

Farm Transfer & Business Succession

Bob Parsons
Extension Ag Economist
University of Vermont
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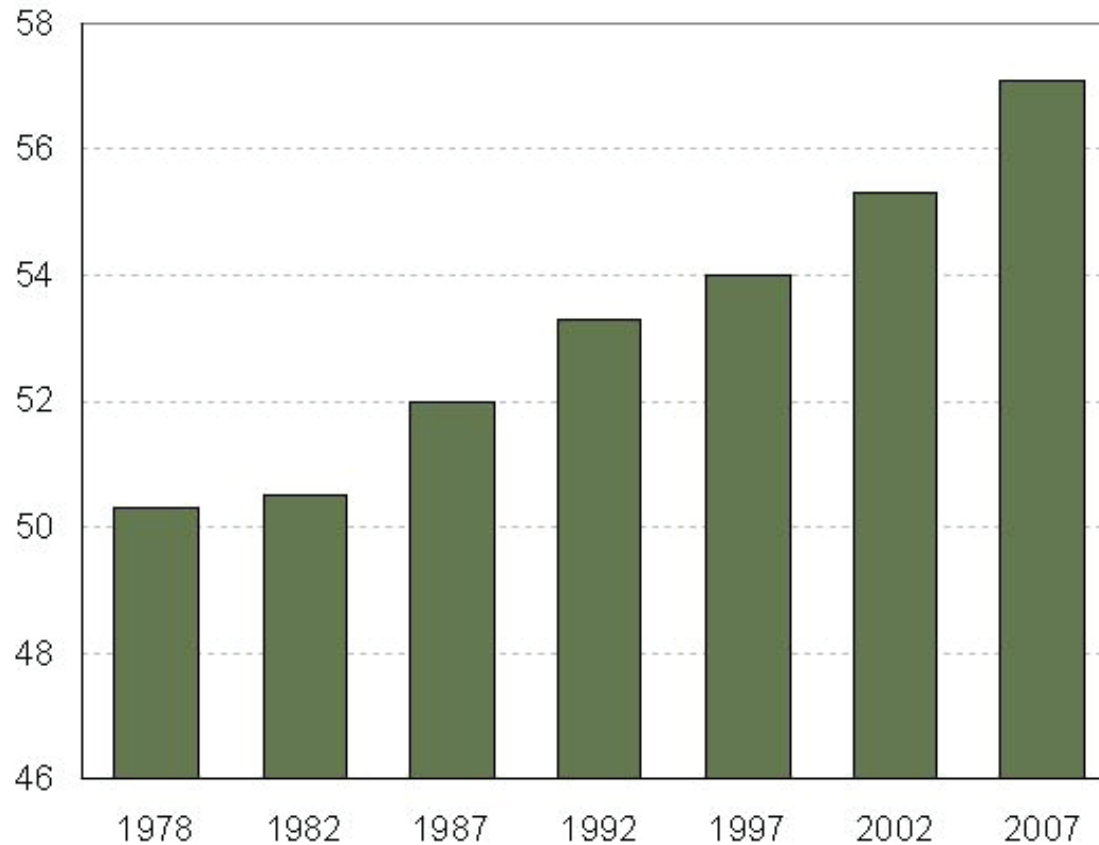


What's Your Concern Today?

- Estate Planning?
- Business Transition?
- Taxes?
- Transferring Assets?
- Business Structures?
- Preserving Farmland?
- Some or All of the above?

Increasing Age of Farmers!

Average Age of Principal Operator



Other Farmer/Farmland Trends

- Greater efforts to preserve farmland
- More absentee farmland owners
- Growth of smaller farms
- Land is extremely expensive
- As Will Rogers said...Buy land, they ain't making any more of it!

Other Trends...

- Young folks wanting to farm
- Farmland too expensive
- No assets or credit
- How to get these folks connected with available farmland big challenge!

Challenges to Transfers/Transitions

- Businesses must plan to survive
- Keeping farmland in family requires planning
- Can we separate land and business
- Can we face Challenge of Transferring
 - Management
 - Ownership
- Lots of challenges!

Road-blocking Issues for Families

- Money!
- Can the young'uns run the business?
- Fear of taxes and healthcare
- Fear of outliving your assets
- Fair vs. Equal treatment of off-farm heirs
- Can't talk with family

Is there a Transition Plan???

- Successor identified?
- How will they gain experience?
- How do they gain management role?
- How to gain ownership?
- Face financial reality?
- Is it workable?

Typical Transfer???

- Young'uns work to learn business
- Earn authority to make mgmt decisions
- Work into business ownership – partner
- Gradually take major management role
- Work toward full business ownership
- Gain ownership of business and land
- Land is usually last to transfer

Be Realistic.....

Why is it that many times we see where a family farm that cannot support 1 family is now believed to be big enough to support 2 families?

First Obstacle: Communication.

When do we discuss transitions?

- When we “have time”?
- A day called “Tomorrow”?
- Its just “not the right time now.”
- When the kids are “ready”?
- When the parents are “ready”?
- The day after its too late?



