

# OPPORTUNITIES TAX ~~ISSUES~~ WITH FARM TRANSFER PLANNING

*Farm Succession Training for Legal &  
Financial Professionals*  
September 23, 2021

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Yankee Farm  
Credit



# **THE “PERFECT” FARM TRANSFER PLAN**



**GIFT/ESTATE  
TAX**

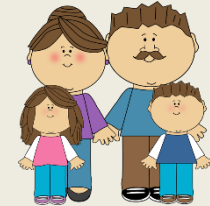
**INCOME  
TAX**

**CASH FLOW**

**LONG  
TERM CARE**

**EQUAL VS  
EQUITABLE**

# GIFT/ESTATE TAX



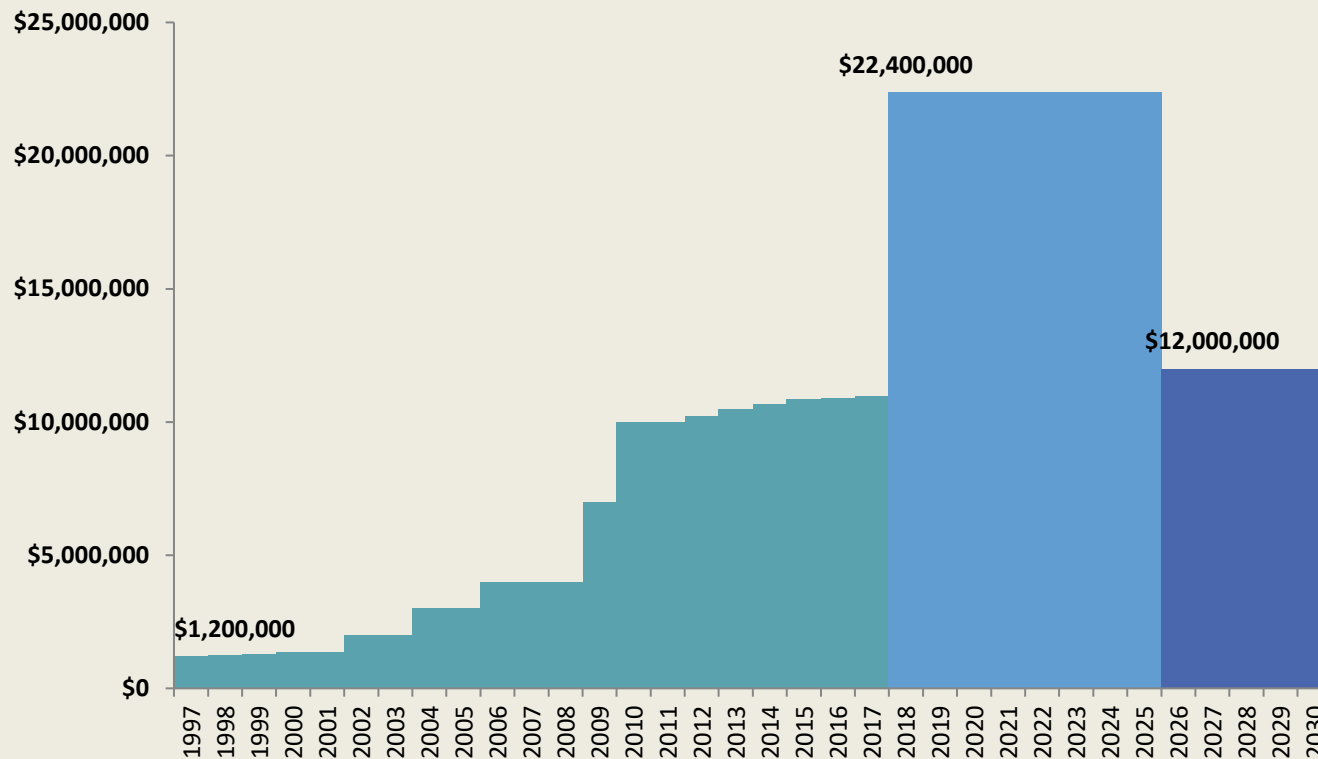
# Federal Lifetime Estate Tax Exemptions

(Combined Husband and Wife)

1997-2030

40%

Rate!



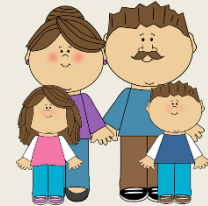
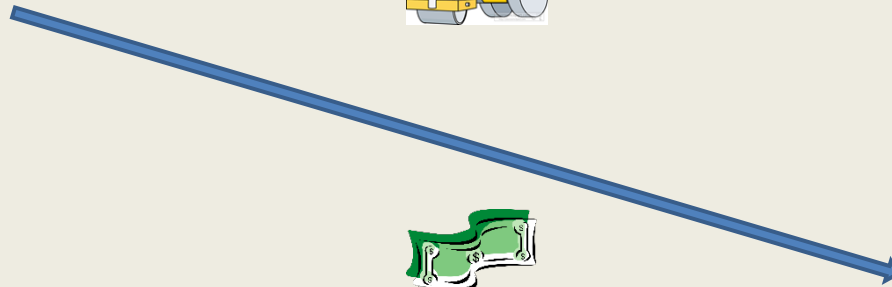


State	Exclusion amount
Connecticut	\$3.6 million
District of Columbia	\$5.682 million
Hawaii	\$5.49 million
Illinois	\$4 million
Maine	\$5.7 million
Maryland	\$5 million
Massachusetts	\$1 million
Minnesota	\$2.7 million
New York	\$5.74 million
Oregon	\$1 million
Rhode Island	\$1.562 million
Vermont	\$2.75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

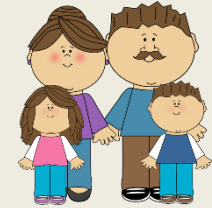
# **INCOME TAX**



# INCOME TAX



# INCOME TAX

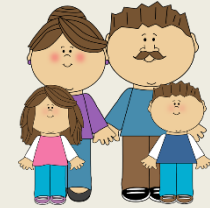
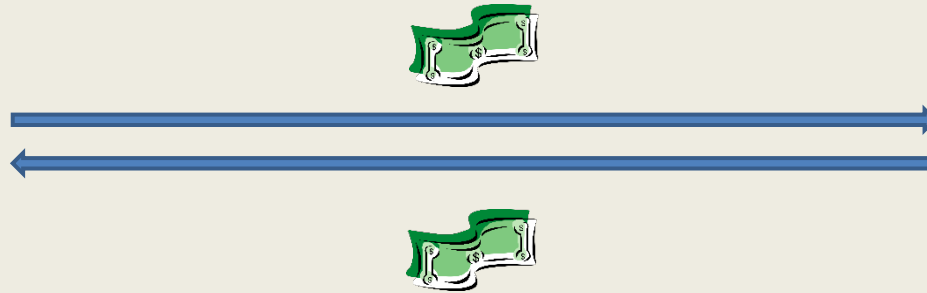


GAIN ON SALE?  
DEPRECIATION RECAPTURE?  
CAPITAL GAINS... LOWER/MAYBE 0% RATES?

STEP-UP IN BASIS?

