



Addressing Transition Planning Challenges for Farms and Ranches

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Representative farm

- ***Wanted results to be applicable to a broad range of farm owners***
- ***Commercially viable, 1.0 FTE farm***
- ***Mom, Dad, Farm Kid, City Kid***
- ***Largely used KFMA data and farm financial ratios***

Representative farm

- ***Net farm income: \$100,000***
- ***Family living expense: \$70,000***
- ***Off-farm income: \$44,356***
- ***Value of farm production: \$660,000***
- ***Total assets: \$3,300,000***
- ***Total debt: \$660,000***
- ***50% income from cattle, 50% income from crops***
- ***Owns 1,146 acres, leases 2,539 acres***

Representative Farm

Table 1. Balance Sheet

Assets		Liabilities	
Breeding Livestock	\$408,784	Long-Term Debt	\$660,000
Equipment	\$500,000	Total Liabilities	\$660,000
Total Operational Assets	\$908,784		
Buildings	\$100,000	Owner's Equity	\$2,640,000
Land	\$2,291,216	Total Liabilities and	
Total Assets	\$3,300,000	Owner's Equity	\$3,300,000

Simulated strategies

- Strategy 1: “Split Down the Middle”
 - Farm Kid and City Kid receive undivided $\frac{1}{2}$ interest in all assets
 - Farm Kid must buy out City Kid
- Strategy 2: “Grow to Equal”
 - Mom and Dad give all Farm Assets to Farm Kid
 - Mom and Dad create financial asset of equal value and give to City Kid

WHAT'LL IT COST, MAN?



What'll it cost, man?! What'll it cost?!

<i>Strategy</i>	<i>Who pays</i>	<i>Annual expense</i>
<i>1a</i>	<i>Farm Kid</i>	<i>\$172,518; \$86,807</i>
<i>1b</i>	<i>Farm Kid</i>	<i>\$89,135</i>
<i>2a</i>	<i>Ma & Pa</i>	<i>\$104,642</i>
<i>2b</i>	<i>Ma & Pa</i>	<i>\$64,503</i>

Remember, annual NFI = \$100,000

Results

Table 2. Alternative Strategies' Probability of Success

Strategy	D/A Ratio < 0.60	Op. Debt < 3 years	No Op. Debt	Cash Reserves >0
1(a)	1%	0%	0%	N/A
1(b)	100%	4%	0%	N/A
2(a)	100%	0%	0%	N/A
2(b)	100%	1%	1%	N/A

A man with dark hair, wearing a patterned shirt, is smiling broadly at a woman with long brown hair. The background is slightly blurred, showing some foliage and a warm light source.

SO YOU'RE SAYING

THERE'S A CHANCE?

memegenerator.net

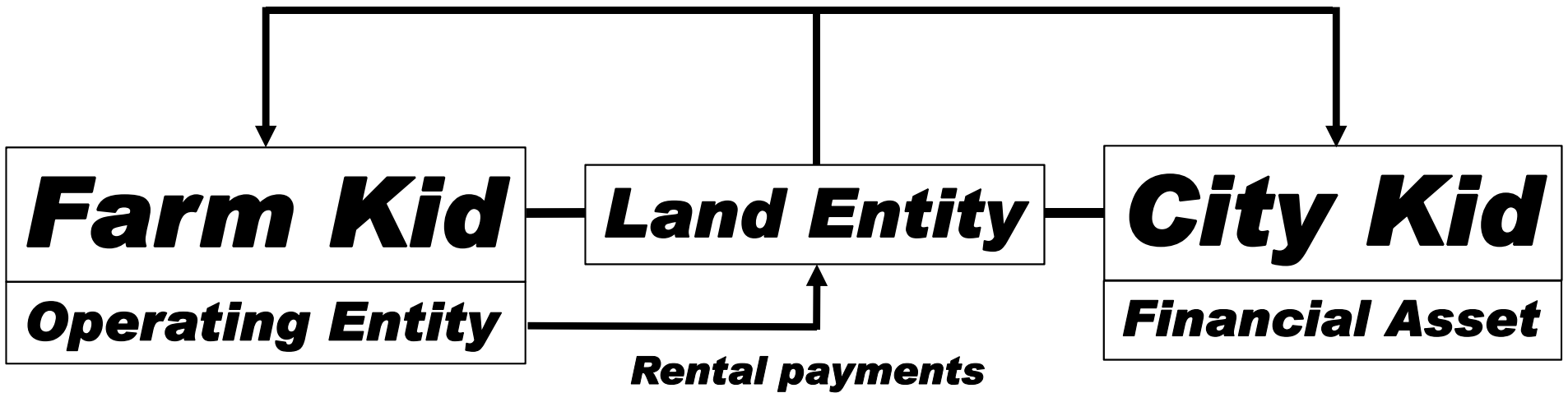
1 Corinthians 12:31b

And I show to you a still more excellent way.

