# OPPORTUNITIES TAX ISSUES WITH FARM TRANSFER PLANNING

Farm Succession Training for Legal & Financial Professionals

September 23, 2021

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## THE "PERFECT" FARM TRANSFER PLAN

GIFT/ESTATE TAX INCOME TAX

**CASH FLOW** 

LONG TERM CARE EQUAL VS EQUITABLE

## GIFT/ESTATE TAX



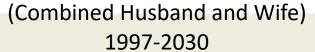


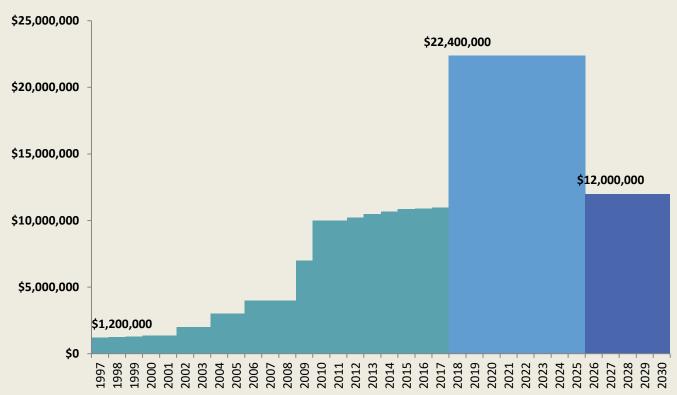


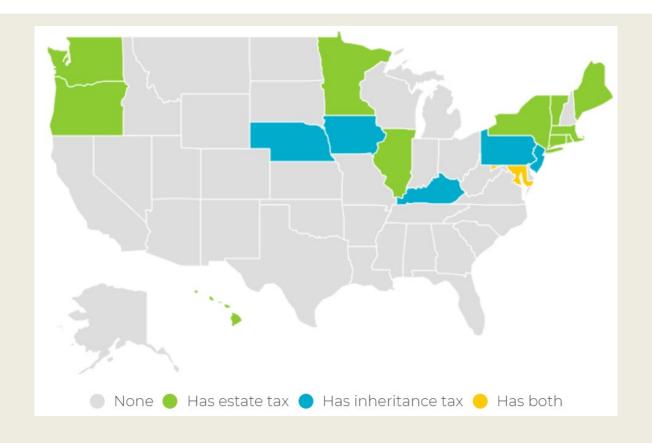




## **Federal Lifetime Estate Tax Exemptions**









State	Exclusion amount
Connecticut	\$3.6 million
District of Columbia	\$5.682 million
Hawaii	\$5.49 million
Illinois	\$4 million
Maine	\$5.7 million
Maryland	\$5 million
Massachusetts	\$1 million
Minnesota	\$2.7 million
New York	\$5.74 million
Oregon	\$1 million
Rhode Island	\$1.562 million
Vermont	\$2.75 million
Washington	\$2.193 million



## **INCOME TAX**

## **INCOME TAX**













### **INCOME TAX**









GAIN ON SALE?
DEPRECIATION RECAPTURE?
CAPITAL GAINS... LOWER/MAYBE 0% RATES?

**STEP-UP IN BASIS?** 

## **CASH FLOW**

## **CASH FLOW**









**FARMER TO LANDLORD? (COLLECT RENTS?)** 

**FUTURE EARNINGS?** 

BUSINESS PROFITABLE ENOUGH TO "PAY" BOTH SR. AND JR?

## **LONG TERM CARE**

## LONG TERM CARE











## LONG TERM CARE

**NURSING HOMES: \$10,000 A MONTH!?!** 

LONG TERM CARE INSURANCE?

MEDICAID: GIVE AWAY ASSETS? (FIVE YEAR CLAW-BACK RULES)

"INCOME ONLY TRUSTS" TO PRESERVE CASH FLOW?

## **EQUAL VS. EQUITABLE**

## EQUAL VS. EQUITABLE







HOW DO YOU SPLIT THE FARM WHEN ONLY ONE OF THE TWO CHILDREN HAVE INVESTED THROUGH "SWEAT EQUITY" OVER THE YEARS?

## WHICH ENTITY TYPE IS THE **BEST** FOR **SUCCESSION PLANNING?**





## WHICH ENTITY TYPE IS THE BEST FOR SUCCESSION PLANNING?



Disclaimer: Depends on Facts and Circumstances, but generally speaking LLCs are preferred

WILLS

TRUSTS

POWER OF ATTORNEY

LIVING WILL

LIFE INSURANCE

## **OPTIONS**

**GIVE IT SELL IT LEAVE IT EARN IT** СОМВО GIVE IT

SR: NO GIFT/ESTATE TAX DUE UNLESS SR. EXCEEDS THE LIFETIME EXCLUSIONS

JR: NO TAX DUE (GIFT/ESTATE/OR INCOME) UPON RECEIVING THE ASSETS

DONOR'S BASIS BECOMES DONEE'S BASIS (NO STEP-UP IN BASIS... CAN'T RE-DEPRECIATE)

RELATIVELY STRAIGHT FORWARD



SR: TAXABLE GAIN DEPENDS ON SR'S ORIGINAL BASIS AND HOW MUCH WAS DEPRECIATED

JR: NEW BASIS EQUALS THE PURCHASE PRICE OF EACH ASSET.

