Income Tax Management for Ag Producers
NDSU Extension Service

November 30th, 2021

Russ Tweiten

Vice President-Succession & Retirement Planning

'We bring more to the table.'

AgCountry® Farm Credit Services

Income Tax Management for Ag Producers—NDSU Extension

What we will cover today:

1. Updates to proposed federal legislation that may impact estate and transition planning
2. Tax management ideas upon retirement
3. Estate planning ideas
4. Transition planning
5. Entity planning

Every farm or ranch is different. And so, each plan may be different. Every farmer or rancher will have their own idea about how this may work best.

Updates

On November 19th the House passed H.R. 5376, known as the Build Back Better Act.

Mostly spending for social programs

Now in the Senate for debate

Review of H.R. 5376 as it relates to Estate and Transition Planning

- ✓ Loss of step-up off the table.
- ✓ Transfer tax off the table.
- ✓ Retro-active changes to 1-1-2021 off the table.
- ✓ No changes to new Grantor Trusts or Life Insurance Trusts.
- ✓ No change in top capital gains tax rate.
- ✓ No change to individual top tax rate (proposal was to take this to 39.6%).
- ✓ Expands NIIT to apply to trade or business income at $400,000/single filer and $500,000 for MFJ.

Review of H.R. 5376 as it relates to Estate and Transition Planning (cont.)

- ✓ Proposal to increase Special Use Valuation limit to $11.7 million (currently $1.19 million) was not included in H.R. 5376
- ✓ Elimination of the minority discount for closely held family businesses was not in H.R 5376.
- ✓ No changes to lifetime estate and gift tax exemption. Exemption for 2022 is $12,060,000. Tax rate stays at 40% and 12-31-2025 sunset provisions remain in place.
- ✓ Annual gifting limit goes to $16,000 in 2022.

Proposals and Updates

Nothing certain as the Build Back Better Plan is still being debated.

The situation is much better than what was proposed in March and April of 2022.

Nothing has been passed by Congress yet.

Retirement Planning – Tax Management with a Successor

Tax Management Ideas:

– Filling up the lower brackets
– Maybe defer into future years?
– Use of a retirement plan (less likely with a successor).
– A solid plan for machinery (sell, gift, lease or combination)
– Is a land sale a good idea? What is the timing? How much rented land?
– Sell cattle on a cattle contract especially if cattle are raised. Maybe the calf crop is on shares or calves go to successor and all cull cows to retiring parents?

Retirement Planning – Tax Management with no a Successor

Tax Management Ideas:

- Filling up the lower brackets
- Maybe defer grain sales into future years?
- Use of a retirement plan such as a pension.
- A tax plan to control auction sale proceeds.
- Charitable Remainder Trusts (machinery and grain).
- If there are cattle, how are these handled?
    - Herd reduction (need something to do!)
    - Total sale
    - Place them on shares with a neighbor

Retirement Planning-Tax Management

Retirement Plans – 401(k)

- ✓ *If age 50 or older; 2021 maximum annual contribution of $64,500/year/person. For 2022 this rises to $67,500.*
- ✓ *Used more often during the farming years with Sole Proprietor famers. Not used much in the final years of farming.*
- ✓ *Not obligated to make contributions each year & cancel at any time. Sometimes used in conjunction with a Pension.*
- ✓ *Consider a "Safe-Harbored" plan if there are employees.*
- ✓ *Not required to withdraw income until age 72.*

There's no requirement that 401(k) money be invested in the stock and bond markets!

Retirement Planning-Tax Management

Defined Benefit Pension

- ✓ *Contributions can be high---$100,000 to $300,000+ per year.*
- ✓ *The idea is to reduce taxes—not eliminate taxes.*
- ✓ *Must have plan in place for 3 years. Pensions can run on a fiscal year using up two pension years in one tax year. Good way to control taxes on auction sale proceeds.*
- ✓ *Contribution amount based on net income, salary if a corp, age, gender, interest rates and other factors.*
- ✓ *Works well with profitable operations that have low or no debt, owners in late 50's to mid 60's, losing tax deductions, corporations and no employees . They require a lot of cash!*
- ✓ *Another way to equalize the estate with non-farming children.*

There's no requirement that pension money be invested in the stock and bond markets!

Retirement Planning-Tax Management

Charitable Remainder Trusts

- ✓ Used most often with a machinery sale but can be used with grain and land as well.
- ✓ Assets transferred to trust first and sold tax free by the trust.
- ✓ Most often used to enhance retirement income and cut the tax bill—customer is usually charitably inclined as well.
- ✓ Charitable Annuity Trust—Payments are fixed (cannot add assets).
- ✓ Charitable Uni-Trust-Payments vary (can add assets).
- ✓ Annually, must withdraw a minimum of 5% of original value and can take up to 50% of original value (5% to 8% most common).
- ✓ Charity must receive at least 10% of original value.
- ✓ Trust cannot last longer than 20 years.