# **CASH FLOW**

## CASH FLOW



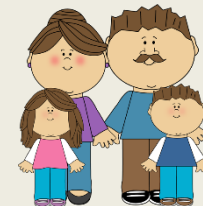
FARMER TO LANDLORD? (COLLECT RENTS?)

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?

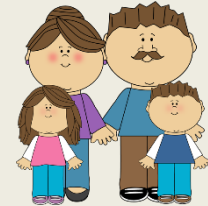
MEDICAID: GIVE AWAY ASSETS? (FIVE YEAR CLAW-BACK RULES)

**“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?

**S CORPS**  
FOR LIFE

WHATEVER  
**ATTORNEY**  
TELLS ME!

NO WAY  
**LLCS** ALL DAY!

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



LLCs

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**

**COMBO**



**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





**SELL IT**

**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 IT**

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

**SELL IT**

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

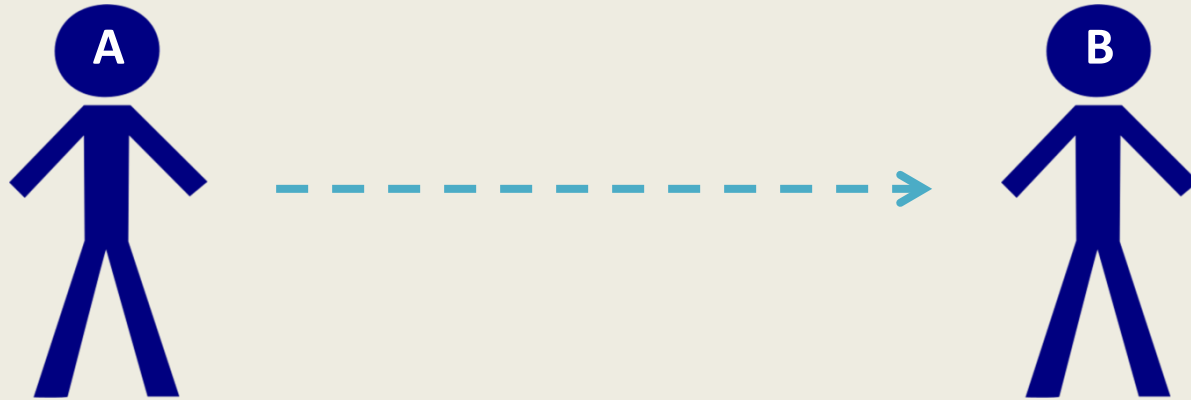
**LEAVE IT**

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

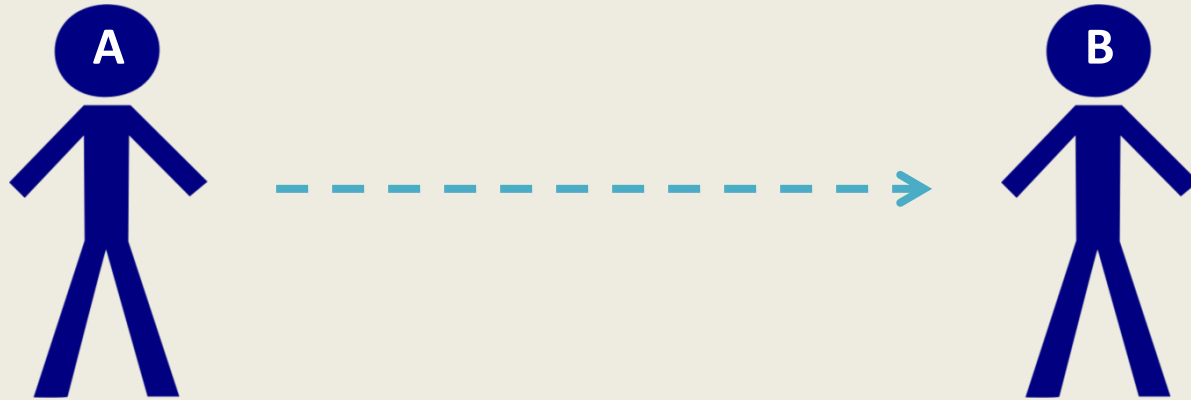
**EARN IT**

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

**A** wants to transfer 50% of his business to **B**



**A** wants to transfer 50% of his business to **B**



**SELL IT**

**GIFT IT**

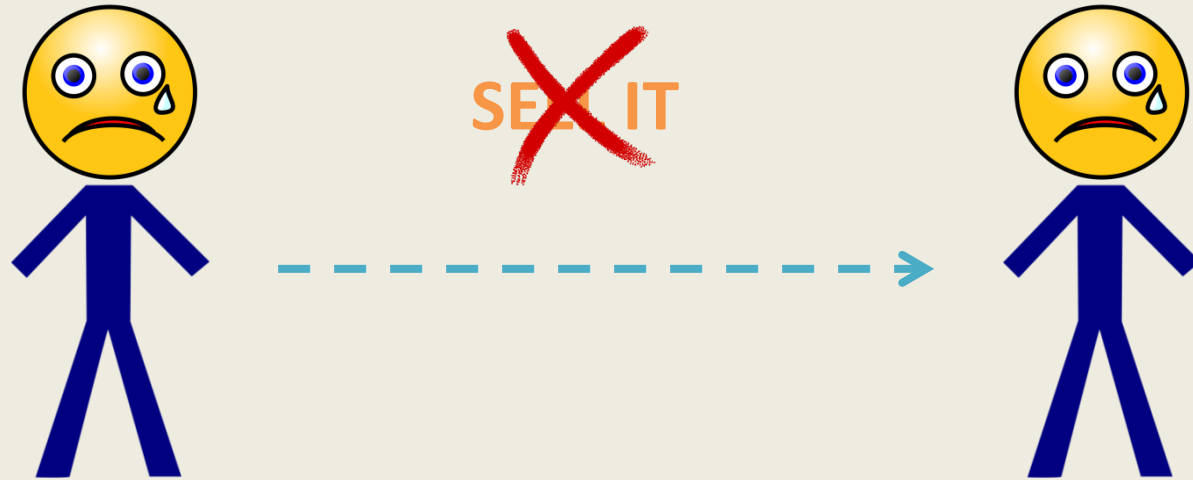
**EARN IT**

A wants to transfer 50% of his business to B



- 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 wants to transfer 50% of his business to B



- 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 wants to transfer 50% of his business to 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 wants to transfer 50% of his business to 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** wants to transfer 50% of his business to **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

LET'S GIVE "B"  
A **PROFITS**  
**INTEREST**



# UNDERSTANDING **INTERESTS**

**CAPITAL INTEREST**

**PROFITS INTEREST**

# UNDERSTANDING **INTERESTS**

## **CAPITAL INTEREST**

- ENTITLES RECIPIENT TO A SHARE OF **LIQUIDATION PROCEEDS**

## **PROFITS INTEREST**

- ENTITLES RECIPIENT TO A SHARE OF FUTURE **PROFITS AND APPRECIATION**

## STARTING POINT

**G** ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

**H** ☒ Domestic partner ☐ Foreign partner

**I1** What type of entity is this partner?..... INDIVIDUAL

**I2** 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	100 %	100 %
Loss	100 %	100 %
Capital	100 %	100 %

**K** Partner's share of liabilities at year end:

Nonrecourse.....\$ \_\_\_\_\_

Qualified nonrecourse financing.....\$ \_\_\_\_\_

Recourse.....\$ \_\_\_\_\_



NET WORTH = \$800,000

**G** ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

**H** ☒ Domestic partner ☐ Foreign partner

**I1** What type of entity is this partner?..... INDIVIDUAL

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**J** Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	%	%
Loss	%	%
Capital	%	%