### **STRATEGIES:**

INSTALLMENT SALES (REMEMBER 0% BUCKETS!)

SALE PRICE ALLOCATIONS (PERSONAL RESIDENCE, UNHARVESTED CROPS, ETC.)

LEAVE IT

SR: NO ESTATE TAX DUE UNLESS ESTATE EXCEEDS THE LIFETIME EXCLUSION AT DEATH

JR: NO TAX DUE (GIFT/ESTATE/OR INCOME) UPON RECEIVING THE ASSETS

INHERITED PROPERTY GETS A **STEP-UP** IN BASIS... OPPORTUNITY TO TAKE TAX DEDUCTIONS AGAIN!

RELATIVELY STRAIGHT FORWARD

EARN IT

JR. AND SR. **FORM AN LLC** AND CAN ALLOCATE PROFITS/LOSSES WITH GREAT FLEXIBILITY.

CAN TURN THE EQUITY FAUCET ON AND OFF TO CONTROL THE TIMING OF THE TRANSITION.

SR'S OWNERSHIP OF THE LLC **GETS STEPPED-UP** AT DEATH. (OPPORTUNITY FOR GETTING DEPRECIATION DEDUCTIONS.... TWICE!)

MORE COMPLEX... BUT WORTH IT!

## COULD BE A COMBINATION OF THESE...

GIVE JR. A 25%
INTEREST IN
YOUR REAL
ESTATE LLC?

**GIVE IT** 

**SELL IT** 

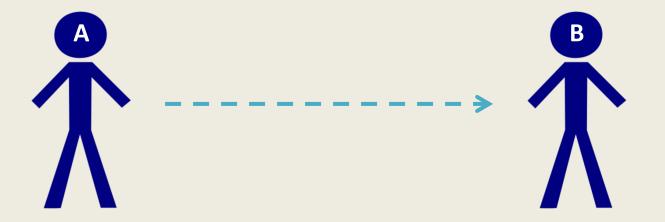
SELL SOME DAIRY
COWS TO JR. ON AN
INSTALLMENT SALE?

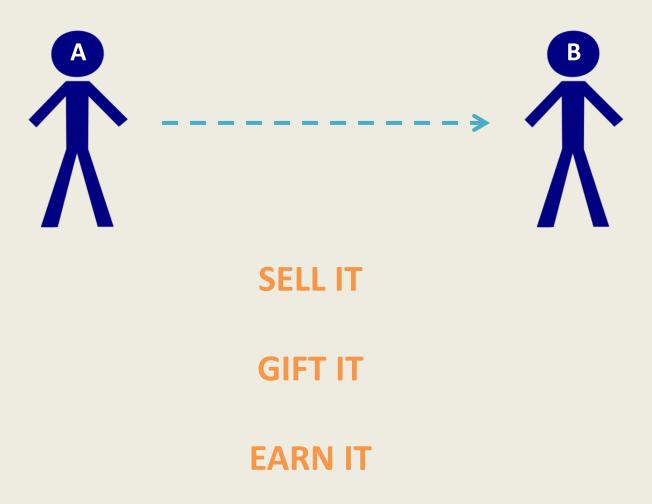
HOLD ON TO THE
REMAINDER OF
REMAINDER AND
THE LAND AND
COLLECT A RENT
COLLECT A RENT
PAYMENT FOR
CASH FLOW?

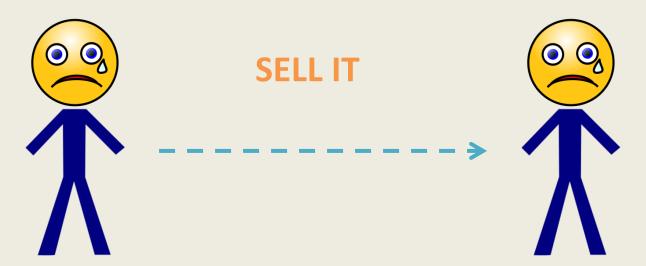
**LEAVE IT** 

**EARN IT** 

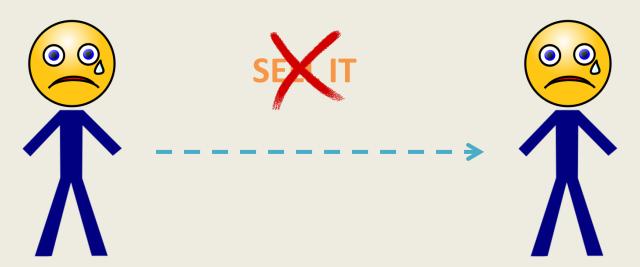
FORM AN
OPERATING LLC
WITH JR. AND
SPLIT PROFITS
75/25?