Retirement Planning-Tax Management

“Operating/Tax” Lease for equipment, bins or buildings:

- ✓ Avoids the up-front tax trap on the sale of deprecated assets if sold on a contract—i.e. Installment Sale. We usually are asked “can we do a rent to own?”. This is a good time to talk lease.
- ✓ Good way to preserve successors working capital.
- ✓ Lessors (Parents/Owners) retain ownership of the equipment
- ✓ Payments deductible to the Lessee (operator). Payments subject to S/E tax for Lessor. Consider combining the lease and land rental arrangement on one document if possible.
- ✓ Duration usually for 3 to 10 years with a 15% or 20% buyout.
- ✓ Build the lease to accommodate trades and upgrades.
- ✓ If a building or bin site—sell the land on a contract with same duration as the lease.

“Machinery, Bins & Grain Handling Equipment

Your Legacy

Estate Planning

Planning for Death and Disability

“If its not in writing, it does not exist”

Estate Planning

Documents you will need:

1. Will or Trust--depends on privacy concerns and probate issues
2. Durable Power of Attorney
3. Health Care Directive review of how assets are titled.
4. A thorough review of how assets are titled. Important.

What should your customers be thinking about:

- ✓ Who represents you and makes decisions for you?
- ✓ How are assets distributed—what about grandkids?
- ✓ How will debt be handled in my estate plan?
- ✓ Business transfer (keeping the farm going) if there is a successor or asset transfer (no need to keep the farm going) if no successor

Business Transfer or Asset Transfer?

Both are Journey's—not a 2 hour meeting!

Business Transfer

- ✓ ***Transition*** *to the next generation*
- ✓ *Communication is vital*
- ✓ *What are the goals for all stakeholders*
- ✓ *Financial Viability*
- ✓ *Succession Plan*
- ✓ *Tax Control Plan*
- ✓ *Retirement Plan*
- ✓ *Estate Plan*
- ✓ *5 to 10 years.*

Asset Transfer

- ✓ ***No Transition*** *to the next generation*
- ✓ *Tax Control Plan*
- ✓ *Retirement Plan*
- ✓ *Estate Plan*
- ✓ *Time frame hinges on the process used to transfer assets- is asset protection a priority?*
- ✓ *Communication is important*
- ✓ *2 to 5 years*

Components of a Well-Structured Estate Plan

A documented plan for the land. Do you want your will or trust to contain language granting a farming child the right to buy and rent land? ***Co-owned land becoming problematic.*** If there is a contract for deed in place, how is this handled in the will?

A documented plan for the farm site. This is especially important if a farming child has paid for improvements to the site (like a bin or shop). Entity owned—what does the will say?

A documented plan for machinery and equipment. If you are gifting machinery, make sure the gift is documented and both the grantor and grantee have the same documentation. If an operating lease is in place, consider how this will be handled in the estate plan. If entity owned how is this handled?

Estate Planning—Successor or No Successor?

What is the plan?

- If there is a successor(s) then we are transferring a business via the estate plan that will take care of the surviving spouse but ultimately get the farm or ranch to the successors in a manner that keeps the operation viable.
- If we are not transitioning and there is/are no successor(s) we are transferring assets to the survivor and ultimately to family.

Is the Goal to be Fair or Equal?

"I want to be equal but fair, too". Hmm???

- ✓ Equal means the estate is split up in equal shares. A $4 million farm; 4 kids (1 farming) means each child has $1 million in their name at parent's death. Is this a good idea and is this fair to a farming heir who has spent their entire life at the farm? We still see this.
- ✓ Usually, equal is unfair to the farming children. Need some kind of recognition for sweat equity and contribution the farming child(ren) makes to the farm. Remember, this is their livelihood.

Business Transfer—Estate Plan Review

How old is your will or trust?

- ✓ Have you "tested" your estate plan—run your balance sheet through your will or trust using today's values and debt and see if the plan is viable?

- ✓ How often is the estate plan reviewed—best to review every 3 to 5 years when transitioning. Every 5 to 10 if not.

- ✓ Have you talked to your family about your estate plan?

Land Transfer Ideas While Alive

Entity Owned (Most common is a LLLP or Limited Liability Limited Partnership);

LLLP Keeps land together maybe as a "Land Legacy".