**K** Partner's share of liabilities at year end:

Nonrecourse.....\$ \_\_\_\_\_

Qualified nonrecourse financing.....\$ \_\_\_\_\_

Recourse.....\$ \_\_\_\_\_



NET WORTH = \$0

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

G	<input checked="" type="checkbox"/> General partner or LLC member-manager	<input type="checkbox"/> Limited partner or other LLC member
H	<input checked="" type="checkbox"/> Domestic partner	<input type="checkbox"/> Foreign partner
I1	What type of entity is this partner?..... <u>INDIVIDUAL</u>	
I2	If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here. .... <input type="checkbox"/>	
J	Partner's share of profit, loss, and capital (see instructions):	
	<b>Beginning</b>	<b>Ending</b>
Profit	100 %	100 %
Loss	100 %	100 %
Capital	100 %	100 %
K	Partner's share of liabilities at year end:	
Nonrecourse.....	\$	
Qualified nonrecourse financing.....	\$	
Recourse.....	\$	



NET WORTH = \$400,000

G	<input checked="" type="checkbox"/> General partner or LLC member-manager	<input type="checkbox"/> Limited partner or other LLC member
H	<input checked="" type="checkbox"/> Domestic partner	<input type="checkbox"/> Foreign partner
I1	What type of entity is this partner?..... <u>INDIVIDUAL</u>	
I2	If this partner is a retirement plan (IRA/SEP/Keogh/etc.), check here. .... <input type="checkbox"/>	
J	Partner's share of profit, loss, and capital (see instructions):	
	<b>Beginning</b>	<b>Ending</b>
Profit	%	%
Loss	%	%
Capital	%	%
K	Partner's share of liabilities at year end:	
Nonrecourse.....	\$	
Qualified nonrecourse financing.....	\$	
Recourse.....	\$	



NET WORTH = \$400,000



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

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	Beginning	Ending
Profit	100 %	100 %
Loss	100 %	100 %
Capital	100 %	100 %

**K** Partner's share of liabilities at year end:

Nonrecourse.....	\$
Qualified nonrecourse financing.....	\$
Recourse.....	\$

**G** ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

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**J** Partner's share of profit, loss, and capital (see instructions):