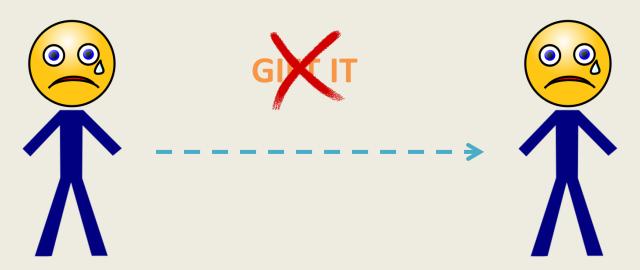
- A now has a large taxable gain!!
- B can't cash flow the purchase
- B can't get the financing
- Limited Flexibility with Timing
- Depreciation Recapture Issues



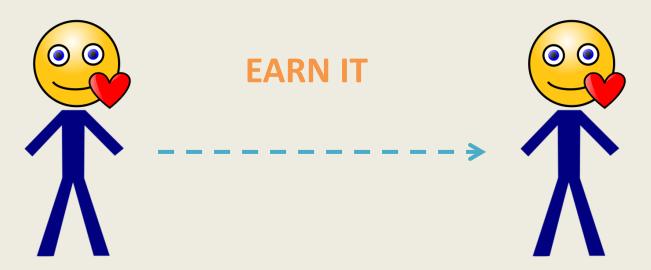
- A now has a large taxable gain!!
- B can't cash flow the purchase
- B can't get the financing
- Limited Flexibility with Timing
- Depreciation Recapture Issues



- A worked hard for this equity!!....
- A might use up gift/estate exemptions
- Annual exclusion gifts take forever!!!
- B might not be ready
- B's siblings now resent B!!



- A worked hard for this equity!!....
- A might use up gift/estate exemptions
- Annual exclusion gifts take forever!!!
- B might not be ready
- B's siblings now resent B!!



- A recognizes no gain from sale
- A preserves gift/estate exemptions
- B is incentivized, both A & B benefit
- B builds equity while deferring tax
- Timing of transition easily controlled



# UNDERSTANDING INTERESTS

CAPITAL INTEREST	PROFITS INTEREST

# UNDERSTANDING INTERESTS

### CAPITAL INTEREST

### **PROFITS INTEREST**

 ENTITLES RECIPIENT TO A SHARE OF LIQUIDATION PROCEEDS ENTITLES RECIPIENT TO A
 SHARE OF FUTURE
 PROFITS AND
 APPRECIATION

#### STARTING POINT

G	General partner or member-manager	LLC	Limited partner or other LLC member
н	X Domestic partner		Foreign partner
11	What type of entity is this p	artner? <u>I</u> I	NDIVIDUAL
12	If this partner is a retir		
J	Partner's share of prof	fit, loss, and cap	ital (see instructions):
	Beginniı	ıg	Ending
	Profit	100 ક	100 %
	Loss	100 ક	100 %
	Capital	100 %	100 %
k	Partner's share of liab	ilities at vear en	d·
1	Tartifor S Share of hab	ilitios at your ori	u.
	Nonrecourse	_	
			\$

_			11
G	General partner or LLC member-manager		Limited partner or other LLC member
н	X Domestic partner		Foreign partner
11	What type of entity is this partner?	II	NDIVIDUAL
12	If this partner is a retirement plan (check here	(IRA	A/SEP/Keogh/etc.),
J	Partner's share of profit, loss, and	сар	ital (see instructions):
	Beginning		Ending
	Profit	og O	8
	Loss	8	8
	Capital	<mark>ૄ</mark>	8
K	Partner's share of liabilities at year	en	d:
	Nonrecourse		\$
	Qualified nonrecourse financing		\$
	Recourse		\$



NET WORTH = **\$800,000** 



NET WORTH = **\$0** 

### **OBJECTIVE IS REALLY TO GIVE B 50% CAPITAL INTEREST**

G	X General partner or LL member-manager	С	Limited partner or other LLC member
н	X Domestic partner		Foreign partner
11	What type of entity is this partne	er? <u>Il</u>	NDIVIDUAL
12	If this partner is a retirement check here		
J	Partner's share of profit, le <b>Beginning</b>	oss, and cap	ital (see instructions): <b>Ending</b>
	Profit	100 %	100 %
	Loss	100 %	100 %
	Capital	100 %	100 %
K	Partner's snare of liabilitie	s ear end	u:
	Nonrecourse		\$
	Qualified nonrecourse fina	incin	\$
	Recourse		. \$

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NET WORTH = **\$400,000** 



NET WORTH = **\$400,000** 

#### **OBJECTIVE IS REALLY TO GIVE B 50% CAPITAL INTEREST**

G	General partner or member-manager	LLC	Limited partner or other LLC member
н	X Domestic partner		Foreign partner
11	What type of entity is this par	tner? <u>I</u> 1	NDIVIDUAL
12	If this partner is a retire check here		
J	Partner's share of profit <b>Beginning</b>	•	ital (see instructions): <b>Ending</b>
	Profit	100 %	100 %
	Loss	100 %	100 %
Ш	Capital	100 %	100 %
K	Partner's snare of liability	ues ear end	u:
	Nonrecourse		\$
	Qualified nonrecourse fi	nancin	\$
	Recourse		. \$

G	X General partner or LLC member-manager		Limited partner or other LLC member
н	X Domestic partner		Foreign partner
11	What type of entity is this partner?.	<u>IN</u>	DIVIDUAL
12	If this partner is a retirement check here.		
J	Partner's share of profit, loss <b>Beginning</b>	s, and capi	tal (see instructions): Ending
	Profit	ફ	8
I .	Loss	٥	્ર
Ш	Capital	ફ	8
k	Capital  Partner's share of limities a		ફ
ĸ	<u> </u>	at year end	% :
k	Partner's share of limities a	at year end	: .\$
ĸ	Partner's share of limities a	at year end	% : .\$