- *Can protect land plus a Buy Sell Agreement can restrict who owns.*
- *Heirs inherit an ownership in the entity vs. inheriting land.*
- *Farmers stay in control when the LLLP is transferred via the estate plan.*

Life Estate

- *Allows parents to transfer land to a child (ren) and legally retain income rights. Good way to transfer equity to a child who needs to buy land.*
- *No probate and possible **protection from a nursing home**.*

Revocable Living Trust

- *Land can remain in Trust or transfer to children in a structured manner.*
- *No probate especially for real estate owned in other states.*

Land Transfer Ideas Through your Will or Trust

Equal

- *5 kids : each inherit a 1/5 ownership in the land*
- *Ownership can fractionalize over time (1/5 heir w/3 kids = 1/15 for grandkids)*
- *Problematic when 1 or 2 want to sell and the others don't. And, how does the farmer tap into the equity when the farmer wants to buyout a couple of siblings?*

Specific

- *Each child inherits whole parcels and manages on their own*
- *Consider an Option or Right of Refusal for the farmer to rent and/or buy land from non-farming siblings.*

Farmland Trust that will own only the land

- *Land goes into a Trust at first or second passing. Why? to protect land, give time for a farmer to buy, irresponsible heirs, children not in agreement.*

Estate Planning – Machinery

Often left to the farming child

- ✓ Any machinery owned at death receives a step up in basis to market value.

Can be left to all children to "equalize" the estate:

- ✓ *Farming heir is typically given an option to buy from the estate at a reduced price (50 to 75% of value?) with proceeds distributed equally to all family members.*

- ✓ *If the discount is steep enough, proceeds often only go to non-farmers.*

Estate Planning – Farm Site

- ✓ If farm site has infrastructure (bins, shop, etc.) then typically left to the farming child.
- ✓ Where is the residence and what is the plan?
- ✓ If a farming child has erected bins, added to the grain handling system or other out-buildings and does not own the land underneath, it's important that they own the land at some point:
  - o *Important for lenders, FSA bin loans and control by the farmer*

Estate Planning-Is Asset Protection a Concern?

Yes—protection from…?

- ✓ Nursing Home
- ✓ Marital or Financial challenges with children
- ✓ Second Marriage
- ✓ Health Concerns
- ✓ Disabled Family Member

Tools and Solutions

- ➢ Insure, Sell, Gift, Self-Pay (60-month look-back)
- ➢ Trusts to retain assets, parents retain assets, pre-nup or post-nup for children
- ➢ Pre-nup, QTIP Trust in Wills
- ➢ Health Care Directive, Irrevocable Trust, Guardianship or Conservator
- ➢ Special Needs Trust, Disinherit??

Transition Plan – Next Generation

Time is your friend in Transition Planning

– Time to give the younger producer a chance to get used to running things and making decisions.

– Time to give the senior producer a chance to get used to giving up control. Get comfortable with identity.

– "Rule of 25"—When should farming children start building equity? Very case specific.

Business Transfer *Goals*
They may be different!

Older Generation Farmer

- ✓ *Successful transition-how is this defined? Timeframe?*
- ✓ *Income security*
- ✓ *Tax Control*
- ✓ *Identity, self-worth and sense of "purpose"*
- ✓ *Farming and non-farming heirs, "equal or fair"?*
- ✓ *Access to Medical Care*
- ✓ *Maybe head south for the winter or acquire a lake home*

Younger Generation Farmer

- ✓ *Successful transition-how is this defined? Timeframe?*
- ✓ *Decision making transfer-when will this happen?*
- ✓ *Growth plans & attitude toward debt*
- ✓ *What about the Will ? Do I have to share my life's work?*
- ✓ *How long will I have to rent assets?*
- ✓ *Work-family balance*

Business Transfer—Financial Viability

How many families can the farm support?

- ✓ What is the senior farmers debt?
- ✓ What are the family living figures for senior and younger generation?
- ✓ Is an off farm job necessary for the next generation or their spouse?
- ✓ How much owned vs. rented land?
  - Will the younger generation need to buy non-family land that is being rented? If this is a **"strong maybe"** or **"I'm pretty sure"** what do the parents wills say about family land at their death? Will the next generation have to buy both family and non-family land? Can the farm afford it?

Business Transfer—Succession Plan

Are the parents ready for a business partner?

- ✓ What is the plan to transfer management
  - Is the next generation involved in all aspects of management?
- ✓ What is the plan to transfer assets?
  - Sell (what can the farm afford?)*
  - Gift-most often with machinery at first, land later on (life estate)
  - Rent (often with land-this is the parents retirement income)*
  - Lease (great for machinery, bin sites, shop)*

* Will these be new expenses to the farm or ranch?

Transition Tools

Machinery:

- ✓ Gift individual pieces each year and have next generation make the trade and pay the boot.
- ✓ In the year of retirement, set up an Operating Lease ("rent to own").
- ✓ For larger operations (multi-owners) when not everyone has a successor, maybe an S-Corp for machinery and building site with a stock redemption plan as owners retire.
- ✓ Gift all or most of the machinery and increase cash rents.