	Beginning	Ending
Profit	%	%
Loss	%	%
Capital	%	%

**K** Partner's share of liabilities at year end:

Nonrecourse.....	\$
Qualified nonrecourse financing.....	\$
Recourse.....	\$



NET WORTH = \$400,000

BUT  
WE  
CAN'T



NET WORTH = \$400,000

# UNDERSTANDING **INTERESTS**

## **CAPITAL INTEREST**

- ENTITLES RECIPIENT TO A SHARE OF **LIQUIDATION PROCEEDS**

## **PROFITS INTEREST**

- 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

**H** ☒ Domestic partner ☐ Foreign partner

**I1** What type of entity is this partner?..... INDIVIDUAL

**I2** 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	100 %	100 %
Loss	100 %	100 %
Capital	100 %	100 %

**K** Partner's share of liabilities at year end:

Nonrecourse.....\$ \_\_\_\_\_

Qualified nonrecourse financing.....\$ \_\_\_\_\_

Recourse.....\$ \_\_\_\_\_



NET WORTH = \$800,000

**G** ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

**H** ☒ Domestic partner ☐ Foreign partner

**I1** What type of entity is this partner?..... INDIVIDUAL

**I2** 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 %
Loss	%	50 %
Capital	%	%

**K** Partner's share of liabilities at year end:

Nonrecourse.....\$ \_\_\_\_\_

Qualified nonrecourse financing.....\$ \_\_\_\_\_

Recourse.....\$ \_\_\_\_\_



NET WORTH = \$0

## 50% PROFITS INTEREST

**G** ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

**H** ☒ Domestic partner ☐ Foreign partner

**I1** What type of entity is this partner?..... INDIVIDUAL

**I2** 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	100 %	100 %
Loss	100 %	100 %
Capital	100 %	100 %

**K** Partner's share of liabilities at year end:

Nonrecourse..... \$ \_\_\_\_\_

Qualified nonrecourse financing..... \$ \_\_\_\_\_

Recourse..... \$ \_\_\_\_\_

**G** ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

**H** ☒ Domestic partner ☐ Foreign partner

**I1** What type of entity is this partner?..... INDIVIDUAL

**I2** 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 %
Loss	%	50 %
Capital	%	%

**K** Partner's share of liabilities at year end:

Nonrecourse..... \$ \_\_\_\_\_

Qualified nonrecourse financing..... \$ \_\_\_\_\_

Recourse..... \$ \_\_\_\_\_



NET WORTH = \$800,000