Family Communication

- Discussion of issues
- Set goals for each generation
- Income reality
- Special needs of each generation
- Can we come to an agreement on discussing a plan that works for both generations and other heirs?



Communication: Talkin' Challenges?

- Farm families ain't good at talking
- Feelings difficult to discuss
- Men especially don't like personal stuff
- Women – tend to prefer equal treatment
 - Avoids conflict
- Most often need outside facilitator
 - Can address issues the family can't

Retirement: Do you have a vision with goals?

Have you thought about how you will meet your retirement dreams?

Are your plans workable...

Do your retirement dreams fit with your plans for the farm business?

Timetable – When will this take place?

Retirement Questions

- Where will you live?
- How much do you need to live on?
- What will be your sources of income?
- What about family relationships/support?
- How about health care?

Where Will You Live?

- On or off the farm?
- Need different home?
- Cost of maintenance and heat?
- Move to home with less steps?
- Winter in the south?
- What if limited health care assistance is needed?

Retirement Income: How Much Do You Need?

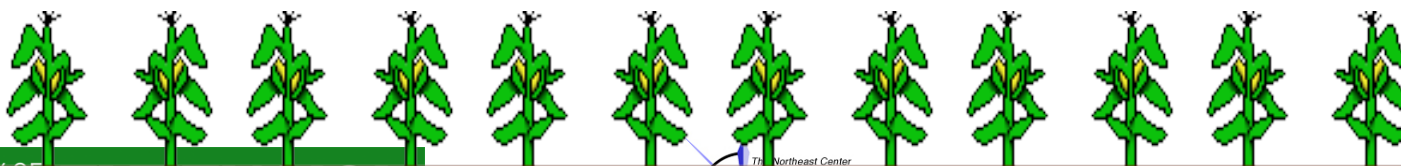
- Estimate needed income ~ \$40K or more
- Factor in life expectancy
- 3% inflation
- \$51,000 in 10 yr, \$68,000 in 20 years
- Where is the income going to come from?



Where are \$\$\$ coming from?



- Social Security income
 - Most farmers don't get much!
- Investments...IRA, Stocks, Savings
- Spouse retirement income
- Often: From farm income or assets



Investments and Financial Planning



**“I retire on Friday and I haven’t saved a dime.
Here’s your chance to become a legend!”**

Income Dilemma...



- Volatile Markets – loss of value
 - Safety tied to low returns
 - Trust in “experts”
 - No easy answer
- Remain diversified
- Expect ups and downs

Farm Income Sources



- Farm Income
 - Continue as owner? Partner? Laborer?
- Rent farm land
- Sell farm property
- Tax implications?
- But can the farm afford to pay you?

Family Relationships/Support?

- Can your children assist you?
- Will they help with household needs?
- Can farm provide resources/income?
- Ultimate...will you have to live with your kids?
- *“Be kind to your kids, for they will be the ones to pick your nursing home.”*

Flipside of Retirement Income...

- What does the younger generation live off of?
 - Peanuts?
 - Poverty wages?
 - Percentage of losses
 - Promise some day this will be yours?
 - Spouse's income?

What Income for Young Generation

- Need \$20K -single & living with folks?
- Get married....\$30K
 - ▶ Trailer, farm house, rent close by?
 - ▶ Make sure spouse has good off farm job?
- Start a family....\$40K-End of off farm job
 - More expenses, insurance
 - Many farm families qualify for food stamps!
- Move into owner position....HOW?

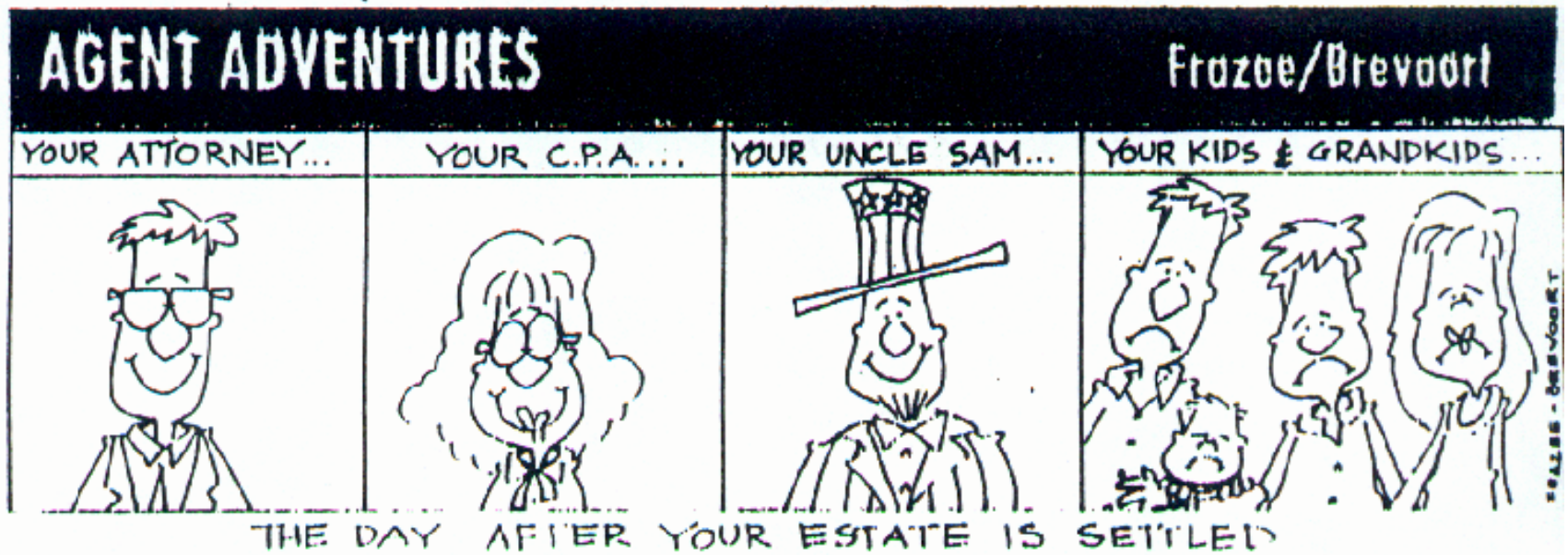
WHAT IS “ESTATE PLANNING?”

