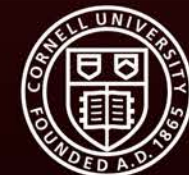


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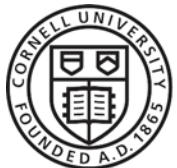
Education & Applied Research



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Selected Topics in Estate and Business Succession Planning for Agriculture

Anna Richards
Cornell PRO DAIRY

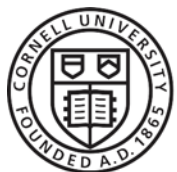


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Family vs. Business Goals

- As businesses move through the generations, not all family members may be active in the business
- Parents generally still want to include them in planning
- Business assets are often the primary source of family wealth
- What is their legacy? Priorities?
 - Perpetuation of the business
 - Preserving family wealth



Defining Business vs. Non-business Assets



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Is “The Farm” a Business or Personal Asset?

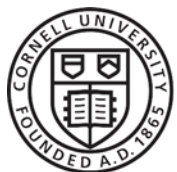
- Business Assets
 - Hard assets owned by the business entity
 - Cows, Equipment, Buildings, Inventories
 - Ownership in other entities
 - Land...maybe?
 - Multiple Entities- Ownership Pattern
 - Owned by “the business” vs. used by the business- leases



Is “The Farm” a Business or Personal Asset?

- Personal Assets

- Include business ownership: LLC Units, Partnership Interest, Corporate stock of the individual, etc.
- Actual business ownership vs. Value of business ownership



Personal Assets

- **Outside Cash Investments**
 - Easiest type of asset to deal with
 - Minimal effect on farm cash flow at time of death
 - Could eliminate or subsidize buyout/retirement \$ needed
 - **Affected farm cash flow to accumulate**
 - Decreases capital available for business use
 - Rate of Return in market vs business over time
 - Available during lifetime or at death



Personal Assets

- Life Insurance
 - Relatively easy to manage
 - Effect on business cash flow.....?
 - Who is paying the premiums? Where is the policy owned?
- Life Insurance Partnerships
 - Ownership pattern
 - Special allocations
 - Understanding Intent
 - Cash Flow



Personal Assets

- Outside Non-Cash Assets
 - Ease of liquidation?
- Outside Business Ownership- non-farm
 - Require higher level of management
 - Rents/royalties vs. Limited vs. Active
 - May be harder to liquidate- business agreements
 - Other family members involved?



Personal Assets

- Farm Related Assets- Land/Land Holding Entity
 - Requires some level of management
 - Ownership structure- individual vs business entity vs trust
 - Ability to liquidate?
 - Risk to security of farm land base vs. return to non-farm heirs
 - Lease agreements

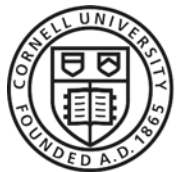


Personal Assets

- Farm Related Assets- Operating Entity ownership
 - Limited vs. General
 - Requires highest level of management
 - Difficult to liquidate
 - High risk/high potential for return



Basic Trust and Taxation Concepts



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What is a trust?

- An arrangement whereby a person holds property as its nominal owner for the good of one or more beneficiary.
- A tool to manage estate taxes.
- A tool to manage liability and creditor exposure.
- A long term care planning mechanism.
- A vessel for transferring asset ownership.

Anything you want it to be...within the law.



Trust Terminology

- Grantor- contributes principal/assets
- Beneficiary- recipient of trust assets
- Trustees- responsible for executing trust document
- Trust protector- provides oversight over trustees
- Corpus (principal)- assets contributed
- Income- income generated from trust assets
- Revocable- assets can be withdrawn by grantor
- Irrevocable- assets cannot be withdrawn by grantor



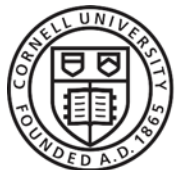
Terminology cont.

- Grantor Trust

- Grantor retains one or more power over assets
- Income is taxed directly to the individual
- Disregarded entity for tax purposes
- Generally at death of grantor becomes...

- Non grantor Trust

- Treated as its own entity
- Income is taxed at trust rates
 - Compressed tax brackets
 - No capital gains treatment



Trust Document

- Governing document of the trust
 - Similar to an operating agreement
- Names beneficiaries, trustee(s), trust protector
- Defines:
 - Type of trust
 - Terms of distributions
 - Responsibilities of trustee(s)
 - Mechanisms to replace trustees, trust protector



Contributing Assets

- Gifted by grantor
 - Complete or incomplete gift?
 - Depends on powers retained
 - Gift return filed
- Business interests vs business assets
 - LLC Units
 - S Corp Shares
 - Must be QSST to retain S status
 - Easier to manage
 - Discount valuation



Distributions

- Directed by trust document
- Executed by trustee
- Distribution of *income*
 - Taxable to the beneficiary
 - Deductible to the trust
- Distribution of *principal*
 - Not taxed to beneficiary or deducted by trust
- Discretionary vs automatic
 - Protection from creditors
 - Control by trustees



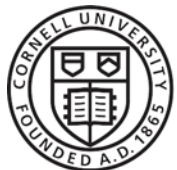
Tax Issues

- Tax Basis

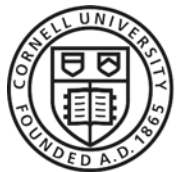
- Gifts (including to a trust): retain the donor's basis
- Inheritance (passes through an estate): step up in basis to FMV as of date of death
 - Can result in significant increase in basis/reduction in capital gain

- Estate tax

- Federal exemption 2019: \$11.4 million per individual, \$22.8 per married couple
- Portability- exemption shared between spouses
 - Must file estate tax return to elect



Use of Business Assets in Passing Family Wealth to Off Farm Family Members



Concerns?