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



NET WORTH = \$0

# YEAR 1

**G** ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

**H** ☒ Domestic partner ☐ Foreign partner

**I1** What type of entity is this partner?..... INDIVIDUAL

**I2** 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 %
Loss	%	50 %
Capital	100 %	90 %

**K** Partner's share of liabilities at year end:

Nonrecourse.....\$ \_\_\_\_\_

Qualified nonrecourse financing .....\$ \_\_\_\_\_

Recourse.....\$ \_\_\_\_\_



NET WORTH = \$900,000

**G** ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

**H** ☒ Domestic partner ☐ Foreign partner

**I1** What type of entity is this partner?..... INDIVIDUAL

**I2** 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 %
Loss	%	50 %
Capital	%	10 %

**K** Partner's share of liabilities at year end:

Nonrecourse.....\$ \_\_\_\_\_

Qualified nonrecourse financing .....\$ \_\_\_\_\_

Recourse.....\$ \_\_\_\_\_



NET WORTH = \$100,000



## YEAR 2

**G** ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

**H** ☒ Domestic partner ☐ Foreign partner

**I1** What type of entity is this partner? ..... INDIVIDUAL

**I2** 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	90 %	83 %

**K** Partner's share of liabilities at year end:

Nonrecourse.....\$ \_\_\_\_\_

Qualified nonrecourse financing .....\$ \_\_\_\_\_

Recourse.....\$ \_\_\_\_\_



NET WORTH = \$1,000,000

**G** ☒ General partner or LLC member-manager ☐ Limited partner or other LLC member

**H** ☒ Domestic partner ☐ Foreign partner

**I1** What type of entity is this partner? ..... INDIVIDUAL

**I2** 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 %

**K** Partner's share of liabilities at year end:

Nonrecourse.....\$ \_\_\_\_\_

Qualified nonrecourse financing .....\$ \_\_\_\_\_

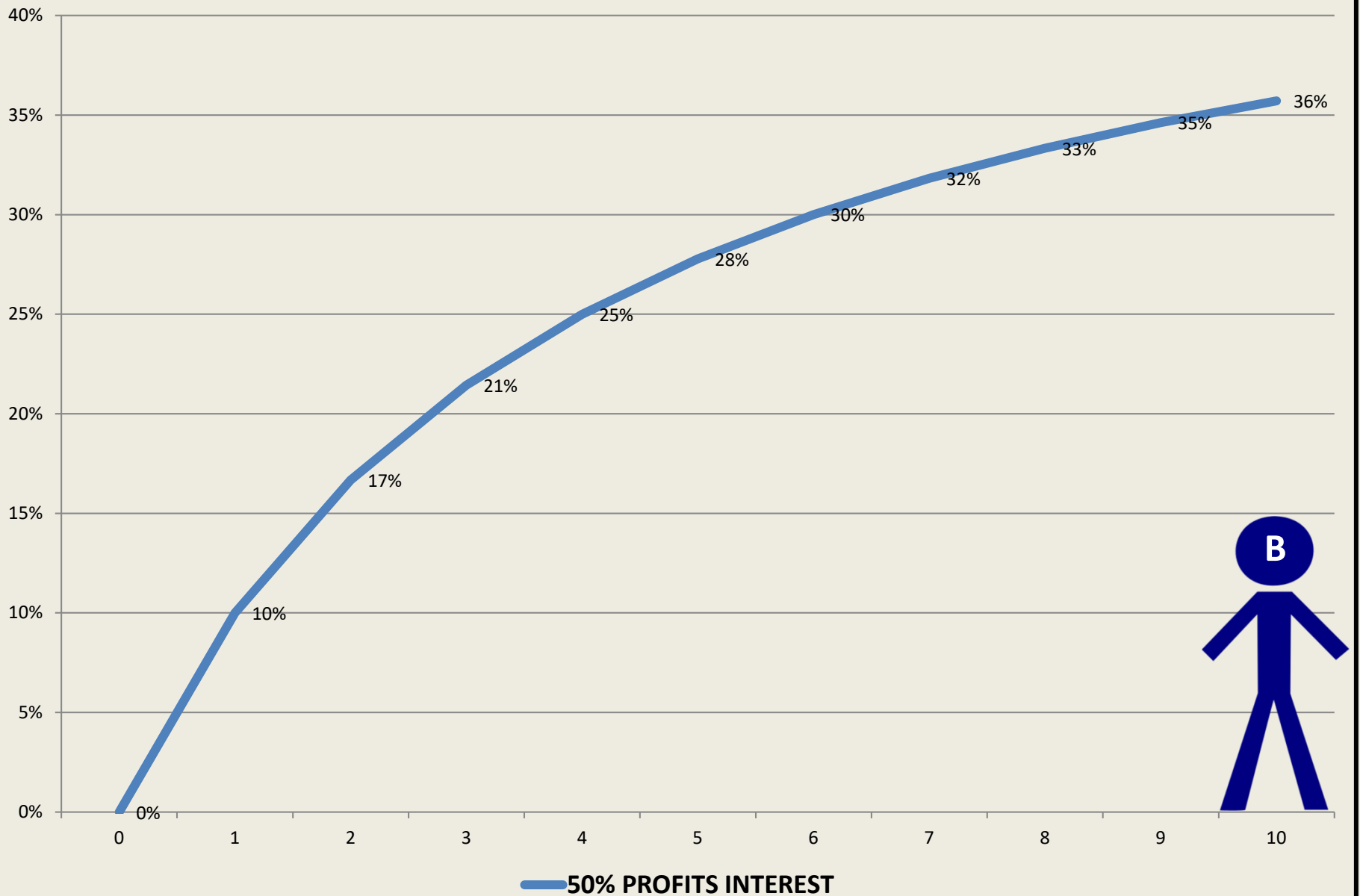
Recourse.....\$ \_\_\_\_\_

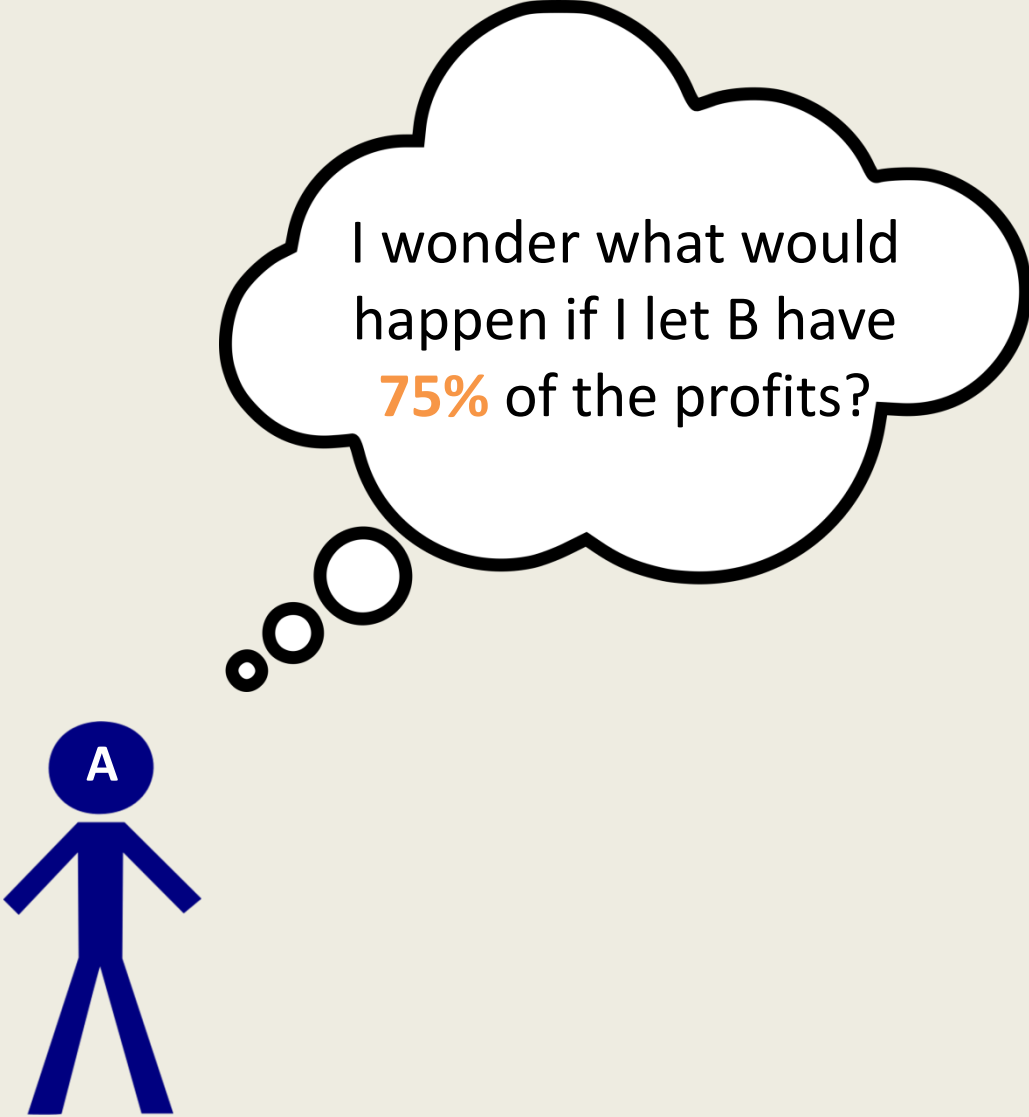


NET WORTH = \$200,000

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

## B's Ownership Over Time

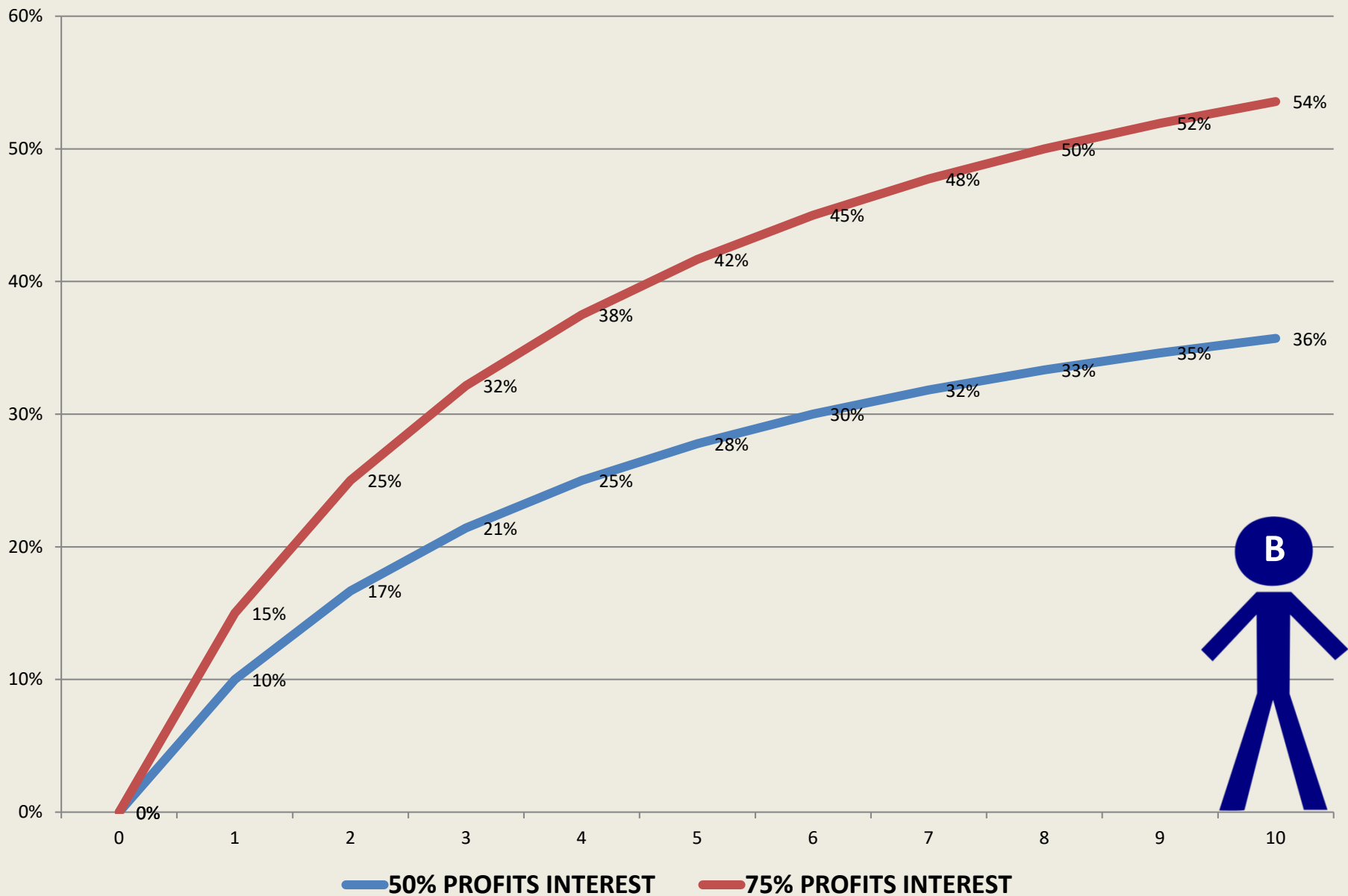


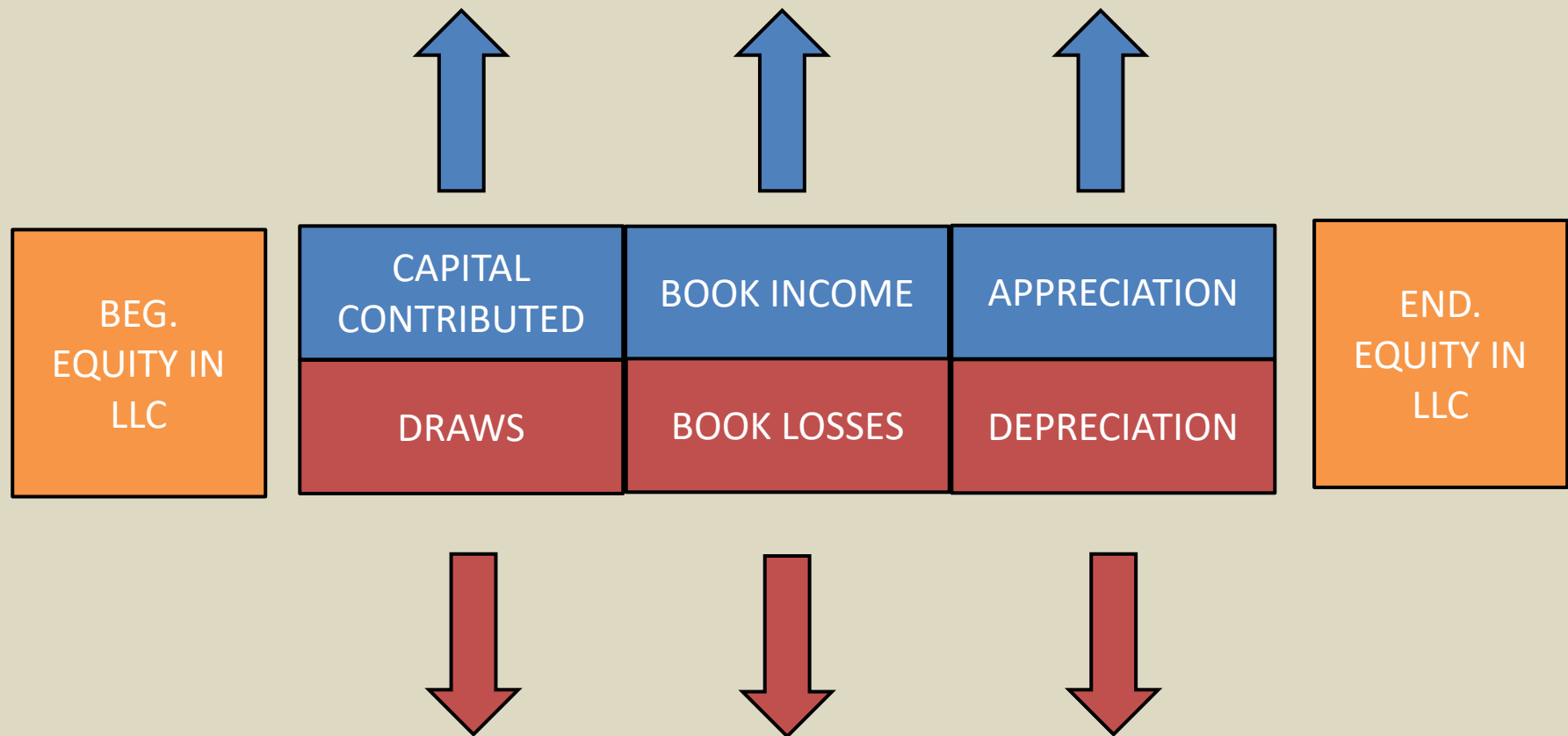


I wonder what would  
happen if I let B have  
**75%** of the profits?