Simulated strategies

- Strategy 3: “Estate Balancing”
 - Land placed in separate entity with equal interests given to both kids
 - Farm Kid given operating assets; City Kid given financial asset of equal value
- Strategy 4: “Sweat Equity Recognition/Discount”
 - Same as Strategy 3 except City kid receives financial asset equal to $\frac{1}{2}$ value of operating assets

Income distributions



***And now, I show you an even
more excellent way***



Strategy 5: “Lifetime Farm Business Transfer”

- Farm operating assets and farm land are placed in separate entities, respectively
- Farm Heir receives annual salary of \$42,000
- Farm Heir purchases shares of the operating entity each year
- Farm Heir receives a larger portion of farm income as well as farm debt with each additional share
- In years when Farm Heir has insufficient funds to purchase a full share, Mom and Dad gift the difference

Strategy 5: “Lifetime Farm Business Transfer”

- At the end of the transfer, Farm Heir and Off-Farm Heir receive equal interests in land entity
- Operating entity pays FMV rents to land entity
- Entity distributes income to Farm Heir and Off-Farm Heir
- Any excess funds would then be split between Farm Heir and Off-Farm Heir
 - Net any gifts Farm Heir received to help fund this transition

Strategy 5: “Lifetime Farm Business Transfer”

- Operating entity value: \$908,784
- Planning horizon: 20 years
- Annual purchase: 5%
- Annual entity payment from Farm Heir: \$45,439
- Annual gift to Farm Heir: Variable (\$45,439- Entity payment)

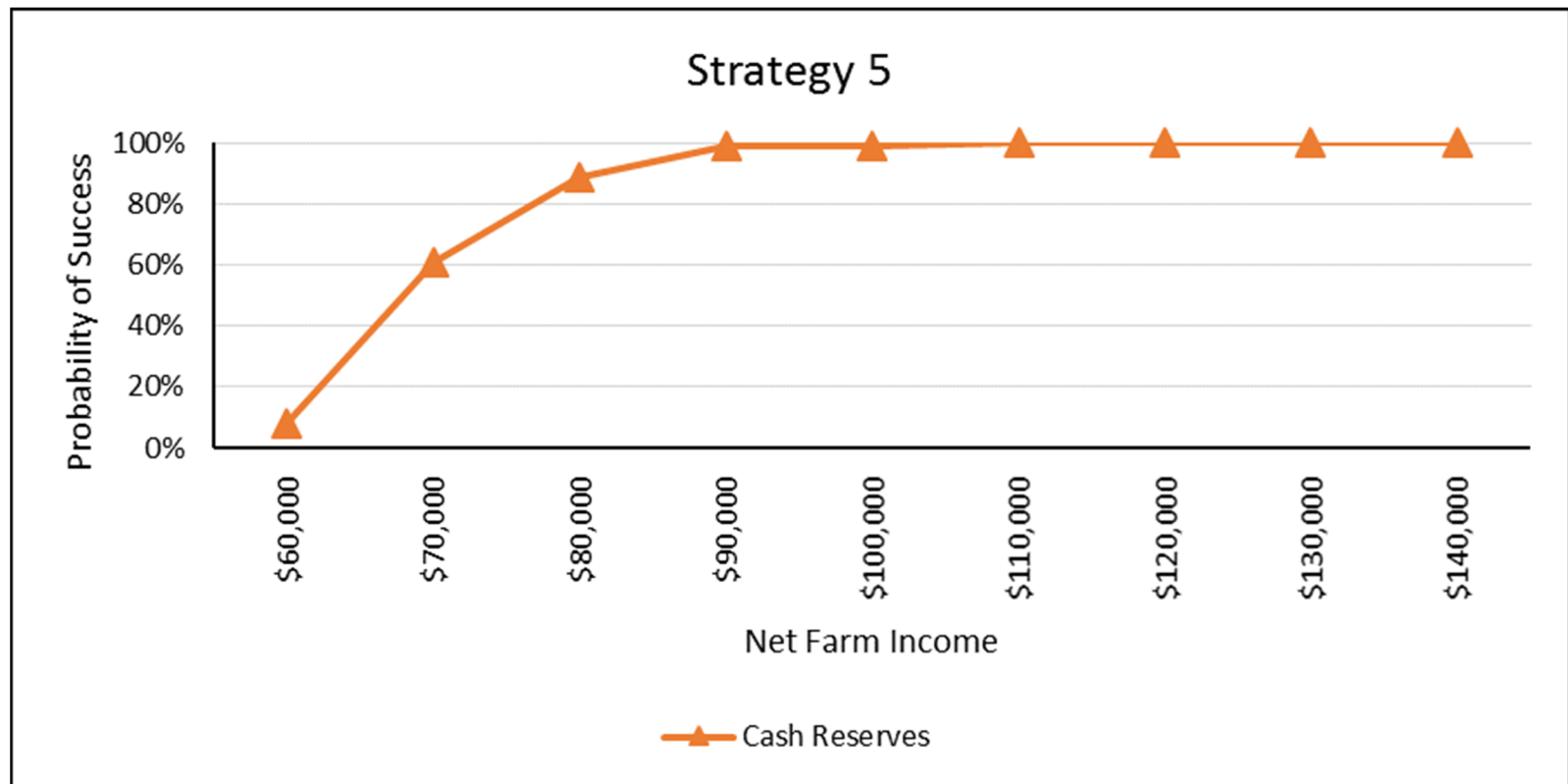
Strategy 5: Lifetime Farm Business Transfer

Criteria

1. 100% success

4. 99% success

Met at \$110,000



Results

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1(b)	100%	4%	0%	N/A
2(a)	100%	0%	0%	N/A
2(b)	100%	1%	1%	N/A
3(a)	100%	96%	89%	N/A
3(b)	100%	100%	97%	N/A
4(a)	100%	100%	97%	N/A
4(b)	100%	100%	99%	N/A
5	100%	N/A	N/A	99%

What'll it cost, man?! What'll it cost?!