Estate Planning is a Lifetime Process whereby:

- I control my property while I am alive and well
- Take care of myself and my loved ones if I become disabled
- Give what I want to whom I want, when I want and the way I want
- Do so with the lowest possible amount of professional fees and court costs



But All Too Often.... The Day After Your Estate Is Settled:



Estate Planning Tools



- Wills
- Trusts
- Power of Attorney-financial matters
- Health Care Directive-
 - Names Health Care Agent
 - Living Will for terminal illness
 - Organ Donation

What is a Will



- A formal document not used until death
- Only transfers property you own at death
- Ineffective for jointly owned property, beneficiary designations, incapacitation, etc.
- Requires probate...can be Good or Bad...
- No will? Vermont has one for you!
 - Spouse 1/3, 2/3 to children

Complications of Most Wills



- Over 80% people die without wills
- Many made out a generation ago
- Need updated every so often
- Doesn't help when physically incapacitated
- Note...If you don't know what your will says...FIND OUT!!!

Important Point...Property Basis

What is it?

- ▶ Your *investment* in property
- ▶ Initial basis depends on how property acquired
- ▶ Purchased – amount paid
- ▶ Gifts – donor's adjusted basis
- ▶ Inherited – all property receives a “step-up in basis to Fair Market Value at date of death

Property Basis...why important?

For breeding stock, machinery and structures, basis is the amount eligible for depreciation

For all property (including land) tax due upon sale is based on capital gains = sales price minus selling cost minus adjusted basis

Adjusted basis is initial basis plus improvements made minus depreciation

Issue of Basis on Capital Gains

- Basis is what you paid for asset
- Selling price less basis is gain
- Tax is on gain
- EX: Buy land for \$50,000, keep 30 years, sell for \$500,000, $500,000 - 50,000 = \$450,000$ capital gain subject to tax.

Be Aware of Beneficiary Designations Outside Will, Trust

- Land Titles
- Life Insurance
- IRAs, 401(k)s
- Payable on Death bank and brokerage accounts
- Supercede the will and trust!



