

TAX ISSUES RELATED TO FARM TRANSITIONS

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TAX ISSUES RELATED TO FARM TRANSITIONS

I. INTRODUCTION

- A. Estate Tax Reform.
- B. 2010 Estate Tax Repeal.
- C. 2011 Return of the Estate Tax.
- D. Expected Legislation Impacting Both 2010 and 2011.
 - 1. Congress likely may impose an estate tax in 2010.
 - 2. Estate tax exclusion amounts and rates will be modified for 2011 and the following years.

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II. FARM TRANSITION PLANNING GOALS

- A. Retain owner control and income
- B. Protect spouse
- C. Provide continuity of farm to farming heir
- D. Treat kids fairly
- E. Minimize taxes
- F. Provide liquidity
- G. Reduce administration costs
- H. Avoid disputes

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III. PROPERTY INCLUDED IN THE FEDERAL GROSS ESTATE AND ALLOWABLE DEDUCTIONS

A. Includible Property (Probate and Non-Probate).

1. Property owned at death.
 - a. Sole
 - b. Tenancy in common
 - c. Joint Tenancy
2. Property over which the decedent held a general power of appointment.
3. Retained life estates.
4. Transfers with retained powers to affect the beneficial ownership of the property.

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5. Life insurance, if the proceeds are payable to the decedent's estate or the decedent owned "incidents of ownership" in the policies.
6. Survivorship annuities.
7. Death benefits under qualified plans

B. Deductions

1. Debts, expenses, and taxes.
2. Theft and casualty losses.
3. Charitable deduction.
4. Marital deduction.

C. Valuation of Property

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IV. UNIFIED ESTATE AND GIFT TAX CREDIT

A. Estate Tax: Applicable Exclusion Amount.

1. Each person may transfer some property that will not be subject to the estate tax.
2. The applicable amount is determined by the year of death.

B. Estate Tax Rates.

1. Congress may impose an estate tax for 2010 of around 45%.
2. 2011 tax rate probably will be the same.

C. Asset Basis.

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V. SALES TO FAMILY MEMBERS

- A. Lifetime transfers of farm or ranch property for less than the fair market value are considered gifts.
- B. No "stepped-up" basis.
- C. May be tax consequences if low basis asset.
- D. May want to delay sale.

VI. INSTALLMENT SALES / CONTRACTS

- A. Appreciated property may be kept in the family and may not be subject to the entire gain at the time of the sale.
- B. Recognition of gain deferred as payments are received.
- C. Gifting contract payments.

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D. No "stepped-up" basis.

VII. GIFTING FARM INTERESTS OR PROPERTY

A. Annual exclusion is \$13,000 per donee.

B. Only present interests qualify as gifts.

C. If an interest is retained, the gift is only complete for the remainder.

D. Lifetime gift exclusion is \$1,000,000.

E. Gift tax returns.

F. No "stepped-up" basis.

G. Document the gifts.

H. Medicaid issues.

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VIII. CONVEYANCE OF FARM OR RANCH WITH A RETAINED LIFE ESTATE

A. Value of transferred property included in decedent's gross estate if use or possession of the property was retained.

B. Owner's continued use and control after transfer.

IX. SPECIAL RULES FOR MARRIED COUPLES

A. Marital Deduction.

1. Entire estate may be left to a surviving spouse.

2. No estate tax until death of surviving spouse.

B. The A-B Estate Plan.

1. Estate is divided into a marital trust ("A" trust) and a credit shelter trust ("B" trust).

2. Trust A gets the marital deduction; Trust B takes the estate and gift tax credit.

C. Liquidity and Life Insurance Policies.

1. Survivorship life insurance, payable on the last death of two insured persons.
2. Especially appropriate for married couples with estates without liquidity.

X. LIQUIDITY AND LIFE INSURANCE POLICIES

A. Survivorship Life Insurance.

B. Irrevocable Life Insurance Trusts to Avoid Gift and Estate Taxes and Expenses.

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C. Irrevocable Life Insurance Trusts for Closely Held Corporations or Businesses.