Strategy	Who pays	Annual expense
1a	Farm Kid	\$172,518; \$86,807
1b	Farm Kid	\$89,135
2a	Ma & Pa	\$104,642
2b	Ma & Pa	\$64,503
3a	Ma & Pa	\$28,817
3b	Ma & Pa	\$17,764
4a	Ma & Pa	\$14,409
4b	Ma & Pa	\$8,882

Remember, annual NFI = \$100,000

The value of transition planning

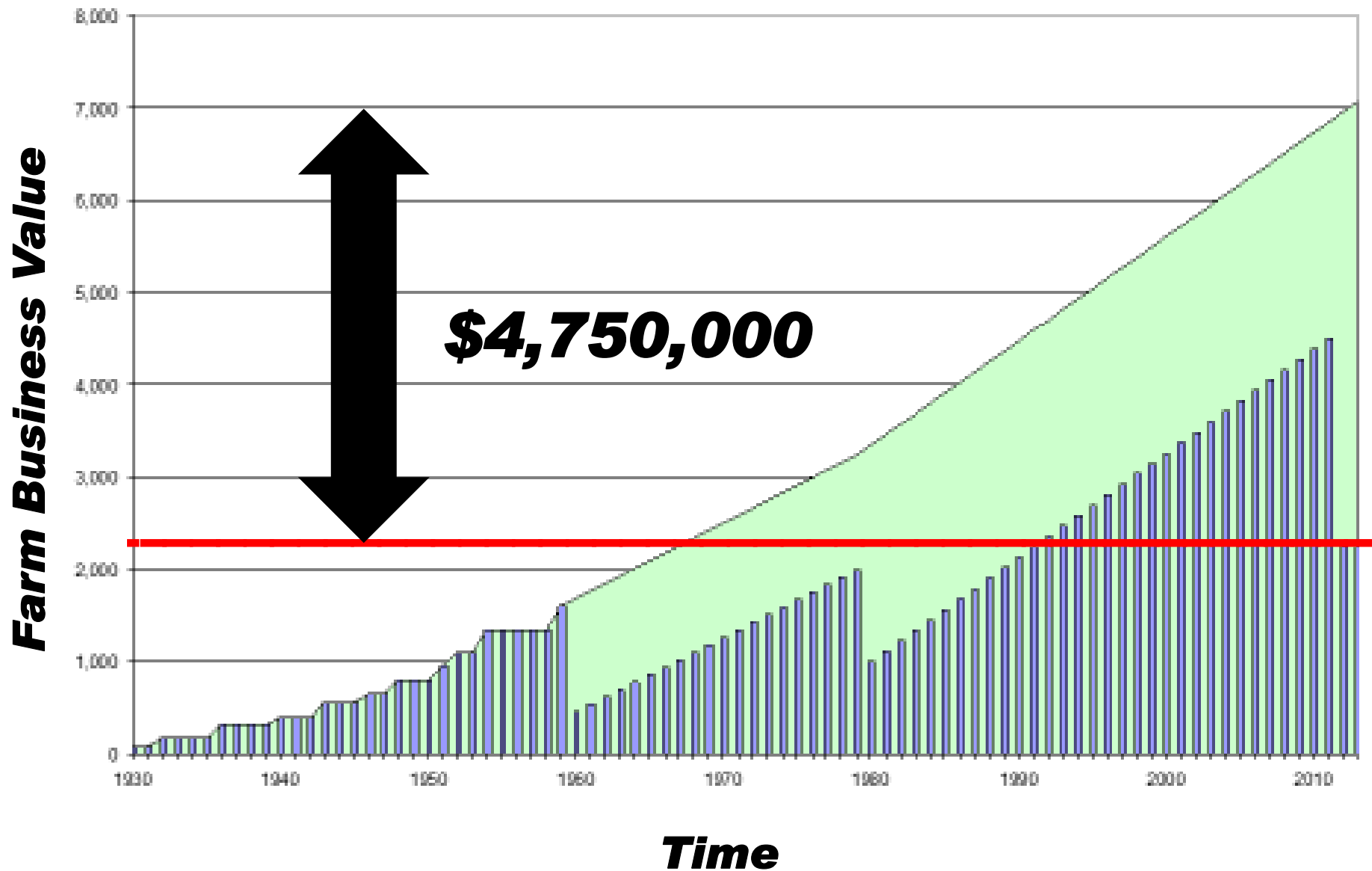


Illustration courtesy Dick Wittman, Wittman Consulting

Numbers don't lie

55%

***U.S. adults with no
estate planning tools***