Transition Tools

Bin Site and Buildings:

- ✓ Operating lease for depreciated assets and contract for deed for the land.
- ✓ Outright gift.
- ✓ Sell, but usually a big tax bill (hear again, consider a lease).
- ✓ Retain as retirement income (rare—most young farmers want some level of control here).
- ✓ In larger multi-owner operations could be placed into an S-Corp with a stock redemption plan.

Transition Tools

Cattle and Grain

- ✓ Grain is usually sold by the senior farmer and a tax plan is set up to control taxes (maybe deferring in conjunction with a retirement plan) unless debt reduction is important.
- ✓ Cattle; a contract works best for raised cattle (contracts rarely exceed 7 years)
- ✓ Cattle; Purchased cattle (most often bulls) are usually sold for cash

Transition Tools

Land

- ✓ Usually retained by parents and passed through the estate unless a protection plan is needed
- ✓ Life Estate; transfer land to children and parents retain income rights.
- ✓ Land Entity; usually a plan to protect, keep the land together, estate tax control and allow farmers to stay in control.
- ✓ Contract for deed that assures the younger producer will own the land and allows the family to determine the terms (Bargain sales are common and AFR is often the foundation for deciding interest rates).
- ✓ Cash sale to farming children using FSA programs; we are seeing this with parents who want to retire with higher levels of debt. If possible, *sell the higher basis land for cash before or a few years after retirement*.
- ✓ Always discuss "Rights of Refusals" and "Options" if land is going to non-farmers.

Entities

When are we using them?

- ✓ To make things better such as tax planning, transition planning, liability protection, administration and adding some structure to the farm.

How are we structuring them?

- ✓ Keep them simple. If the operator does not honor the proper structure or follow state law requirements, neither will the courts.
- ✓ If multiple owners, make sure a Buy Sell Agreement is in place to state who can own, how the entity is valued and terms for selling or transferring an interest to other owners or other family members
  - ✓ Not a good idea to have farming and non-farming children co-own an operating entity.
  - ✓ With a land entity, co-ownership of farming and non-farming children is OK but a very clear Buy Sell Agreement needs to be in place.

Entities

Where used

Partnerships

- ✓ Usually between related family members
- ✓ Simplify administration and maximize FSA payments
- ✓ Creates efficiencies

LLC

- ✓ When liability protection is needed
- ✓ Watch state Anti-Corporate Farming Laws if farmland is in an LLC
- ✓ For liability protection to work, all income goes to LLC checking account and expenses paid for by the LLC checkbook

Entities

Corps

- ✓ Mostly for tax management but may also need liability protection.
- ✓ Easiest entity to transition
- ✓ One FSA limit regardless of owners
- ✓ Messy and complicated to unwind

Entities

Limited Partnerships (LP, LLP and LLLP)

- ✓ Not used much as an operating entity as FSA limits are reduced to one regardless of the number of owners.
- ✓ We like the LLLP for land because of the structure. General partners control and often estate planning documents leave the general interests to farmers. Also, LLLP can make estate planning easier as parents do not need to decide how land is allocated to each child.
- ✓ Anti-Corporate Farming rules do not apply so non-farmers can set up a Limited Partnership.

Transition—Two Entity Idea

Operating Entity - (Sole Prop, General Partnership, LLC, Corp.)

- ✓ Owns Grain/Livestock
- ✓ Owns machinery, grain handling and other buildings
- ✓ Checkbook for the operation
- ✓ This entity is 100% transitioned to the next generation of farmer(s)

Land Entity - (LLLP—General Partners control, Limited Partners no control)

- ✓ Owns some or all of the land—a way to keep the land together
- ✓ Limited interests left equally to all children with farming children set up to manage and control the entity by leaving the General Interests to them via the estate plan
- ✓ Buy Sell Agreement states who can own, how to value and how to transfer
- ✓ Can help control estate taxes

What Does Not Work

- Last minute Plans
- “My kids will work it out – they get along great”
- Purchasing land from siblings when you are 60+
- Too many owners of the land
- High debt & high family living and a desire to transition or retire
- Promising all children a chance to farm
- *Poor Communication within the family*
- Last minute changes to the estate plan
- Not talking to your professionals

Success!

How to succeed with farm estate, transition and retirement planning

- ✓ ***Open, honest and ongoing Communication***
- ✓ ***Time to think, plan and adjust***
- ✓ ***Have a good Team to help you***

Thank you for Attending!

Russ Tweiten, CTFA, CRPC
VP Succession-Retirement Planning

1900 44th Street South, Fargo, ND 58103

(701) 429-7307

Russell.Tweiten@Agcountry.com