- Effect on business cash flow
- Effect on business operation and management
- Effect on business liquidation or transfer
- Effect on future family relationships



Senior Generation

- Do you want non-farm heirs to benefit from the farm business?
- If so, when?
 - During your lifetime? Upon your death?
 - During the business's lifetime? Only upon liquidation?
- Do you want them to have to actively manage an asset or receive a dividend?
- Do you want it to be guaranteed or dependent upon asset performance?



Do you want non-farm heirs to benefit from the farm business?

No

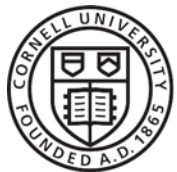
- Life Insurance
- Outside Cash Investments
- Unrelated business Investments
- Communicate value
 - Net worth vs. management required
 - Liquidity

Yes...

- More questions...



During the life of the business or only
upon liquidation?



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Only if it ceases to operate...

- Limited non-transferrable non-voting interest
 - Operating agreement- prevent withdrawal of capital
 - Buy sell agreement- prevent or limit ability to liquidate
 - Allows business to continue using capital without disrupting cash flow
 - Potential SE Tax Savings- Functional Limited Member
 - Minimal protection for non-farm heirs
 - Income tax effect



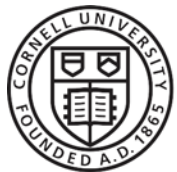
Only if it ceases to operate...

- Continuation Trust Structure
 - Business ownership contributed to trust with heirs as beneficiary
 - During lifetime- grantor trust
 - Taxed to grantor, disregarded for income tax purposes
 - After death- Requires more intensive income tax management
 - Taxed at trust level
 - Distribution of income
 - Not required- up to grantor
 - Ability to protect business cash flow
 - Distribution of principal
 - Only if business ceases to operate



Only if it ceases to operate...

- Continuation Trust Structure
 - More protection for non-farm heirs
 - Role of trustees
 - Fiduciary responsibility
 - May affect business management
 - Ability to borrow money
 - Tiered decision making in operating agreement
 - Trustee criteria
 - Familiarity with agriculture
 - Business acumen
 - Objectivity



During the life of the business...

...guaranteed or performance based?



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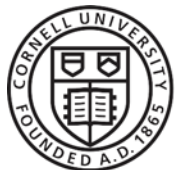
Guaranteed Return

- Land Rents
 - Ownership Structure:
 - Individuals
 - Joint Tenants vs. Tenants in Common
 - Rights of Survivorship- “Last Man Standing”
 - Ability to sell individual share
 - Ability to negotiate lease agreement terms
 - No operating agreement to govern management



Land Rents- Ownership Structures cont.

- LLC
 - Operating Agreement dictates control
 - Limited vs. General member
 - Tiered decision making
 - Negotiating Lease Agreements
 - Additional investments
 - Distributions



Land Rents Cont.

- Lease agreement dictates terms
 - Cash flow
 - Rents determined- FMV vs Cash flow need
 - Caution- unlike ownership patterns
 - Distributive share P/L
 - Guaranteed payment for use of capital
 - Purchase options
 - How value is determined
 - Terms
 - Who can force



Land Rents- Ownership Structures

- Trust
 - Land vs. LLC Units
 - Ability to retain management control
 - Manager Managed vs. Trustees
 - Buy and sell land
 - Negotiate lease terms
 - Liquidation/Distribution
 - Buy/Sell
 - Lease Agreement
 - Trust document
 - Distribution of Profits
 - Discretionary Distributions- protects from creditors, matrimonial disputes, claims, etc.
 - Net Rental \Rightarrow LLC Members by Profit % \Rightarrow Trust \Rightarrow Beneficiaries



Limited Membership- Guaranteed

- Guaranteed Payment for Use of Capital
 - Guaranteed- by definition cannot be subject to business performance
 - Not subject to SE
 - Similar to interest
 - Amount based on....
 - FMV when received?
 - Market rate? AFR? Historical business performance?



Limited Membership- Performance Based

- Profit Distribution
 - Cash flow issues
- Return to Capital- Tiered
 - Similar to GP for use of capital but tied to performance metrics
 - Challenge- determining metrics
 - No longer a GP for tax purposes (not guaranteed)



Long Term Care Issues



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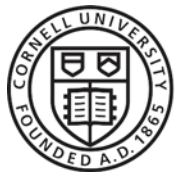
Long Term Care Planning

- Cost
 - SD: average over \$81k/year, NY: over \$100k
- Medicaid
 - Eligibility: \$2000 resources, \$2300 monthly income
 - Exceptions: community spouse, personal residence
 - Lookback period- 5 years
- Long Term Care Insurance
 - State partnerships make more affordable



Intentionally Defective Grantor Trust

- Commonly called Income Only Trust
- Grantor retains right to *income* from trust, not principal
- Disregarded for income tax purposes
- Assets are removed from Medicaid estate
- Assets pass through the estate at death
 - Preserve step up in basis
 - Consideration if close to estate tax limits
- Distribution of assets still governed by trust doc



Healthy planning looks like...

- Individual owners have the right to use the *value* of their business ownership as a personal asset in estate and family wealth planning (subject to business agreements).

AND

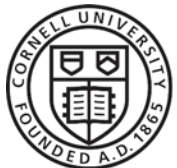
- Their business partners have the right to understand this planning and how it affects their ability to continue to operate the business.



Questions?

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