BUT WE CAN'T



NET WORTH = **\$400,000** 

NET WORTH = **\$400,000** 

# UNDERSTANDING INTERESTS

### CAPITAL INTEREST

### **PROFITS INTEREST**

 ENTITLES RECIPIENT TO A SHARE OF LIQUIDATION PROCEEDS ENTITLES RECIPIENT TO A
 SHARE OF FUTURE
 PROFITS AND
 APPRECIATION

# UNDERSTANDING INTERESTS

### CAPITAL INTEREST

- ENTITLES RECIPIENT TO A SHARE OF LIQUIDATION PROCEEDS
- TRANSFER OF CAPITAL INTEREST IS EITHER A GIFT OR TAXABLE TO RECIPIENT

### **PROFITS INTEREST**

- ENTITLES RECIPIENT TO A
   SHARE OF FUTURE
   PROFITS AND
   APPRECIATION
- TRANSFER OF PROFITS
  INTERESTS CAN BE TAX
  FREE TO BOTH PARTIES

# TAX FREE UNLESS

1.) SUBSTANTIALLY CERTAIN AND PREDICTABLE STREAM OF INCOME

OR

2.) PARTNER DISPOSES OF INTEREST WITHIN TWO YEARS OF RECEIPT

# LET'S SEE HOW IT WORKS...

### **50% PROFITS INTEREST**

G	General partner or LLC member-manager	;		Limited partner or other LLC member
н	X Domestic partner			Foreign partner
11	What type of entity is this partner	?	II	NDT JUAL
12	If this partner is a retireme check here		(IF	sEP/Keogh/etc.),
J	Partner's share of profit, lo	ss, a	иp	ital (see instructions):
	Reginning			Ending
			_	100.0
	Profit	100	용	100 %
l	Profit Loss	100	ઝ	
				100 %
ĸ	Loss	100 100	રુ જ	100 % 100 %
к	Loss Capital	100 100 s at year	१ १ end	100 % 100 % d:
к	Loss Capital Partner's share of liabilities	100 100 s at year	용 용 end	100 % 100 % d: \$
ĸ	Capital Partner's share of liabilities Nonrecourse	100 100 s at year 	% % end 	100 % 100 % d: \$

G	X General partner or LLC member-manager		Limited partner or o LLC member	ther
**	V Domestic partner		Foreign partner	
11	What type of en this partner?.	<u>IN</u>	DIVIDUAL	
12	If this partner is a check here		SEP/Keogh/etc.),	
J	Partner's share of pr	s, and capit	al (see instructions)	):
	RAMINNINA		Fnding	
	Profit	ફ		io %
		90	5	
	Profit		5	
K	Profit Loss	\( \rangle \)	5	0 %
K	Profit Loss Capital	१ १ at year end	5	0 %
K	Profit Loss Capital Partner's share of liabilities a	% 8 at year end	. \$	0 %
K	Profit  Loss  Capital  Partner's share of liabilities a	% 8 8 at year end	. \$ . \$	0 %



NET WORTH = **\$800,000** 



NET WORTH = **\$0** 

### **50% PROFITS INTEREST**

G	X General partner or LLC member-manager		Lir	mited partner or other C member
н	X Domestic partner		Fo	reign partner
11	What type of entity is this partner?.		IND	UAL
12	If this partner is a retirement check here			EP/Keogh/etc.),
J	Partner's share of profit, loss	, a	apital	(see instructions):
	Profit	100 %	) of	100 %
	Profit Loss	100 %		100 % 100 %
			ó	
ĸ	Loss	100 % 100 %	o o	100 %
ĸ	Loss Capital	100 % 100 % It year e	් end:	100 % 100 %
к	Loss Capital Partner's share of liabilities a	100 % 100 % It year e	g g end:	100 % 100 %

G	General partner or LLC member-manager		imited partner or other LC member	
**	Domestic partner	F	oreign partner	١
11	What type of enterminist this partner?	·· INI	DIVIDUAL	
12	If this partner is a check here	n (IRA/		
J	Partner's share of p	d capit	al (see instructions):	١
	RAMININIA.		Fnaina	4
	Profit	ક	-	g 6
		ુ જ	50 9	) 항 항
	Profit		50 <sup>§</sup>	
K	Profit Loss	% %	50 <sup>5</sup>	8 6
K	Profit Loss Capital	% % ar end:	50 <sup>9</sup> 50 <sup>9</sup>	ह ह
K	Profit  Loss Capital  Partner's share of liabilities at yet Nonrecourse	ક ક ar end:	50 \$ 50 \$ \$	ह ह
K	Profit  Loss Capital  Partner's share of liabilities at year	ક ક ar end:	50 \$ 50 \$ \$ \$	ह ह



