

# Farm Transfer & Business Succession

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## Connecticut Cooperative Extension System

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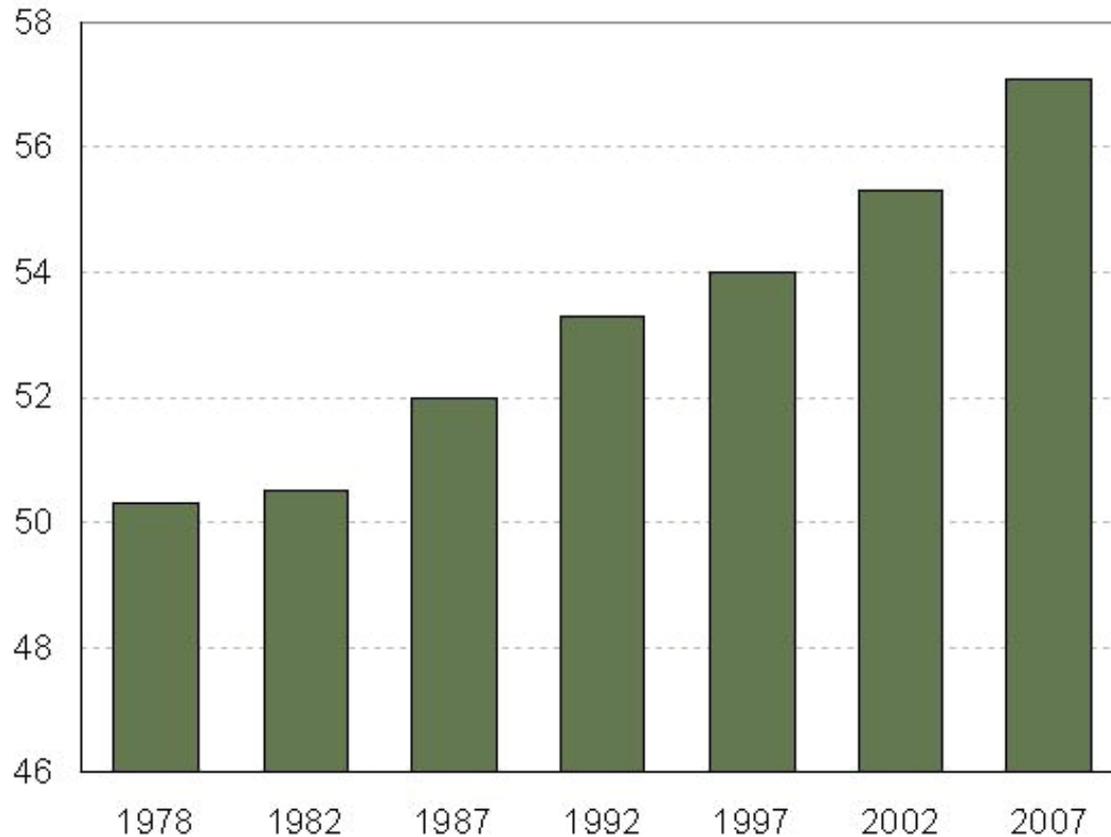
**National Institute  
of Food and  
Agriculture**

# 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
- More farmers that do not have an successor
- 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

# 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

# Let's 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 health care assistance is needed?

# Retirement Income: How Much Do You Need?

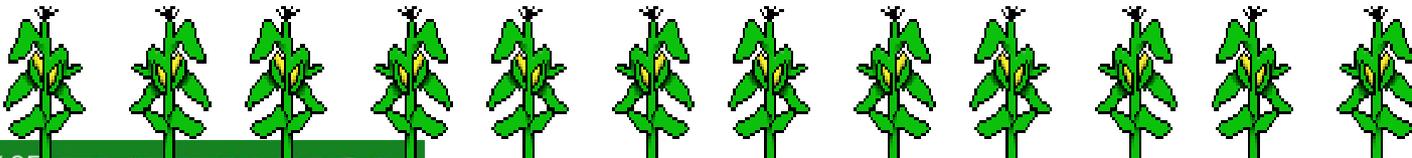
- Estimate needed income ~ \$50K or more
- Factor in life expectancy
- 3% inflation
- \$65,000 in 10 yr, \$88,000 in 20 years
- Where is the income going to come from?



# 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!”**

# 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?
  - Poverty wages?
  - Percentage of losses?
  - Promise that some day this will be yours?
  - Spouse's income?

# What Income for Young Generation

- Need \$25K -single & living with folks?
- Get married....\$40K
  - ▶ Trailer, farm house, rent close by?
  - ▶ Make sure spouse has good off farm job?
- Start a family....\$50K-End of off farm job
  - More expenses, insurance
  - Many young farm families qualify for food stamps!
- Move into owner position....HOW?