64%

***Farm/agribusiness owners
with no estate planning tools***

88%

***Farm/agribusiness owners
with no retirement plan***

Mom

26

28

40

Dad

26

28

40

Farm Kid

0

2

14

City Kid

0

12

Year

0

26

28

40

Mom and Dad born

Farm Kid born

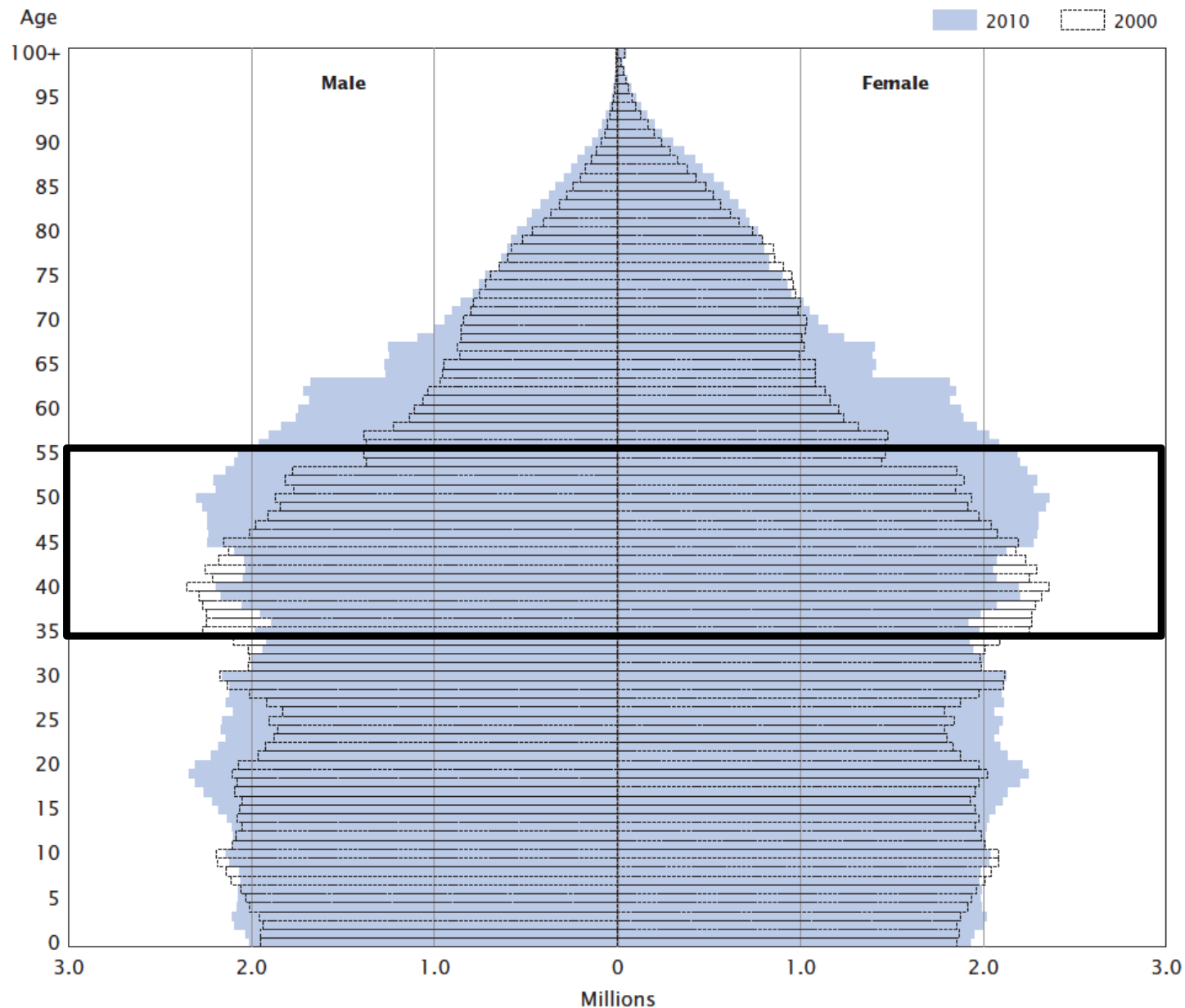
City Kid born

**Mom and Dad's
"Early Epiphany"**

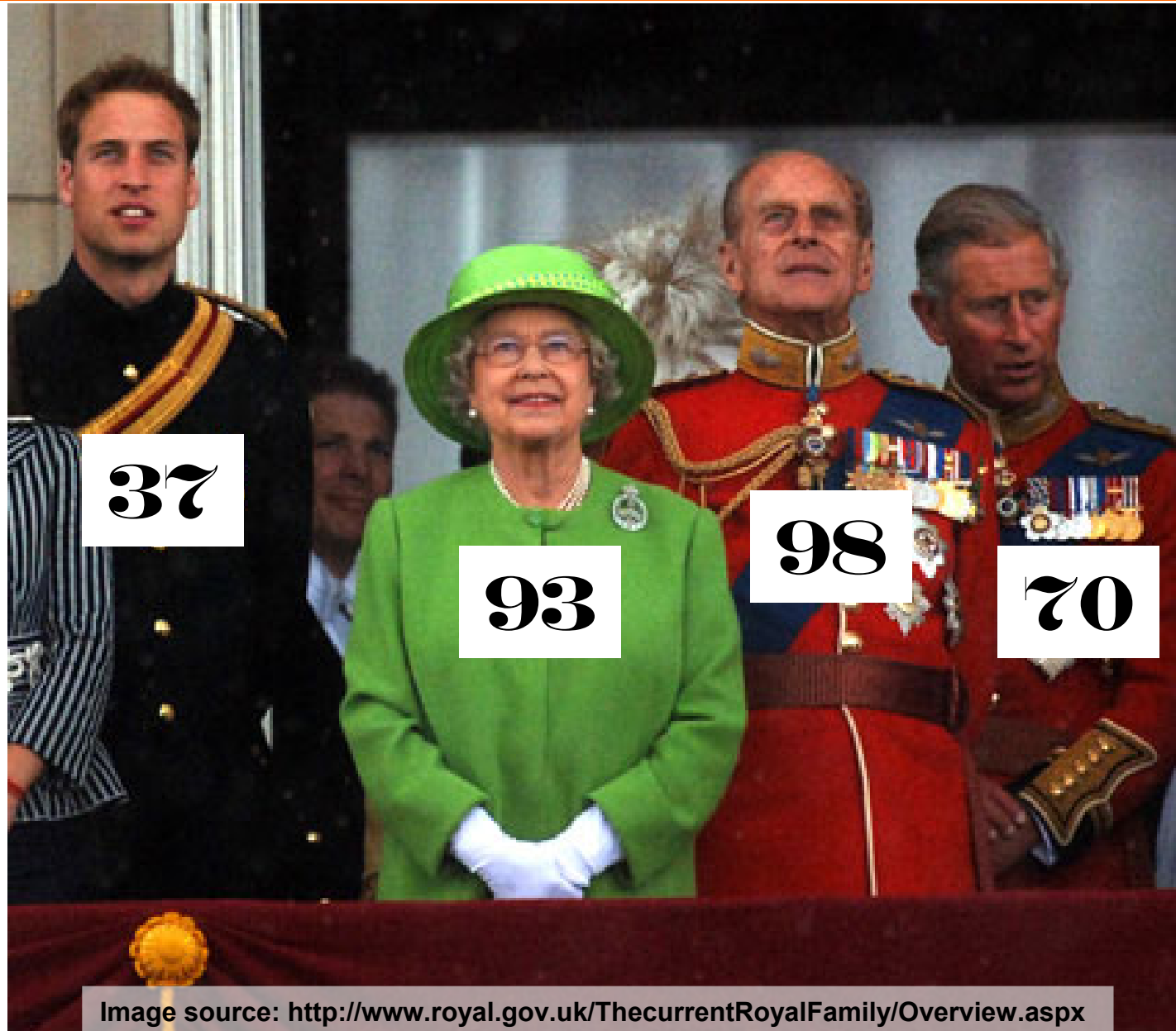
Mom	58	76	81	
Dad	58	76		
Farm Kid	32	50	55	76
City Kid	30	48	53	74
	58	76	81	102
	Mom and Dad's "Average Epiphany"		Mom dies "Early" +41 "Average" +23	
	Dad dies "Early" +36 "Average" +18		Farm Kid dies Mom dies +21	

Overall Population Age Distribution

Source: U.S. Bureau of the Census, Age and Sex Distribution 20120 Census



Challenges in farm transition











The Country Mouse and the City Mouse

A retelling of Aesop's Fable by Eric Blair





Entitlement

vs.