ASSUME \$100,000 Profits and \$100,000 Appreciation



NET WORTH = **\$800,000** 

NET WORTH = **\$0** 

## YEAR 1

G	X General partner or LLC member-manager		Limited partner or ot LLC member	her
н	X Domestic partner		Foreign partner	
11	What type of entity is this partner?	<u>I</u>	NDIVIDUAL	
12	If this partner is a retiremen check here	t plan (IRA	A/SEP/Keogh/etc.),	
J	Partner's share of profit, los <b>Beginning</b>	s, and cap	ital (see instructions):  Ending	
	5 5			
	Profit	용	5	0 %
	•	90	_	
	Profit		5	0 %
ĸ	Profit Loss	% 100 %	5) 5) 9)	0 %
к	Profit Loss Capital	100 % at year end	50 50 90 d: \$	0 %

G	X General partner or LLC member-manager		Limited partner or other LLC member		
l H	X Domestic partner		Foreign partner		
11	What type of entity is this partner?	· <u>I</u>	NDIVIDUAL		
12	If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here.				
J	Partner's share of profit, loss, and capital (see instructions):				
	Beginning Ending				
	Profit	8	50 %		
	Loss	90	<b>50</b> %		
	Capital	બુ	10 %		
ĸ	Partner's share of liabilities at year end:				
	Nonrecourse\$				
	Qualified nonrecourse financing \$				
	Recourse		\$		



NET WORTH = **\$900,000** 

E	
1	1

NET WORTH = **\$100,000** 

## YEAR 2

G	X General partner or LLC member-manager			Limited partner of LLC member	r othe	er
Н	X Domestic partner			Foreign partner		
11	What type of entity is this partner?		II	NDIVIDUAL		
12	If this partner is a retirement check here.				. [	
J	Partner's share of profit, loss <b>Beginning</b>	, and o	сар	ital (see instruction <b>Ending</b>	าร):	
	Profit	50	<b>ે</b>		50	કૃ
	Loss	50	બુ		50	용
	Capital	90	્ઠ ર		83	કૃ
ĸ	Partner's share of liabilities a	t year	en	d:		
	Nonrecourse			\$		
	Qualified nonrecourse financi	ng		\$		
	Recourse			\$		

G	X General partner or LLC member-manager		Limited partner or other LLC member	
н	X Domestic partner		Foreign partner	
11	What type of entity is this partner?	<u>I</u> I	NDIVIDUAL	
12	If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here.			
J	Partner's share of profit, loss, and capital (see instructions):  Beginning Ending			
	Profit	50 %	50 %	
	Loss	50 %	50 %	
	Capital	10 %	17 %	
ĸ	Partner's share of liabilities at year end:			
Nonrecourse\$				
	Qualified nonrecourse financing \$			
	Recourse		\$	