A

## B's Ownership Over Time



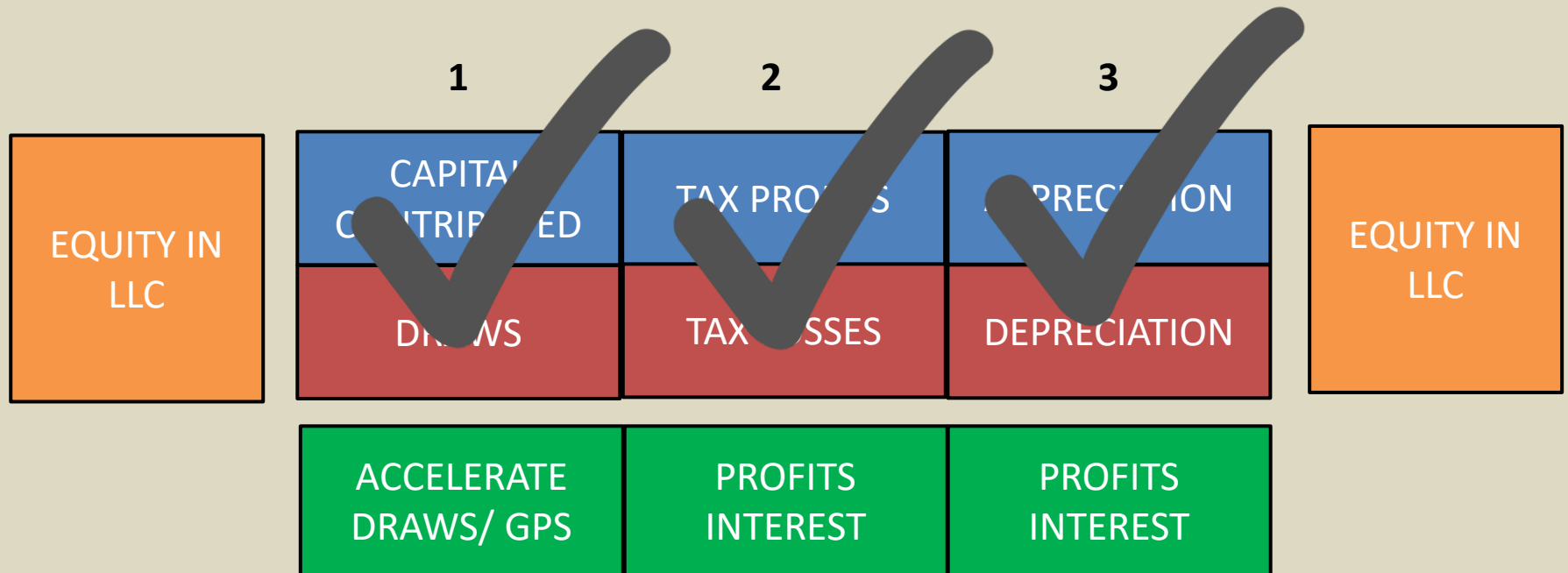


OPPORTUNITIES –  
FACTORS WE CAN “CONTROL”

	1	2	3	
BEG. EQUITY IN LLC	CAPITAL CONTRIBUTED	BOOK INCOME	APPRECIATION	END. EQUITY IN LLC
	DRAWS	BOOK LOSSES	DEPRECIATION	

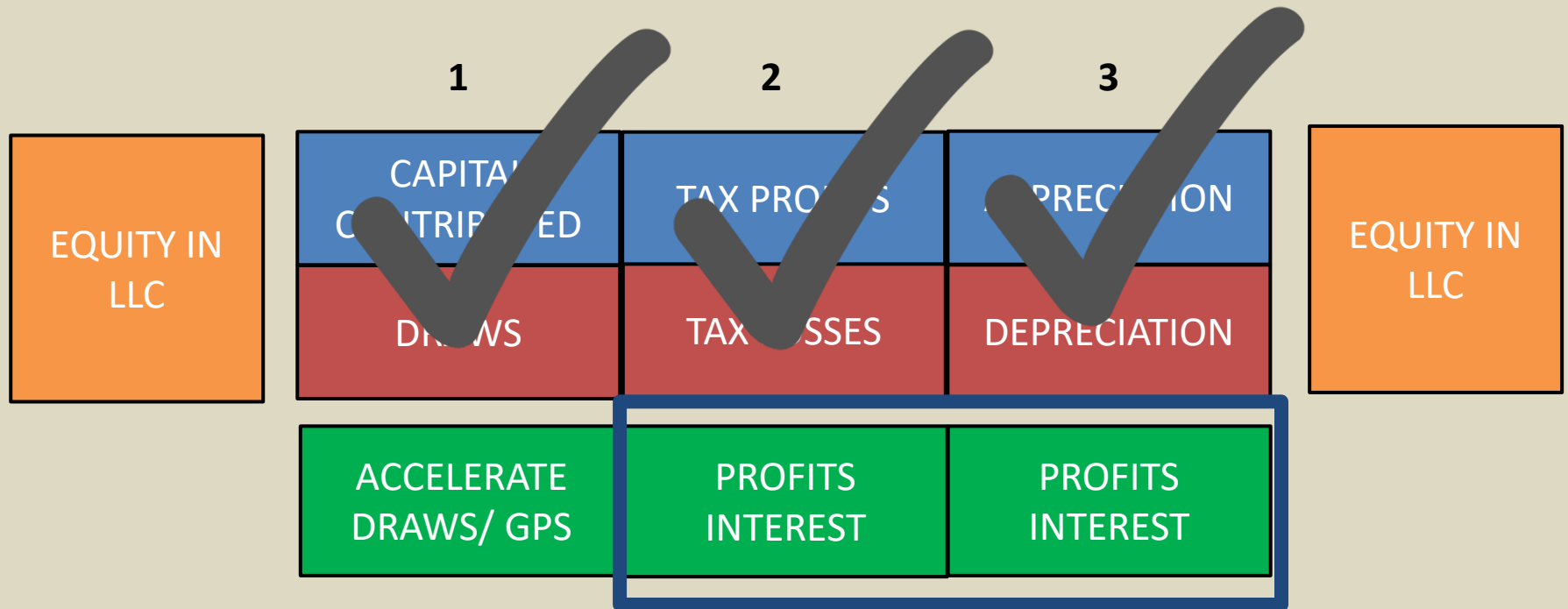
Which of the **three** can we “control”?