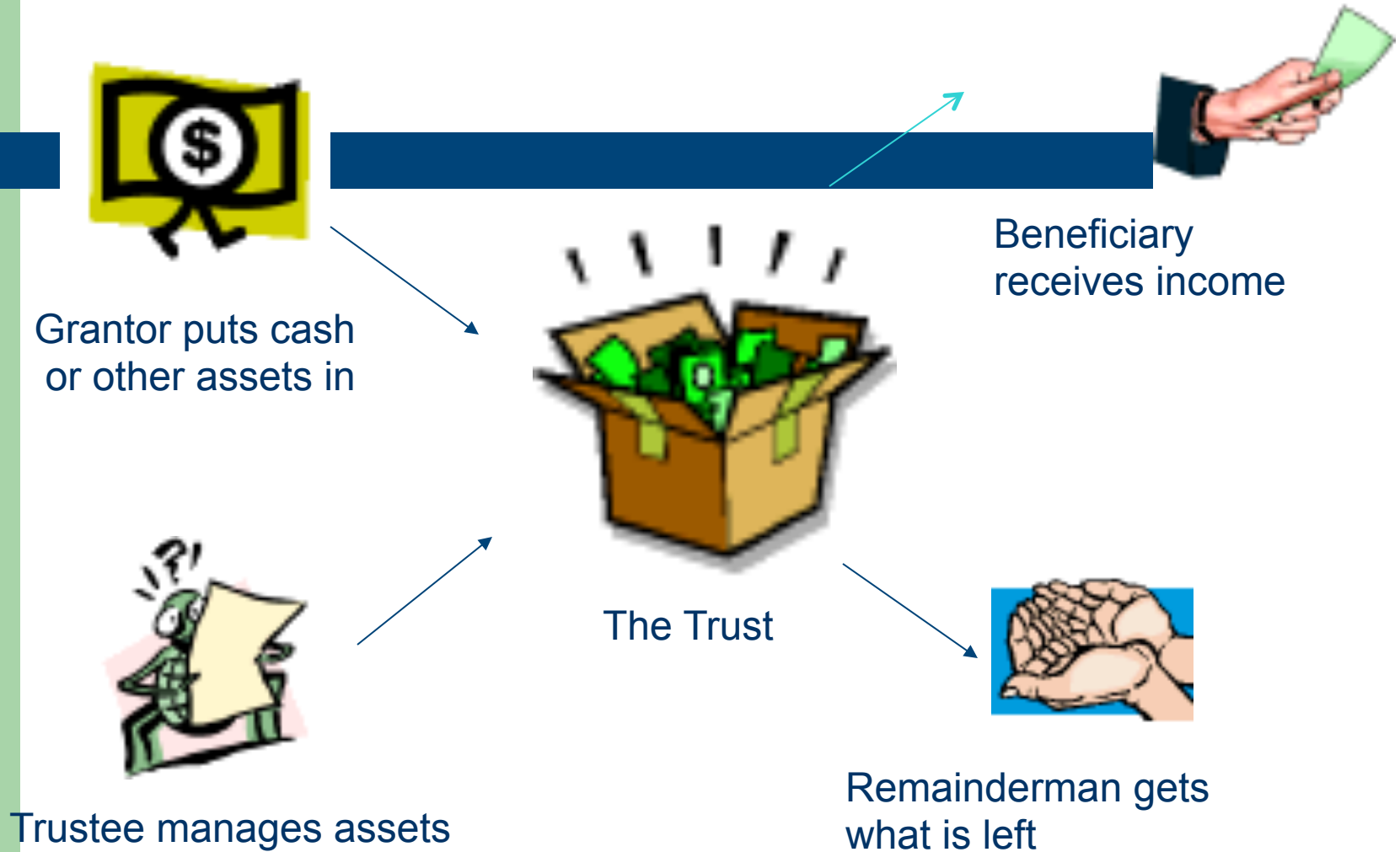
Becoming More Common... Revocable Living Trusts

- A Trust is a legal entity apart from the person or persons who create it, which is designed to hold and control the distribution of property.
- Revocable Living Trusts make it possible to control what happens to the assets of the Trustmaker both during the Trustmaker's life and years after death
- Facilitates the provision of your care if you become incapacitated.

WHAT IS A TRUST?

- A Trust is composed three separate roles:
 - The TRUSTMAKER (also referred to as the Grantor or Settlor) creates and funds the Trust
 - The TRUSTEE holds the property and administers the Trust
 - The BENEFICIARY receives benefit from the Trust
- Note: the same person can serve in each role

The Trust



HOW IS A REVOCABLE LIVING TRUST DIFFERENT FROM A SIMPLE WILL?

- A Revocable Living Trust is a private document, not subject and enacted without being public record
- Trust administration is much more efficient, and has lower professional costs
- Unlikely to be contested
- Revocable Living Trusts can be useful for dealing with carry over basis and minimizing estate taxes

REVOCABLE LIVING TRUSTS ENABLE MORE SOPHISTICATED PLANNING

- Revocable Living Trusts make it possible to control what happens to the assets of the Trustmaker both during the Trustmaker's life and even years after death
- This, in turn, facilitates the provision of:
 - Creditor/predator protection
 - Spendthrift and remarriage protection
 - Care for children (or spouses) with special needs
- Useful for incapacity planning

How is a Trust different from a Will?

- Trust is private document, not subject to public.
- Trust administration is much more efficient and can have lower professional costs
- Contests are very unlikely
- Revocable Living Trusts can be useful for dealing with estate taxes
- Most still have a will to cover other assets

Beware of “Trust Snake Oil Charlatans”

- Some groups sell trusts as way to avoid probate
- Sell, prepare, and move on
- Never funded...assets have not been retitled...so trust is worthless.
- Don't ever, ever,....you get the idea!

Fair vs. Equal Dilemma

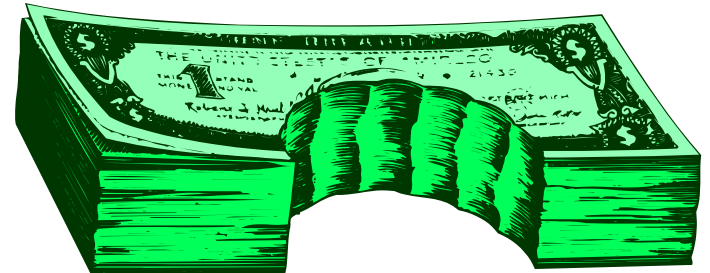
- How do you treat off-farm heirs
- Equal is seldom ever fair
- Splitting valuable farmland – can kill farm business
- Essential...operator of farm business must control the land!

Other Estate Planning Documents

- Health Care Directive-
 - Names Health Care Agent
 - Living Will for terminal illness
 - Organ Donation
- Should ALWAYS be completed by attorney
- Laws vary from state to state

Taxes to Consider

- Estate Taxes
 - Don't forget CT Tax!
- Earned Income Tax
- Capital Gains Tax
- Gift Tax



UNDERSTANDING ESTATE TAXES???