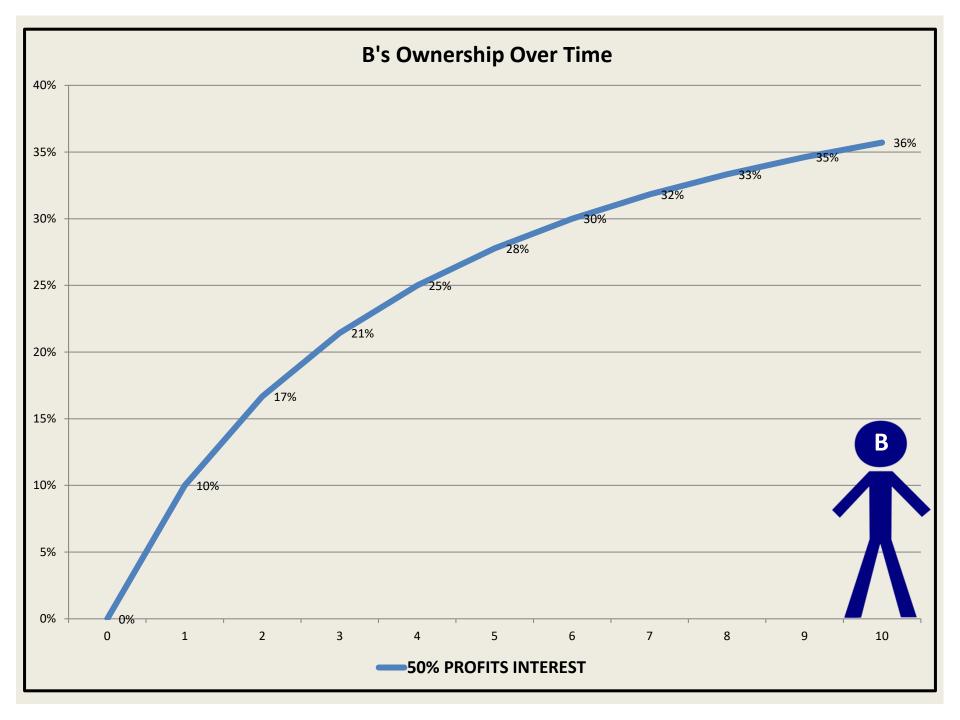


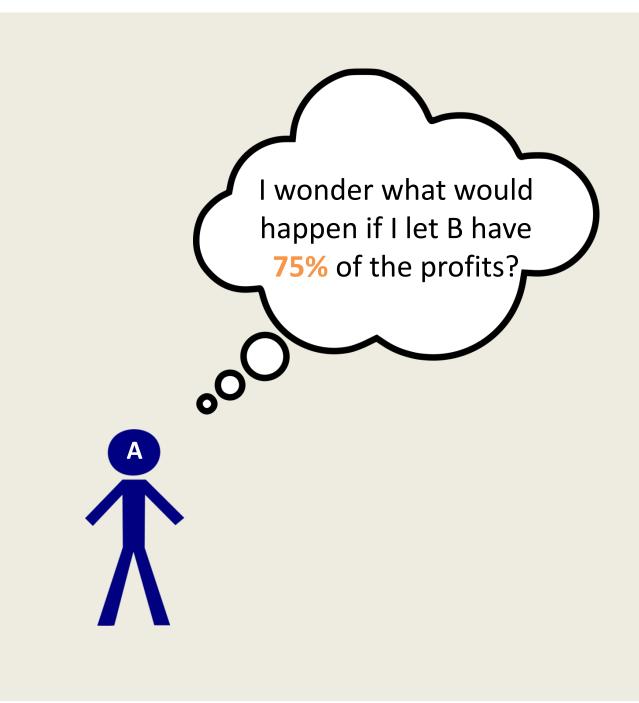
NET WORTH = **\$1,000,000** 

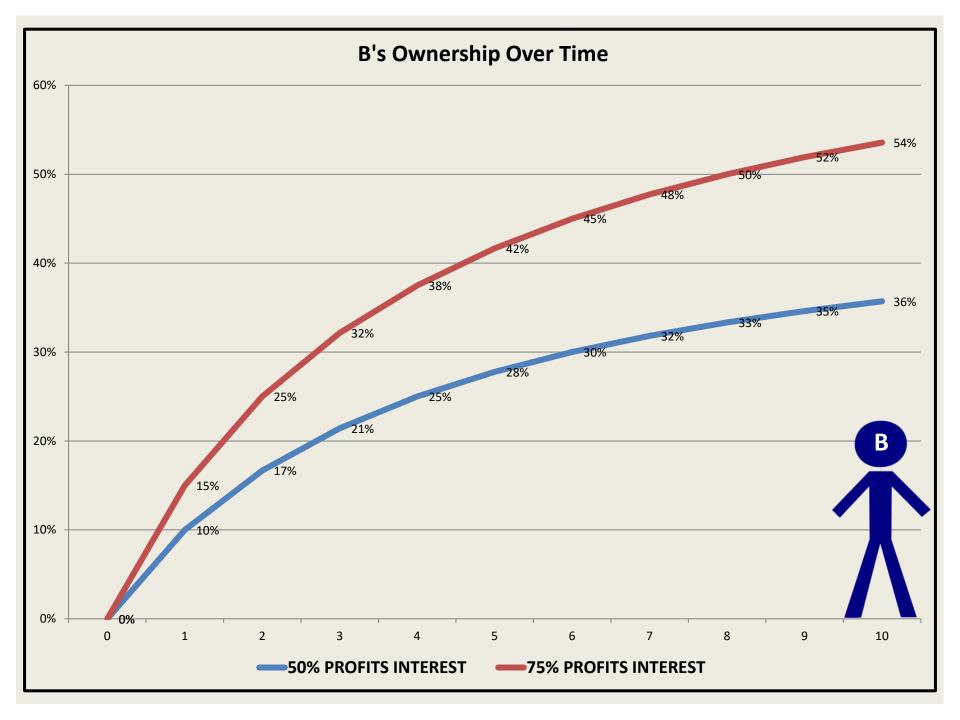


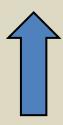
NET WORTH = **\$200,000** 

(By the way, only paid tax on \$100,000)