OPPORTUNITIES –  
FACTORS WE CAN “CONTROL”



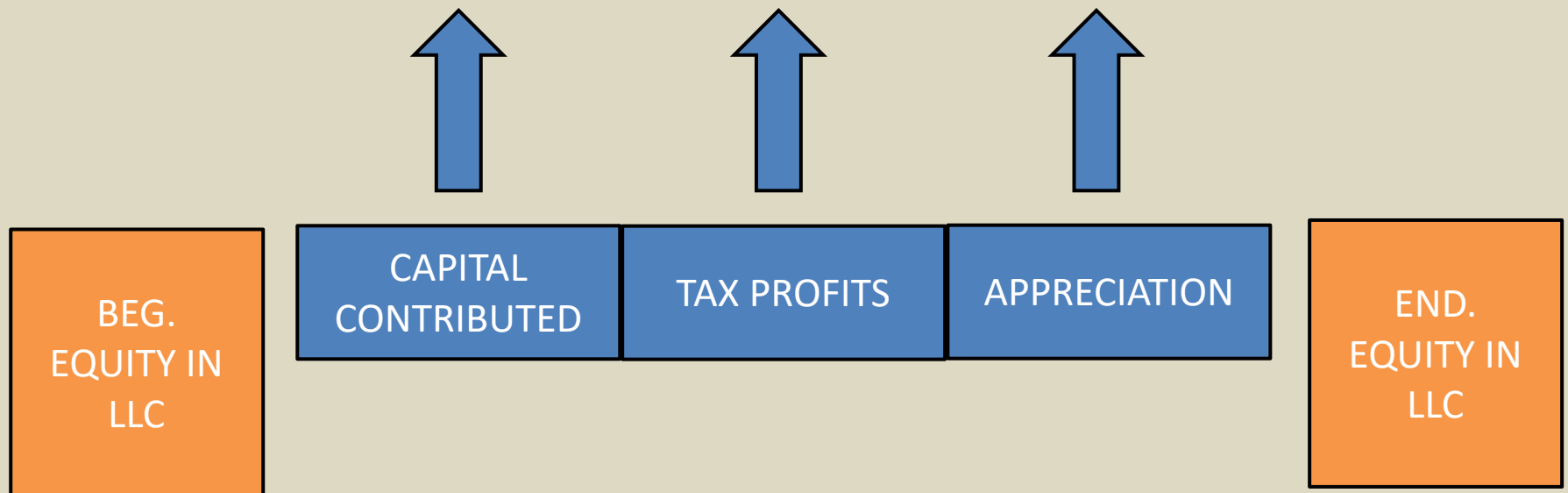
I would argue all three!!!

OPPORTUNITIES –  
FACTORS WE CAN “CONTROL”



I would argue all three!!!

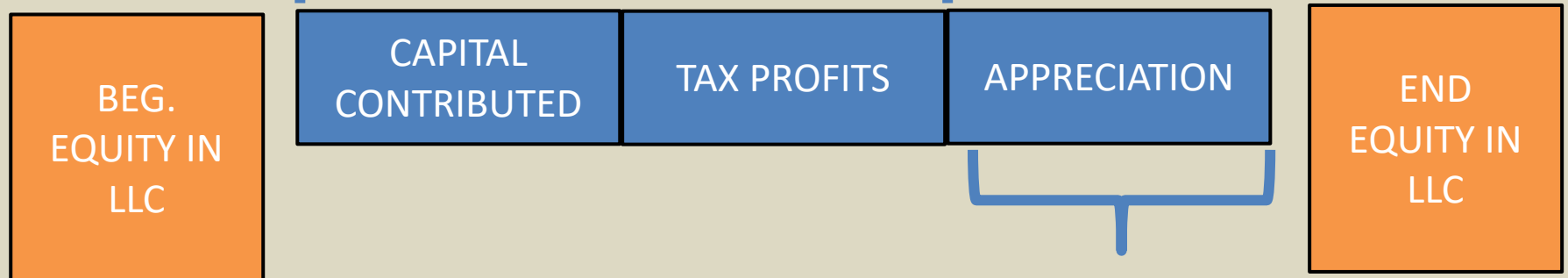




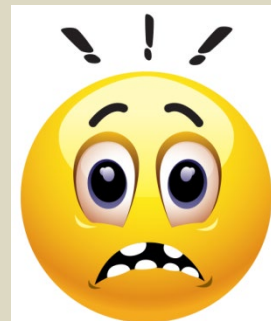
Three ways to build equity in LLC.

Which is the best?

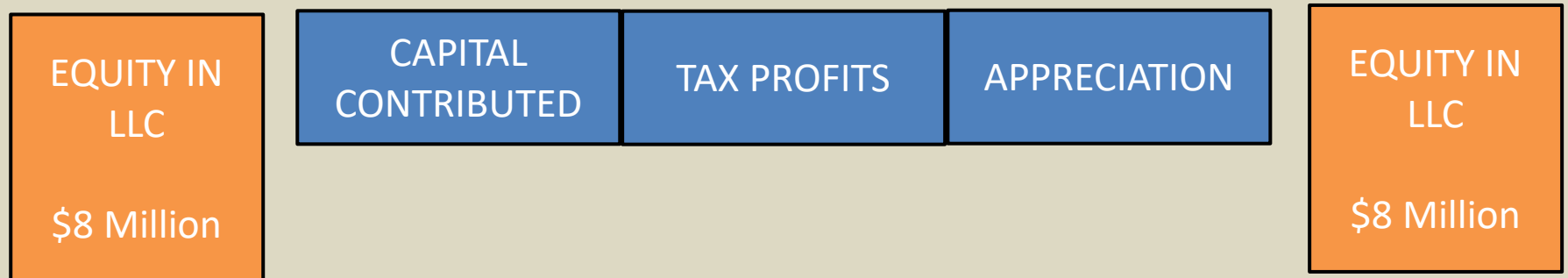
Already paid tax on these!!!



Ticking  
time bomb!?!