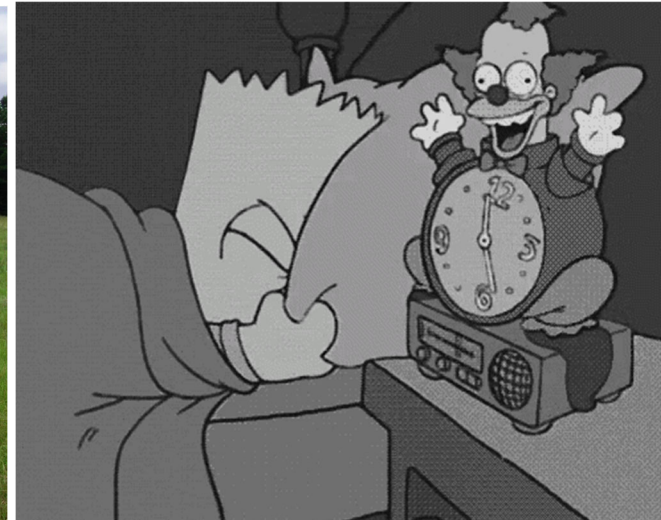
Opportunity

EQUAL

≠

EQUITABLE

Deploy your plans / evaluate / revise

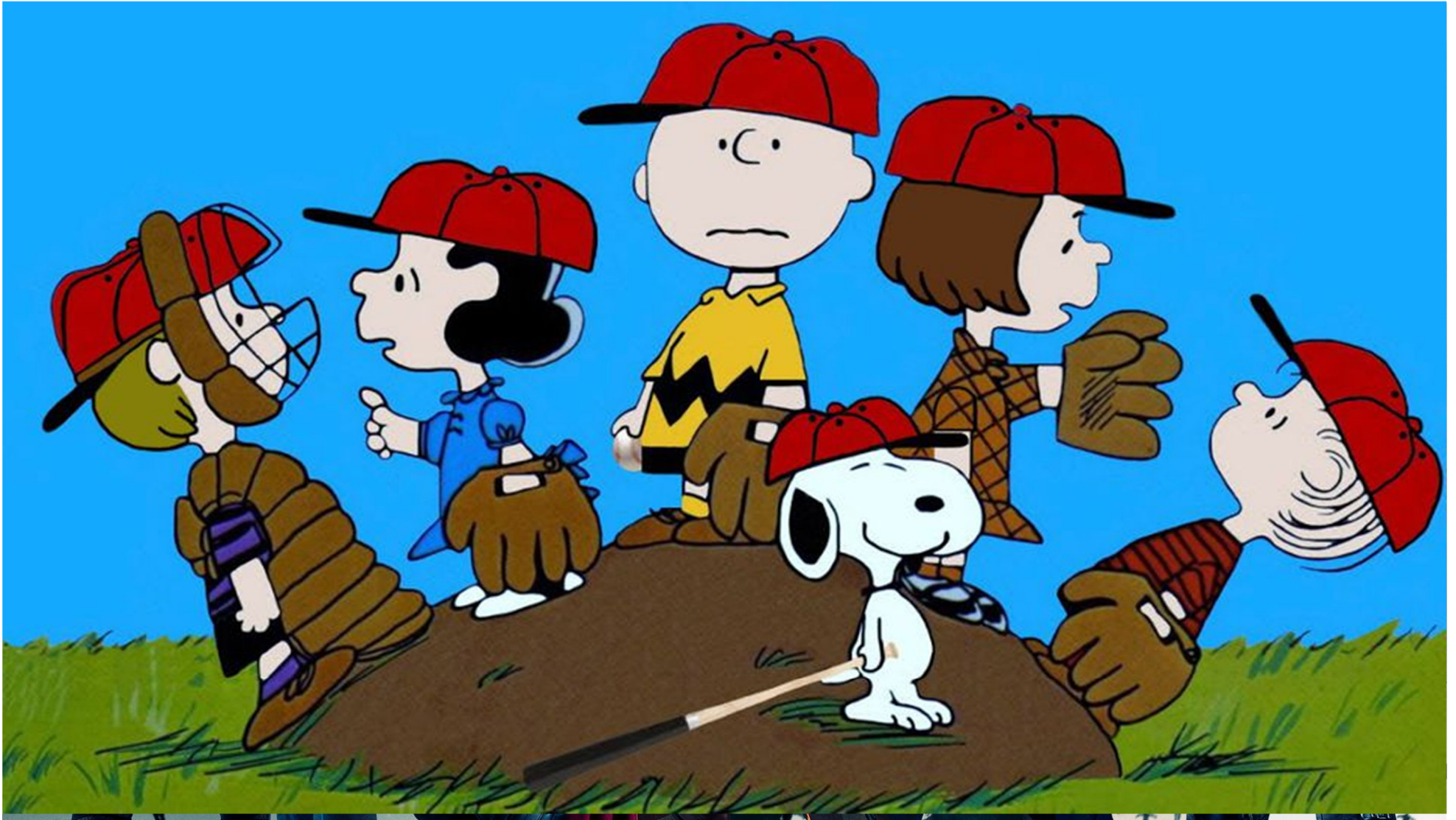


Leonid and lawyers



VLADISLAV ROGOZOV

Don't go it alone



The transition team: The Accountant



The transition team: The Attorney



The transition team: The Investment Advisor



The transition team: The HR Advisor



The transition team: The Referee



The “hit by a _____” plan



***“No battle plan
survives contact
with the enemy.”
-Colin Powell***







For more information

<http://agecon.okstate.edu/farmtransitions>





THANKS!

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Income and Estate Tax Considerations of the Farm Business Transition

July 2019

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Agricultural Economics Dept.

The Scenarios

1. Each Heir treated equally

Dollar value equality

Everyone given undivided interest

2. Lifetime Business Transfer

Land placed in an Entity

Operating assets placed in a different Entity

Farm heir receives an annual salary

Farm heir purchases interest in operating entity

Gifting used to help farm heir buy interest

Scenario 1 Tax Considerations

Everyone treated as equals – at death and often with no plan being established

- Estate tax not a problem (2019 exclusion is \$11.4 million for individuals or \$22.8 million for spouses)
- Asset basis stepped-up (FMV date of death)
- Farm heir buys business assets from other heirs (no cap gain on the sale if done soon)
- Farm heir rents business assets from others (non-farm heirs in the business of renting?)