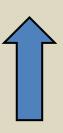








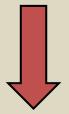




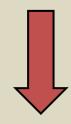
BEG. EQUITY IN LLC

CAPITAL CONTRIBUTED	BOOK INCOME	APPRECIATION	
DRAWS	BOOK LOSSES	DEPRECIATION	

END. EQUITY IN LLC







# OPPORTUNITIES – FACTORS WE CAN "CONTROL"

1 2 3

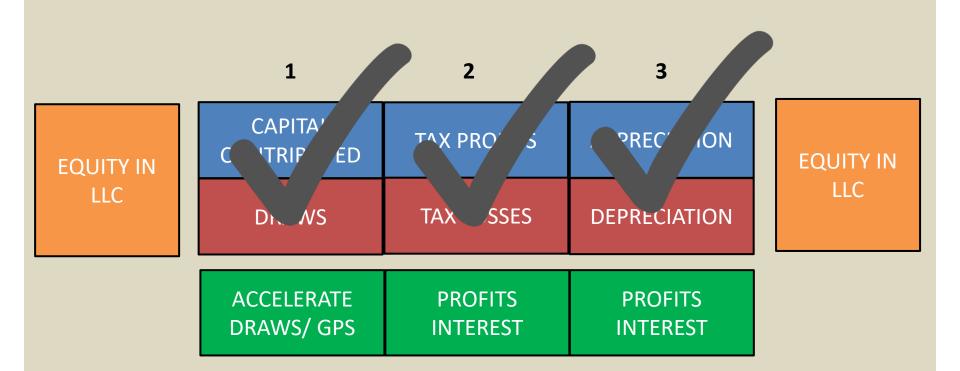
BEG. EQUITY IN LLC

CAPITAL CONTRIBUTED	BOOK INCOME	APPRECIATION
DRAWS	BOOK LOSSES	DEPRECIATION

END. EQUITY IN LLC

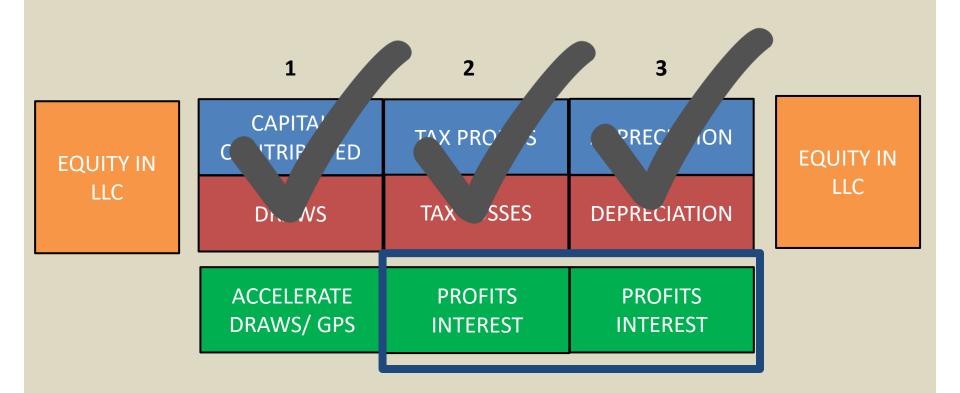
Which of the **three** can we "control"?

# OPPORTUNITIES – FACTORS WE CAN "CONTROL"

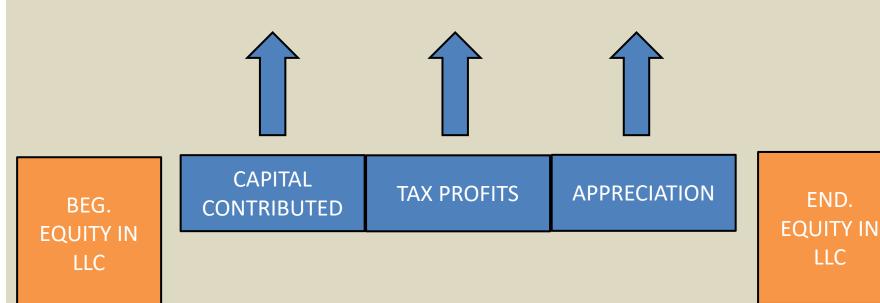


I would argue all three!!!

# OPPORTUNITIES – FACTORS WE CAN "CONTROL"

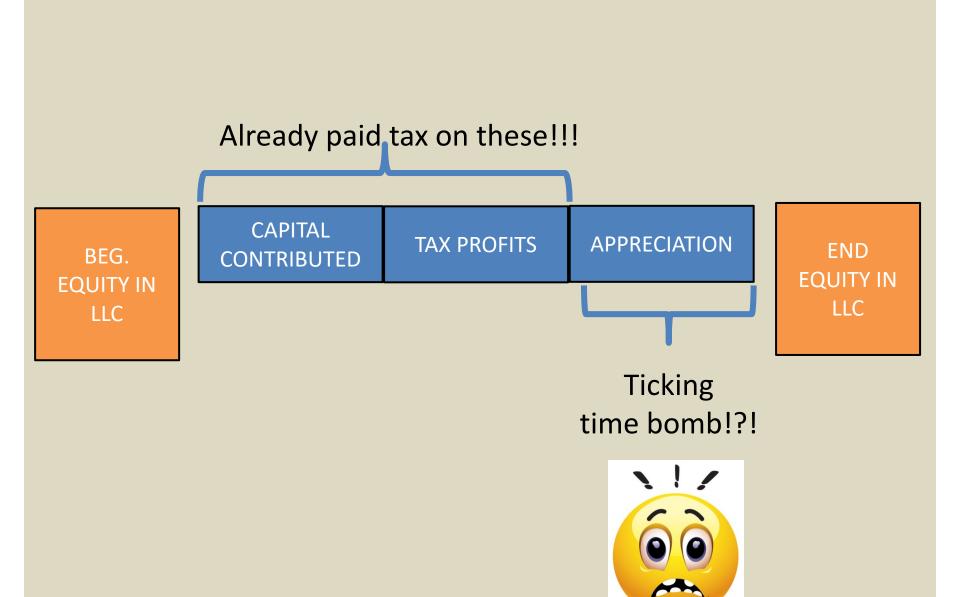


I would argue all three!!!



Three ways to build equity in LLC.

Which is the **best**?