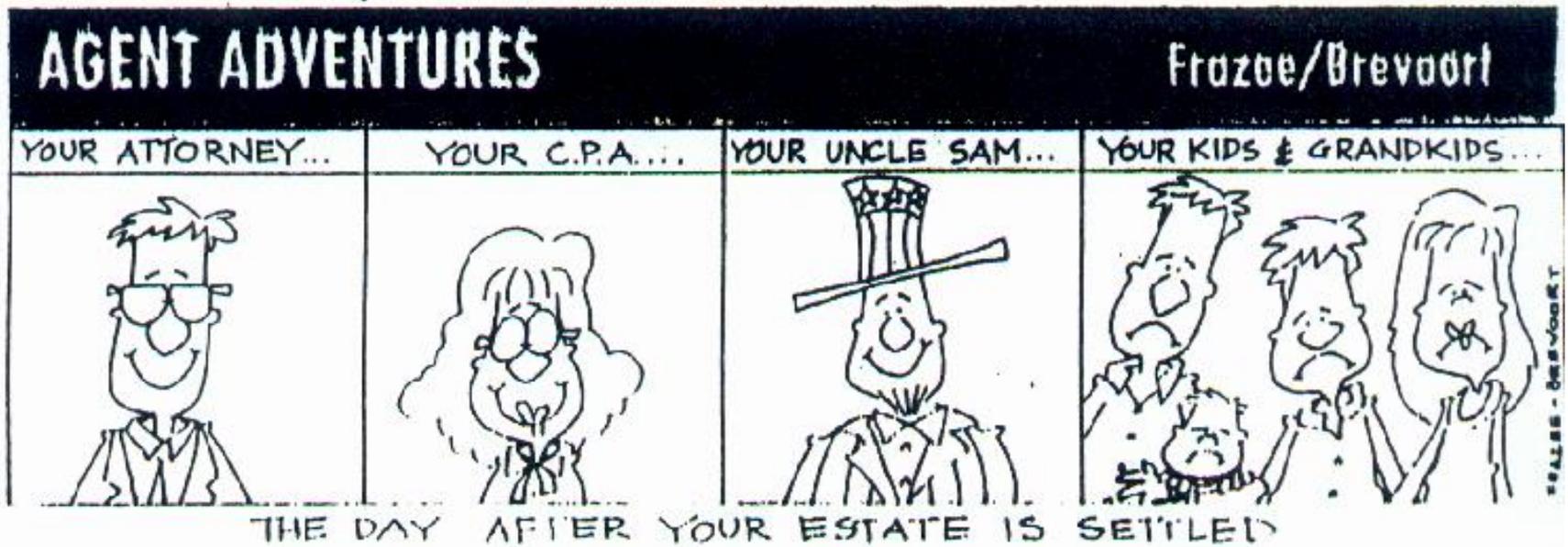
# WHAT IS “ESTATE PLANNING?”

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? Your state has one for you!

# 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!!!**

# 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!

# Be Aware of Beneficiary Designations Outside Will, Trust

- Land Titles
- Life Insurance
- IRAs, 401(k)s
- Bank & 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.

# The Trust



Grantor puts cash and/or other assets in



Trustee manages assets



The Trust



Beneficiary receives income



Remainderman gets what is left

# 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
- Difficult to contest
- Revocable Living Trusts can be useful for dealing with estate tax issues if set up correctly
- Use an Attorney!!!

# 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

# 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

- A tax on the net value of what you own at death (Net, not Gross!)
- For 2015
  - \$5.4 million exclusion with portability
  - Rate begins at 35%
  - Unlimited exclusion to spouse
  - Unlimited Step up in Basis

# Don't forget....CT Estate Taxes

- Taxable estates >\$2,000,000
- Rate begins at 7.2%
- No portability
- Solving federal can still have CT tax repercussions!

# Capital Gains Tax

- Tax on gain earned on capital assets, especially land
- Buy land for 50,000
- Sell land for \$1,000,000
- Capital Gain of \$950,000
- 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%

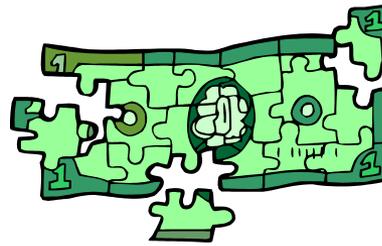
# Gift Taxes

- **Once in a lifetime gift of \$5.4 million**
- **Unlimited Marital gifts**
- **Annual \$14,000 gift to as many as you want**
- **Taxes paid by gifter**