- **In 2010 THERE was no Federal Estate TAX**
 - Limited Step up in Basis to \$1.3 Million
- 1/1/2011 the Federal Law reverted back to 2001 law
- Early 2011 Congress passed new estate tax law
- Expires 12/31/2012
- Congress is very concerned about unemployment for accountants and estate attorneys!

UNDERSTANDING ESTATE TAXES

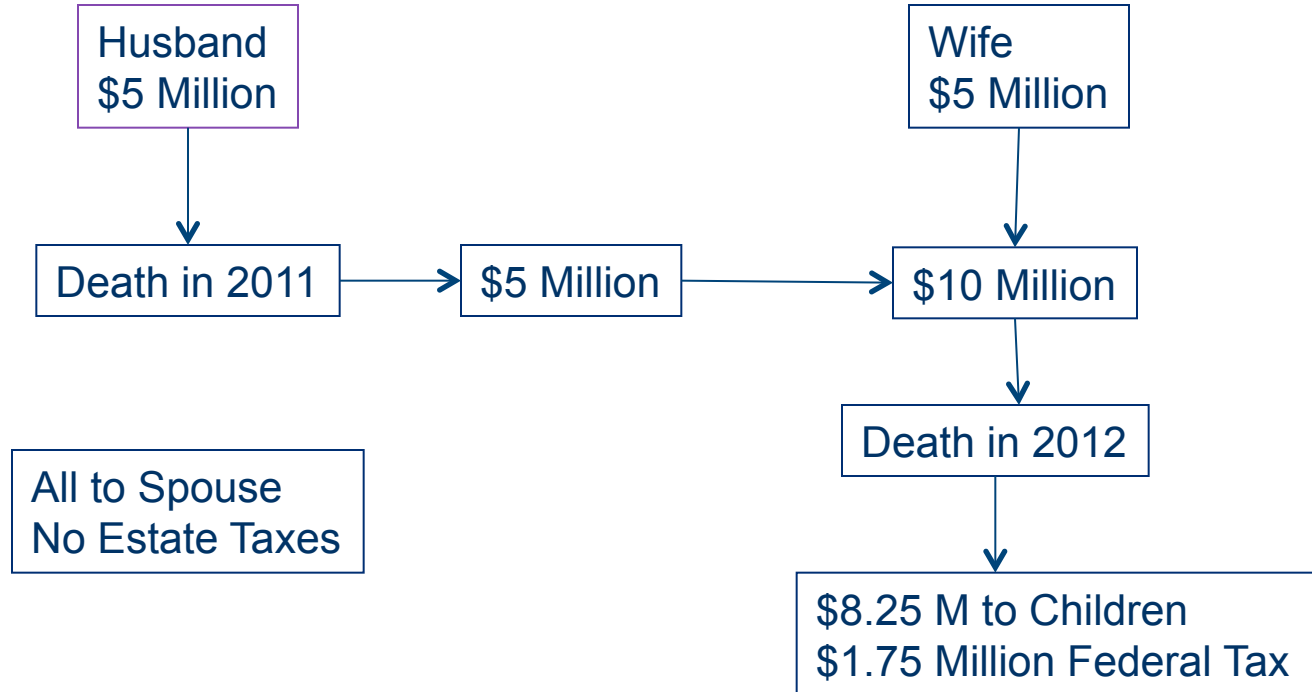
- A tax on the net value of what you own at death (Net, not Gross!)
- For 2011-12
 - \$5 million exclusion
 - Per individual
 - Unlimited exclusion to spouse
 - Unlimited Step up in Basis

UNDERSTANDING ESTATE TAXES

- 1/1/2013 Revert to 2001 Law
- \$1M applicable exclusion amount
- Unlimited step up in basis
- Burning question: What will Congress do and when?