XI. C CORPORATIONS: TAX ADVANTAGES AND DISADVANTAGES

A. Formation and State Limitations on Using a C Corporation for Farming.

1. Anti-Corporate farming statutes.
2. Procedures for forming a corporation.

B. Overview of Federal Taxation of C Corporations.

C. C Corporation Disadvantages.

1. Double taxation.
2. High corporate tax rates on most income

3. Strict corporate formalities.

D. C Corporation Advantages.

1. Low tax rates on first level of income.
2. Availability of better fringe benefits for owner-employees.
3. Can elect fiscal year.
4. Ordinary loss for failed small business C corporation.
5. Personal liability protection for shareholders.
6. Stockholders can also be employees and receive compensation not subject to double taxation and not subject to self employment tax.

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E. Divisive Reorganizations.

1. Spin-offs, Split-offs, Split-ups.
2. Corporation Can Distribute Appreciated Property without a Corporate Level Tax.

F. Stock Redemptions.

1. Solution to possible liquidity problems related to estate taxes.
2. Farm business may qualify under percentage tests for a 14-year extension for estate tax payment if it operates as a closely held corporation.

G. Employee Stock Ownership Plans (ESOPs).

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1. A qualified retirement plan to invest in the qualifying employer's securities (stock).
2. Tax-deferred sales to ESOPs.
3. Stock options (qualified and non-qualified).

XII. FAMILY LIMITED PARTNERSHIPS AND FAMILY LLCs

A. Transfer of Family Business with Limited Estate and Gift Taxes.

1. Family Limited Partnerships (FLPs).
2. Family Limited Liability Companies (FLLCs).

B. Managerial Control of Family Business can be Retained during Lifetime.

C. Avoidance of C Corporation Double Taxation.

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D. Transfers to Family Members in Lower Tax Brackets by Shifting Income.

E. Shield Assets from Creditors by Transfers to Business Entities.

F. Minority and Marketability Discounts for Family LPs and LLCs can Reduce the Value of Gifted Interests.

G. Disadvantages.

H. Leveraged Partnership Transactions

1. Operation
2. Benefits
3. Risks

XIII. GRANTOR RETAINED ANNUITY TRUSTS (GRATS)

- A. A Grantor Retained Annuity Trust (GRAT) is a Split-Interest Trust in which the Grantor (the person setting up the trust) Retains an Annuity Interest.
- B. A GRAT can Receive a Reduction in the Value of the Transferred Interest or be Used to Significantly Reduce the Unified Tax Credit.
- C. The Value of the GRAT Gift (remainder) Interest is the Fair Market Value of the Property Transferred to the Trust Minus the Value of the Retained Annuity Interest.

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XIV. DEFERRAL OF ESTATE TAX

- A. Taxes Due Nine Months after Decedent's Death.
- B. Deferral for Closely-Held Businesses, 10 Equal Installments for up to 5 Years with Interest.
- C. Eligibility Requirements for Deferral.

Decedent was a U.S. citizen.

Value of the decedent's interest in the is more than 35% of the adjusted gross estate; and

The closely held business is either:

- (A) A sole proprietorship;

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(B) A partnership, if at least 20% of its value is included in the decedent's gross estate or if there are 45 partners or less; or

(C) A corporation, if 20% or more of the value is included in the decedent's gross estate or if the corporation has 45 shareholders or less.

XV. MODIFIED CARRYOVER BASIS AT DEATH (NEW RULE FOR 2010)

A. Stepped-up Basis Rules Replaced with Carryover Basis Rules.

1. Income tax basis of property will be carried over from the decedent.

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2. The decedent's adjusted basis of the property, or the fair market value of the property on the date of the decedent's death, whichever is less.

B. General Basis Increase Provision.

1. Executor can step-up the basis of assets by a total of \$1,300,000.

2. For properties passing to a surviving spouse, an additional \$3,000,000 in basis step-up is available.

C. Basis Step-up for Property Passing to Decedent's Spouse.

1. Up to \$4,300,000 in date-of-death-basis step-up.

2. Qualified spousal property only.

D. Executor's Authority and Limitations in Increasing Basis of Assets to a Stepped-up, Date-of-death Value.

1. Basis increase limited to the fair market value of the asset.
2. Increase amounts will be adjusted for inflation.

XVI. BASIC ESTATE PLANNING DOCUMENTS

A. Powers of Attorney for Property.

1. Durable.
2. Springing.

B. Health Care Directives.

C. Living Wills.

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D. Wills.

1. Advantages.
2. Disadvantages.
3. Simple.
4. Complex.

E. Trusts.

1. Revocable.
2. Irrevocable.
3. Testamentary.

XVII. CONCLUSION

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