Scenario 1 Tax Considerations

- Farm heir income tax issues are not changed with ordinary income, SE tax, & capital gain
- Non-farm heir selling any or all assets; little to no capital gain income (stepped-up basis)
- Non-farm heir renting:
 1. just land – ordinary income
 2. just machinery and equipment – ordinary income and SE tax
 3. land plus machinery and equipment – ordinary income and **no** SE tax

Scenario 2 Tax Considerations

Lifetime transfer of the business

- Create separate entities for the land and the operating assets
- Land entity: Trust or Limited Liability Co. (LLC)
- Operating entity: Partnership, LLC taxed as a disregarded entity, LLC taxed as a partnership, or Sub S Corporation

Scenario 2 Tax Considerations

The land entity (keep the land in a viable unit)

- Trust (Irrevocable at death of first generation)
 - Dynasty trusts
 - Rule against perpetuities
- LLC
 - Operating agreement specifies manager(s)
 - Operating agreement specifies succession
 - Operating agreement specifies longevity

NOTE: land entity should be maintained until farm operation is dissolved

Scenario 2 Tax Considerations

Operating entity

- LLC (established as a single member aka disregarded entity) during test period
- LLC (established as a partnership)
- General Partnership
- Subchapter S corporation

The agreement should be written to avoid problems or disagreement among the heirs

Scenario 2 Tax Considerations

The agreement should specify:

- Farm operators:
 - Partners (general and limited)
 - Members of the LLC
 - Shareholders of the S Corp
 - Managers or decision makers
- Income and expense distribution
- Exit strategy for operators
- Longevity
- Termination plan

Scenario 2 Tax Considerations

The land holding entity:

- Flow through – net income is distributed
- Arrangement to allow for management, acquisition, and accumulation of real property

The operating entity:

- Pays rent for use of real property
- Complete control of the farm business

Scenario 2 Tax Considerations

Step-up in basis to fair market value date-of-death can result for land if it is put into a trust. (Trustee must understand Agriculture)

Step-up in basis may be allowed for assets put into a partnership, LLC treated as a partnership (The Internal Revenue Code has provisions which allow adjustments)

Step-up in basis of the stock for an S Corp.

IRC Sections to be Aware Of

- Partnership or LLC taxed as a partnership
 - IRC section 754 election to adjust basis of assets to FMV when transferred
 - Works in conjunction with **IRC section 734** for the exiting partner
- Sub-S Corporation
 - IRC section 336(e) election
 - Seller treats as a capital gain transaction the sale of the corporate stock
 - Buyer treats the purchase of capital assets as a depreciable transaction

Conclusion

- It is not impossible to ensure that the farm remains viable for future generations but keep things flexibility
- The tax consequences can be managed
- Family members can be treated equitably and fairly
- Proper planning and communication is a must
- Be sure to seek professional assistance (farm business advisor, accountant, attorney, and farm family consultant)

-
- Questions and comments
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Estate Settlement and Trust Management



\$30 trillion in assets held by baby boomers will shift to the next generation over 30 years

Guido van der Hoeven:

Husband

Father

Grandfather

Extension Specialist

Enrolled Agent

Successor Trustee

Introduction or Bona Fides

- 30 plus years of assisting rural families with farm/forest management issues: Wealth transfer is one such issue. And sometimes it is difficult to discuss
 - Facing mortality
 - Being “fair”....versus “equal”
- Teach folks how to eat an elephant: one bite at a time
- Assuming the role of an successor trustee or estate executor/manager is more difficult than talking/educating about the topic.

A Lifecycle to Consider

Resources

- Liquid
- Not Liquid
 - Land
 - Business Resources
 - > Stuff
 - > People

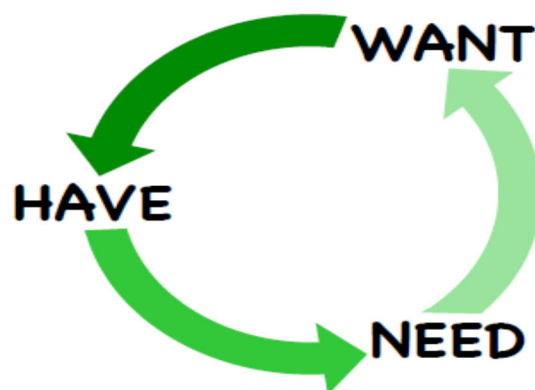
Family

- Who likes the land?
- Business Involvement
- Special Circumstances
 - Grandchildren
 - Marriages
 - Personal Debt

Current Estate Plan?

Goals

- What do you want **your** life to be like in the future?
- What do you want for your **family** in the future?
- What do you want to have happen to your **stuff** in the future?



Plans

- Additional Resources
- Retirement Income
- Updated Estate Plan
- Business Disposition Plan
 - Succession?
 - Sale?

Kathi Beratan 2/23/2018

Taxation: Probably not an issue

- Federal Estate Tax Exclusion Amounts (2019)
 - Individual \$11.4 million dollars tax free
 - Married Couples \$22.8 million tax free
- Federal Gift Tax Exclusion Amounts (2019)
 - Annual Exclusion Amount: \$15,000
 - Lifetime Exclusion Amount: \$11.4 million per each
- North Carolina Estate and Gift Tax
 - Repealed: 2013 and 2009 respectively.

The Job is Similar: Name is different

- Executor(trix): person(s) selected by the decedent, in a will, to execute the will.
- Administrator: person appointed by the Probate Court to administer the settling of an intestate estate.
- Trustee(s): person(s) given powers under a trust to manage, conserve and preserve assets held in trust for the benefit of beneficiaries.
- Power of Attorney: limited to specific area of responsibility.