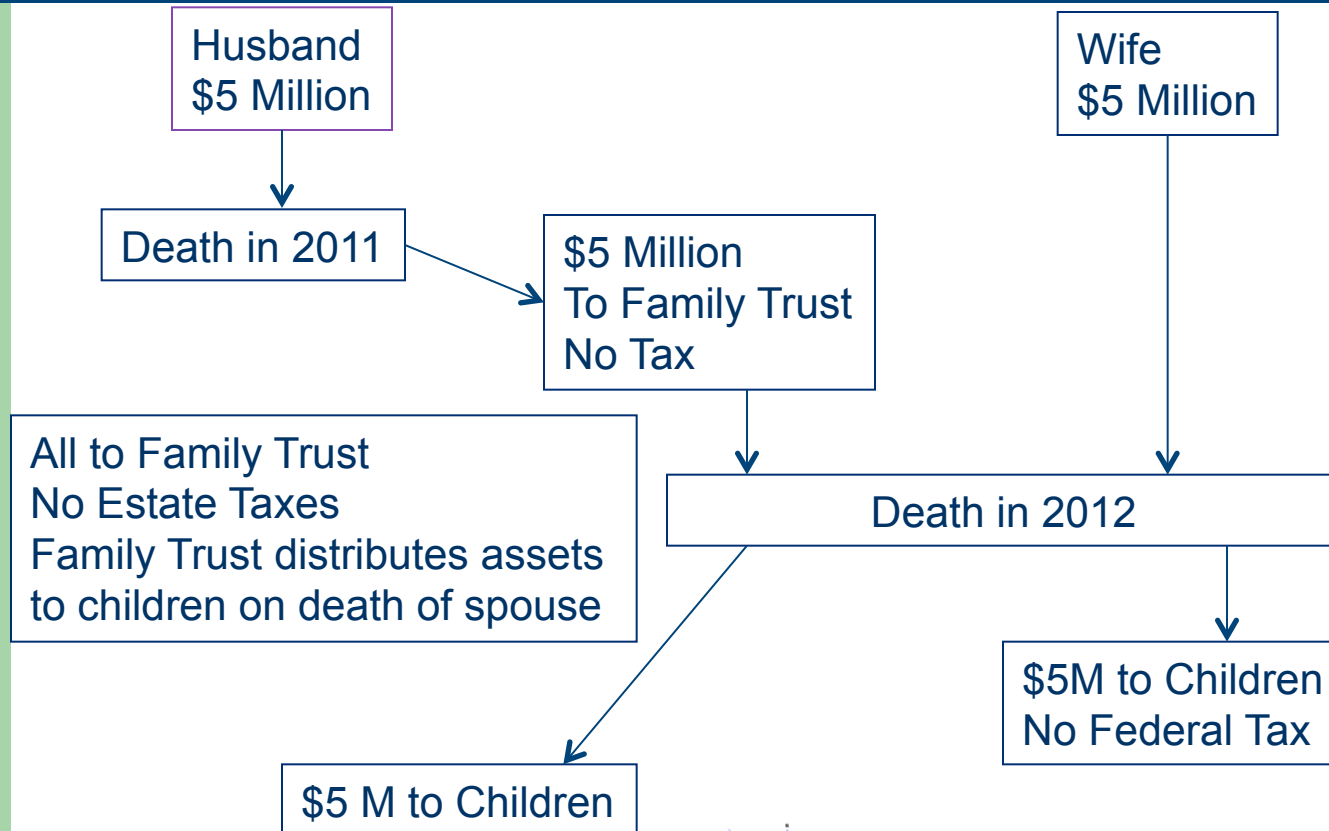
Impact of Tax Planning

Example: Without Tax Planning



Impact of Tax Planning

Example: With Tax Planning



Capital Gains Tax

- Tax on gain earned on capital assets, especially land
- Buy land for 50,000
- Sell land for 350,00
- Capital Gain of \$300,000
- Taxed at rate of 15-25%

Earned Income Tax

- Income subject to Social Security Tax and income tax
- Tax rate of 15.3%
- On top of income tax
- Marginal tax rate can rise above 40%

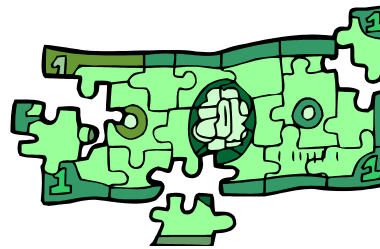
Gift Taxes

- Once in a lifetime gift of \$5 million
- Unlimited Marital gifts
- Annual \$13,000 gift to as many as you want
- Taxes paid by gifter

Methods to Transfer Estate Assets

Common Tools

- Wills
- Gifts
- Sales
- Leases
- Trusts



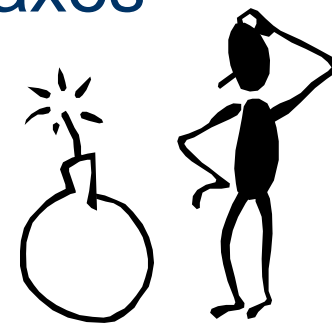
Inheriting Property

- ❖ Owner maintains control until death
- ❖ Can change decision until death
- ❖ Receiver benefits from “stepped up basis” of current market value



Disadvantages...

- ❖ Have to wait until death of owner
 - ❖ May be ready to retire before owner dies!
- ❖ Wills may not control much of your property
 - ❖ Ownership descriptions
- ❖ Assets can be subject to inheritance taxes
- ❖ Inflation confounds tax planning



Gifts

Parting with property and control over it

- Giving personal or farm assets to family members, on-farm individuals or others
- Give up to \$5,000,000 lifetime
- Can give \$13,000 to individual per year
Couple can give \$26,000 per year



Advantages of Gifting

- ❖ Reduces taxable estates of giver
 - Future appreciation in value benefits receiver
- ❖ Donor transfers tax obligations
 - Receiver gets asset at its adjusted tax basis
- ❖ Helpful for young farmers to acquire assets
 - Equipment, livestock or land