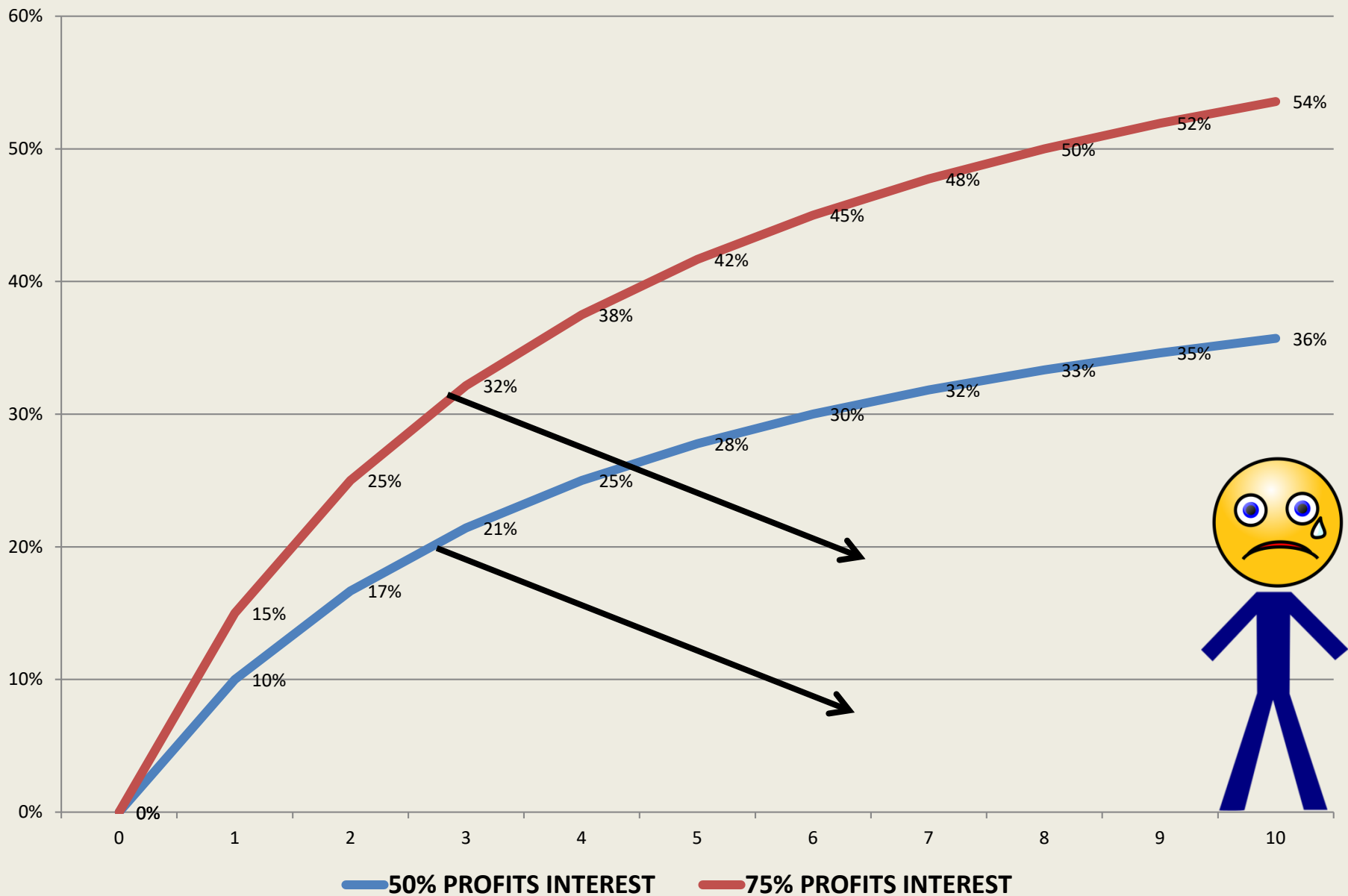
Solution: “Diversify” ... Gain Equity by all three methods?



# OTHER CONSIDERATIONS

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

## B's Ownership Over Time



# POWER OF THE **GUARANTEED PAYMENT**

In the real world...

Both A and B need cash from the business



A should take a **draw**  
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 SHARE OF FUTURE **PROFITS** AND **APPRECIATION**
- TRANSFER OF PROFITS INTERESTS CAN BE **TAX FREE** TO BOTH PARTIES

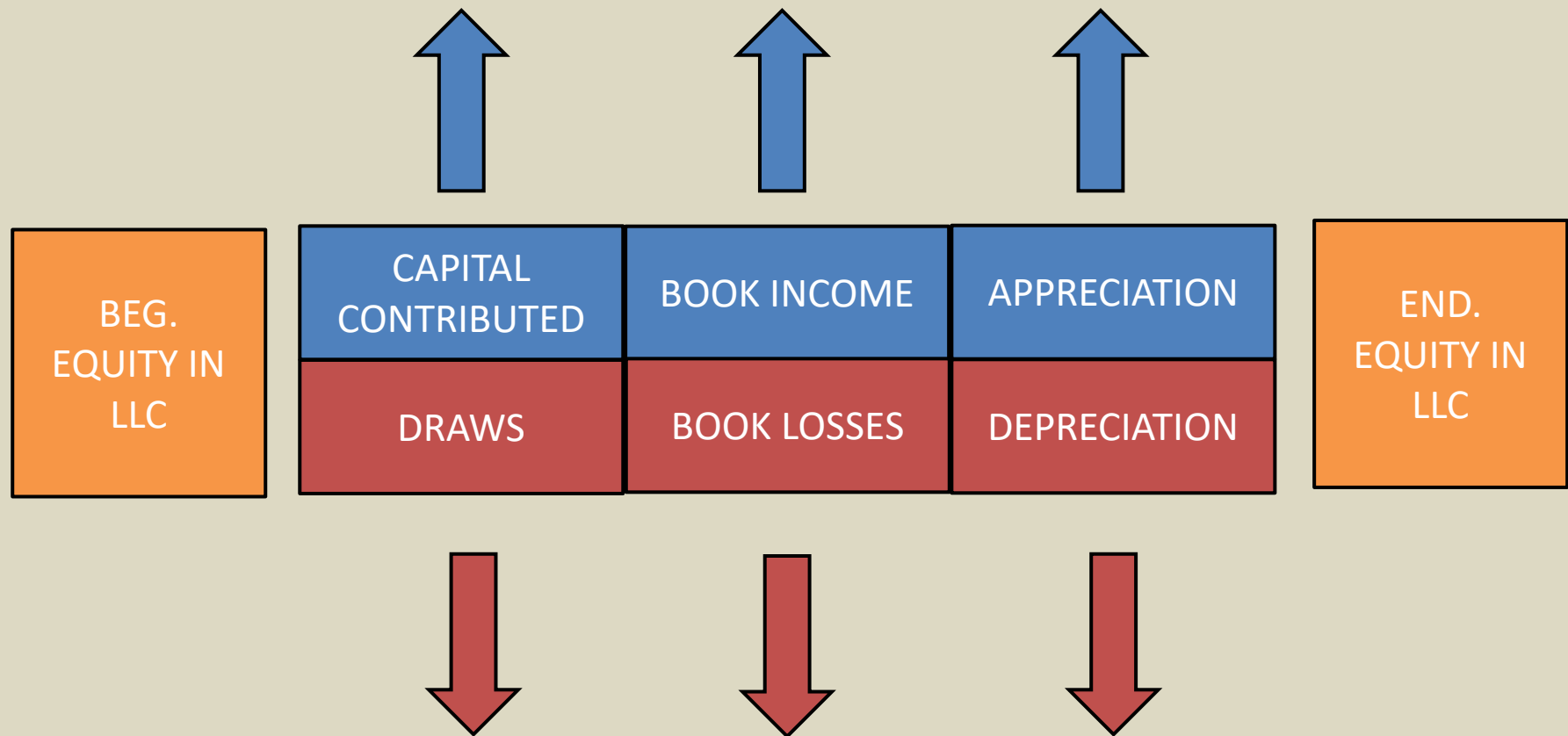


# TAX FREE **UNLESS**

1.) SUBSTANTIALLY CERTAIN AND **PREDICTABLE**  
STREAM OF INCOME

**OR**

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



# 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.



*Taken from Farm Credit's "Advanced Partnership" Training Program*



# 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

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