

- Pensions/Annuities/IRAs
- Social Security
- Rental Income
  - Passive Income
  - $25,000 ordinary loss limitation
  - Different deduction rules
  - Subject to self employment income?
- Business Income

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# Proper Planning: Think of the whole picture

- Do a retirement budget – How much will it cost to live?
  - What are the income tax implications of retirement income?
- Estate plans developed prior to 2013 should be reviewed for current applicability
- Provide for Long Term Care and Medical Expenses
- Certain taxes may be unavoidable for certain estates, therefore planning for handling those expenses need to be made
- Income tax implications are merely part of the puzzle – they should be considered and figured into the plan, but should not drive the direction of the plan.


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