# Solution: "Diversify"... Gain Equity by all three methods?

EQUITY IN LLC \$8 Million CAPITAL CONTRIBUTED

**TAX PROFITS** 

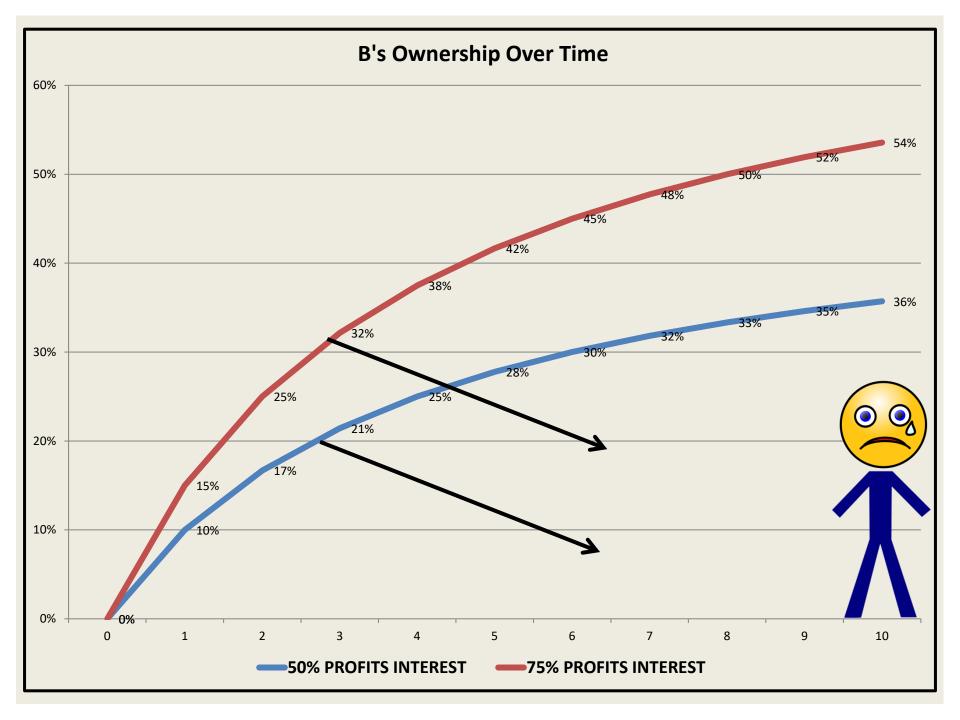
**APPRECIATION** 

EQUITY IN LLC

\$8 Million

# OTHER CONSIDERATIONS

- Depreciation during down cycles... plan backfires?
- Power of the Guaranteed Payment
- Family Partnership Rules, and other ambiguities
- Built In Gains on Contribution



# POWER OF THE GUARANTEED PAYMENT

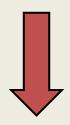
In the real world...

Both A and B need cash from the business

BEG. EQUITY IN LLC

CAPITAL BOOK INCOME		APPRECIATION
DRAWS	BOOK LOSSES	DEPRECIATION

END. EQUITY IN LLC



A should take a **GP**B should take a **GP** 

# **SUMMARY**

Here's the top 4 slides in case you zoned out...

# UNDERSTANDING INTERESTS

### CAPITAL INTEREST

- ENTITLES RECIPIENT TO A SHARE OF LIQUIDATION PROCEEDS
- TRANSFER OF CAPITAL INTEREST IS EITHER A GIFT OR TAXABLE TO RECIPIENT

### **PROFITS INTEREST**

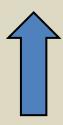
- ENTITLES RECIPIENT TO A
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   PROFITS AND
   APPRECIATION
- TRANSFER OF PROFITS
  INTERESTS CAN BE TAX
  FREE TO BOTH PARTIES

# TAX FREE UNLESS

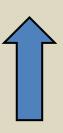
1.) SUBSTANTIALLY CERTAIN AND PREDICTABLE STREAM OF INCOME

OR

2.) PARTNER DISPOSES OF INTEREST WITHIN TWO YEARS OF RECEIPT



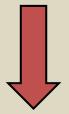




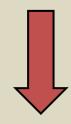
BEG. EQUITY IN LLC

CAPITAL CONTRIBUTED	BOOK INCOME	APPRECIATION	
DRAWS	BOOK LOSSES	DEPRECIATION	

END. EQUITY IN LLC







# OTHER CONSIDERATIONS

- Depreciation/losses during down cycles... plan backfires?
- Power of the Guaranteed Payment
- Family Partnership Rules, and other ambiguities
- Built In Gains on Contribution

#### Family Partnership Rules:

Conclusion: It should be possible to allocate total profits (cash and accrual) as well as appreciation to Junior in excess of his capital ownership without triggering any IRC §2704 issues because as outlined here, all parties have identical liquidation and distribution rights. Clients need to be careful if donor retains preferential rights to distributions either currently or upon liquidation.





# SUMMARY / STRATEGIES

- **HISTORICALLY HIGH** GIFT / ESTATE TAX EXEMPTIONS
- THINK ABOUT HOW YOUR PLAN IMPACTS FUTURE TAX DEDUCTIONS (STEP-UP)
- TAKE ADVANTAGE OF **0% CAPITAL GAINS** RATES IF SELLING (INSTALLMENT SALES)
- FORMING AN LLC AND BRINGING IN JR. CAN HELP CONTROL TIMING OF TRANSITION

GIFT/ESTATE TAX	INCOME TAX	CASH FLOW	LONG TERM CARE	EQUAL VS EQUITABLE
WILLS	TRUSTS	POWER OF ATTORNEY	LIVING WILL	LIFE INSURANCE
GIVE IT	SELL IT	LEAVE IT	EARN IT	COMBO

# THANK YOU

### Jon Jaffe

Farm Business Consultant Farm Credit East

### **Nick Bullock**

Senior Farm Tax Specialist Yankee Farm Credit