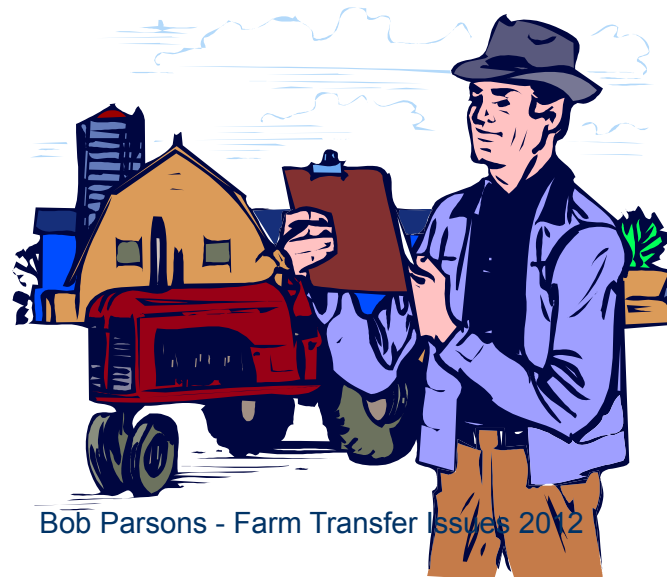
Disadvantages...

- ❖ Gifts cannot be conditional
- Limited legal recourse to get back
- ❖ No longer control asset
- ❖ Donee receives donor's basis
- ❖ Need to recognize gift thru title transfer or written agreement
- ❖ Transferring partial interest may be problematic



Sales of Farm Assets

- Outright or direct sale
- Sell by installment plan
- Bargain sale
- Purchase agreement



Installment Sales

- Puts the seller in the position of lender
- Spreads tax and income over several years, but ...
- Provides buyer with key source of credit

Seller - risk of default and repossession

Buyer – owns and controls asset

Bargain Sale

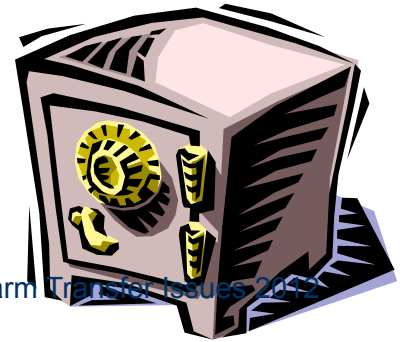
- Sell at price below market value
Common with family members
- Has income and gift tax implications
IRS will likely consider difference a gift
- Consult with tax advisor!



Leases

Arrangement gives individuals the right to use property for a set term, rate, and time.

- Transfers asset use but not ownership.
- Can be used for land, bldgs, equip, livestock
- Good tool to use prior to ownership transfer.



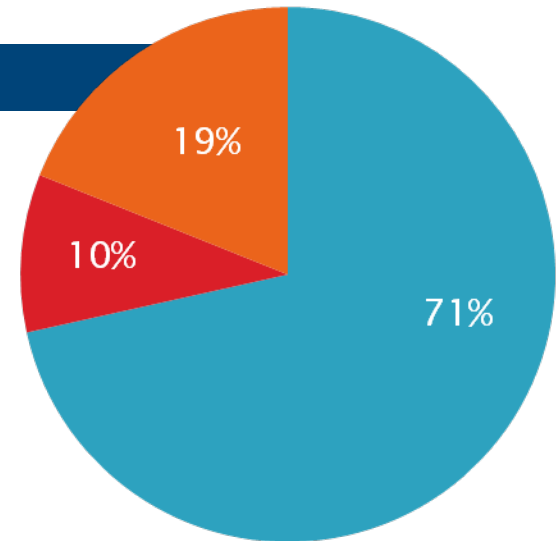
Farm Business Structure

Sole Proprietorship

Partnership

Corporation – S & C

Limited Liability Company



■ Sole Proprietors
■ Partnerships
■ Corporations

Business Organization

- Sole Proprietorship
- Partnership
- Limited Partnership
- Limited Liability Company (LLC)
- Corporation
Subchapter C or S



Important Factors Determine Which One for You...

- Number of owners & sources of capital
- Decision making & management flexibility
- Profit sharing & income taxes
- Limiting your own personal liability
- Easing transfer of business property
- Life of the business

Sole Proprietorship

- An individual (couple) operating a business without forming a registered separate entity or in formal or informal partnership with another individual
 - ✓ Assets owned by individual (couple)
 - ✓ Liabilities and actions sole responsibility of individual
 - ✓ Business profit reported on Schedule F or Schedule C is placed on individual's 1040

Partnership

Two or more individuals join together to operate a trade or business for profit, formal or informal agreement

- ✓ Joint ownership of assets
- ✓ Unlimited liability for debts and actions of partner(s)
- ✓ Partnership files form 1065 that transfers owner share of profits (losses) to personal 1040

Limited Partnership

Formal Partnership with two types of partners

- ◆ ***General partner***...Manage and Control day to day operations
- ◆ ***Limited partner***...
 - ✓ Not actively involved with management
 - ✓ Cannot bind partnership to debt or contract
 - ✓ Treated like an investors, losses are limited to partnership investment
 - ✓ Still has risk of liability

Corporation

- Business entity created and registered under provisions of state law

The Corporation...