# Methods to Transfer Estate Assets

## Common Tools

- Wills
- Gifts
- Sales
- Leases
- Trusts



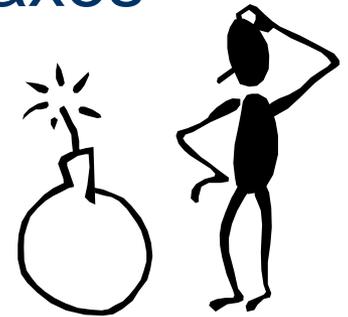
# Inheriting Property

- ❖ 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



# Giftng

Parting with property and control over it

- Giving personal or farm assets to family members, on-farm individuals or others
- Give up to \$5,400,000 lifetime
- Can give \$14,000 to individual per year  
Couple can give \$28,000 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



Bob Parsons - Farm Transfer Issues 2015

# Installment Sales

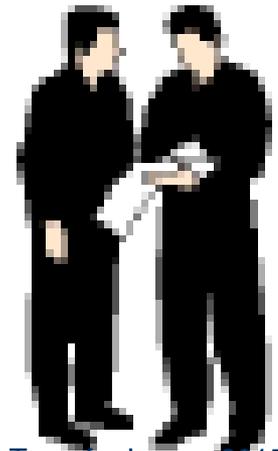
- Puts the seller in the position of lender
- Spreads tax and income over several years, but ...
- Provides buyer with key source of credit

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.



# Some Concerns with Leases

- Good way to give access to young farmers
- Be sure of compatibility before signing long term leases
- Be sure terms are what you can live with
- Held to signed agreement

# Conservation Easements

- Sell development rights for set amount
- Imposes restriction on use of land
- Terms....Forever, which is a long time
- Can provide cash & peace of mind to owners
- Heirs held with restrictions
- Is this really what you want to do?

# Challenges w/Conservations Easements

- If debt, lender must be in on agreement
  - Selling lender's collateral
  - Lender will want part or most of sale
- Often subject to capital gains taxes
- What do you have left after paying lender and Uncle Sam and State of Connecticut?

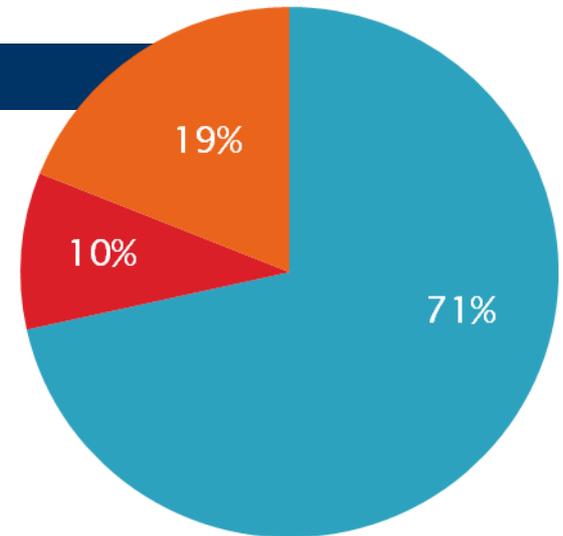
# Farm Business Structure

Sole Proprietorship

Partnership

Corporation – S & C

Limited Liability Company



- Sole Proprietors
- Partnerships
- Corporations



# 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
  - ✓ Limited liability for limited partners

# 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, EVER 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 a bit 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

# False Image of the “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 ain’t 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 but may only own a minority share.

# 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

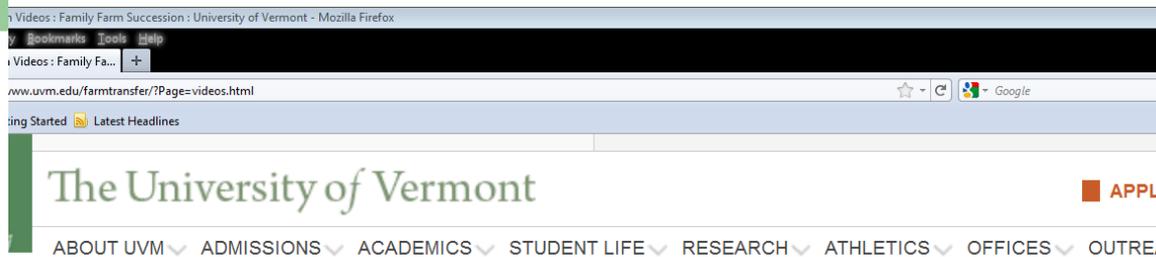
- Includes only "skilled nursing" and conditions as insulin dependence, feeding tube, 5/week rehab, etc.
- Part A covers up to 100 days "skilled nursing" with co-insurance rules from day 21 through day 100.
- Medicare pays for only about 9 percent of nursing home care in the United States
- Will not 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
- Exploding Medicaid costs causing states to make sure only eligible patients receive help.



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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 PI

- [Financial Viability and Fa](#)
- [Family Farm Business Ag](#)

#### 5. Selecting a Busin

At: <http://www.uvm.edu/farmtransfer/>  
Click on “Transferring The Farm Videos”

# 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!!



***THANK YOU!***  
**ANY QUESTIONS?**