Source of Trustee Power

- Those stated in the trust document;
- All powers over the trust property that an unmarried individual has over their own property, unless limited by the trust document;
- Additional powers appropriate to manage investment, management, administration, or distribution of trust property unless limited by the trust document; and
- Powers conferred upon trustee by the NC Uniform Trust Code, unless limited by the Trust.

Duties of the Trustee

- Duty to administer the trust in good faith and prudently in accordance with trust document in the best interest of the beneficiaries.
- Duty to separate assets. No co-mingling of trust assets with others.
- Duty to defend the trust and protect from claims of others.
- Duty to report and keep adequate records of trust activities.
- Duty to preserve trust assets and make them productive.
- Duty to follow the “*Prudent Investor Act*”

Duties of Executor/Administrator

- Locate the will (hopefully the “last one”)
- Schedule Family meeting/conference
- Gather appropriate information
- Probate the will
- Prepare Notice to Creditors
- Tax and Banking details: open an account
- Locate, gather and secure estate assets
- File Inventory with Clerk of Court
- Identify all the debts of the decedent (pay or reject)

Duties of Executor/Administrator

- Disburse funds to pay debts and administrative fees
 - File any required tax forms and pay taxes due
 - File annual account with the Clerk of Court
 - Distribute assets to estate's beneficiaries
 - File final accounting with Clerk of Court and close the estate.
-
- May take a year or more to accomplish these tasks.

Choose Wisely

- For You, the “testator/settlor”, recognize the broad tasks of estate and trust management are different:
 - The “people job”
 - Supporting through a transition
 - Making “life choices”
 - Trustworthy
 - The “money job”
 - Conservative and thoughtful; not a Spendthrift
 - Understands financial concepts and business (farming/timber)
 - Bonded?
 - Trustworthy

People for Estate Jobs

- Getting the right people in the right seats on the right bus
 - Jim Collins in *Good To Great*
 - Executor or Trustee (younger than you?)
 - Guardian for minor children or disabled family member
 - Be certain you have asked and received agreement from folks to serve in a capacity
 - Prepare for contingencies
 - How deep is your bench?



Know where/what the “stuff” is

- You, executor, administrator, trustee, and perhaps the beneficiaries
- You (and spouse) need to create a list...of the stuff
 - Balance sheet
 - Assets may be “lost” or forgotten
 - Paid up life insurance
 - Personal property
 - Business property: equipment, livestock, land,
 - In today’s connected age: virtual accounts
 - Financial and Social Media: Understand linkages

What is to be Managed?

- Farm / Timber: May have to go a season or two which will require knowledgeable decisions
 - Tenant relationships
 - What's fair to both parties?
 - Material and active management?
- Home (place)
- Rental property: Likewise...decisions
- Financial assets
 - Relationships with Financial professionals

The Players

- Trustee / Successor Trustee
 - “Owns” the assets of the trust but the trust document directs how assets are to be used for the benefit of beneficiaries...and ultimately, perhaps, distribution of assets as a will substitute.
- Executor
 - Follows will instructions (kinda like a road map) to settle the estate and distribute the assets.

The Players

- Administrator
 - Follows the rules of intestate succession of North Carolina to settle the estate and distribute the assets.
- Power of Attorney (POA) (a document with limited powers)
 - Financial
 - Banking/Investment management
 - Manage business
 - Paying “the bills”
 - Medical (Health care issues)
 - Doctors
 - Hospital (Acute care / Rehab)
 - End-of-life issues

Assumption of Duties

- Presentation by **X** with documentation to:
 - For wills and intestate estates: Probate Court
 - Register of Deeds (not all counties operate the same)
 - County Tax Office
 - Financial institutions: Banks, Credit Unions, Investment Houses
 - Insurance Companies
 - Utility Companies
 - Health Care Providers
 - Doctors
 - Hospitals
 - Pharmacies
 - Businesses/Vendors to keep the “business of life” going

Person's Lack of Communication

- Don't trust (or misunderstand role of) professionals
- Executor, Trustee, beneficiaries, etc.
- BEING SECRETIVE
 - Talking about wealth and money in the rural community can be seen as rude
 - You and the family **NEED** to talk, before its too late, e.g., a year before they think they need too.
 - Then talk to your professional team

Talk and make YOUR wishes known



In Summary

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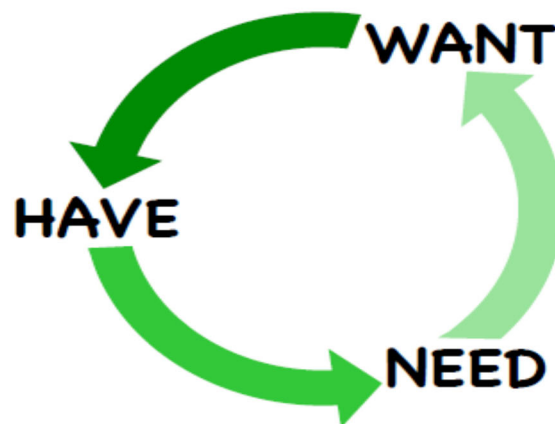
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Kathi Beratan 2/23/2018

Thank you for Your Attention

- Questions?



Contact Details

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