- ✓ Owns assets and incurs liabilities
- ✓ Hires employees but has no dependents
- ✓ Enters into contracts
- ✓ Pays taxes and stockholders pay taxes on dividends
- ✓ Stockholders liability limited to investment

Hybrid: S Corporation

- ✓ An election made whereby a corporation's earnings are not taxed at the corporate level
- ✓ Profits (losses) are passed through to shareholders to be included on their individual tax returns
- ✓ S Corporation election limited to domestic corporations with **one class of stock** and 100 or fewer shareholders

Complications of Corporations

- Double taxing of C-Corporations
- One class of stock for S-Corporations
- **NEVER, NEVER, NEVER, PUT LAND INTO A CORPORATION!**
 - Land coming out of a corporation subject to Capital Gains tax.

Growing Trend of Farms Today... Limited Liability Company (LLC)

- ✓ Business entity created & regulated under state law and differs from state to state
- ✓ Combines corporate characteristic of limited liability for owners with the flexibility and flow-through tax attributes of a partnership
- ✓ Portrays the image of an entity to do all things needed to carry out its business

LLC Operating Agreement

- ✓ Highly flexible document defining the governance and role of members
- ✓ It provides the structure necessary to guide the internal workings of the company
- ✓ Allows members to tailor operations to meet personal needs according to the state law

Challenges of LLCs

- Advantage: Operating agreement is flexible
- Disadvantage: Operating agreement is flexible
- No set operating agreement
- Registering as an LLC does not make you an LLC

“Magical” LLC

- LLC does not prevent you from being sued
 - Still need liability insurance!
- LLC limits liability if “shield cannot be pierced”
 - Must operate according to agreement
- Limited financial liability a farce
 - Bankers will require personal assets as collateral for LLC liabilities
 - Bankers may not be bright but are not that dumb!

Example: Farm Business LLC

- ❖ Farm business set up as an LLC
- ❖ LLC owns inventory, machinery, & livestock
- ❖ LLC leases real estate from parents/owners
- ❖ LLC members are farming parents & children
- ❖ LLC acquires/disposes assets/financing as needed
- ❖ Parents gradually transfer control & ownership of LLC as defined in LLC Operating Agreement
 - ❖ Transfer ownership shares by sweat equity, gifts, sales, etc.

Example Part II: Farmland

- ❖ Farm owned by Parents as an LLC
- ❖ Agreement defines ownership classes
- ❖ Plan to distribute shares by gift, sale, inheritance, etc.
- ❖ Farming LLC has long term lease on Real Estate
- ❖ Farming LLC members will have RE management role
- ❖ Off-farm heirs will get some ownership shares but have no authority/management role/no say, but will be recognized if real estate is sold
- ❖ Farming heirs control the use of the land


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Transferring the Farm Video Series



These videos were made possible with funding from the [USDA Risk Management Agency](#).

Video Navigation

- 1. Farm Case Studies**
 - [North Williston Cattle Company Farm Family Case Study](#)
 - [Richardson Family Farm Case Study](#)
 - [Hall and Breen Farm Family Case Study](#)
- 4. Farm Business Planning**
 - [Financial Viability and Farm Transfer](#)
 - [Family Farm Business Agreements](#)
- 5. Selecting a Business Entity**

At: <http://www.uvm.edu/farmtransfer/>
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UVM Home

Family Farm Succession

UVM Extension

Transferring the Farm Virtual Workshop

- Introduction
- First Things First
- Planning for Retirement
- Estate Planning
- Farm Business Planning
- Selecting a Farm Business Entity
- Taxes
- The Family and Farm Transfer
- Farm Case Studies

Transferring the Farm Videos



Transferring the Farm Virtual Workshop

At: <http://www.uvm.edu/farmtransfer/>
Click on "Virtual Workshop"

Final Points...

- Remember to:
 - Communicate with family
 - Seek advice from others
 - Consider reality of the business
 - Make informed decisions
 - Use Legal, Financial and Accounting experts
 - Develop a plan!

Most Difficult Step...

At some point you have to.....

stop procrastinating and.....

Set the plan in motion!!



Another Big Concern....Health Care

Fear of Losing the farm for nursing care

- ✓ Die before you need LT care
- ✓ Self Finance – Good Luck!
- ✓ Children will care for you?
- ✓ Long Term Care Insurance – Expensive!
- ✓ Medicare?
- ✓ Medicaid?

Self Financing....

- Need liquid assets
- Stocks, bonds, savings, etc
- Reverse mortgage
- Fear of farmers...have to sell the farm???
- Planning must be done so farm and farm business are not put at risk!

Medicare

- Includes only "skilled nursing" and conditions as insulin dependence, feeding tube, 5/week rehab, etc.
- Part A covers up to 100 days "skilled nursing" with co-insurance rules from day 21 through day 100.
- Medicare pays for only about 9 percent of nursing home care in the United States
- Will not pay for custodial care, only skilled care

Medicaid...Let the Gov't Pay for it!

- Medicaid (eligibility program)
 - Citizenship and residency requirements
 - Must be 65 or blind/disabled
 - **Assets** – what is your financial picture on your application date
 - **Income** – cap on applicant's income

Medicaid Income Requirements

- Individuals must pay most of their income to nursing home
- Spouse income is not counted in determining Medicaid eligibility
- Other requirements vary from state to state

THANK YOU!
ANY QUESTIONS?

