Preserving Your Legacy
PNDSA
Getting the Next Generation Ready in
Today’s Environment
Corey F. Brock

Serving Farm Families in Washington, Oregon & Idaho

Corey F. Brock, Attorney
LEGACY

• What does it mean to you?

• Do you want to preserve?

• Are you working to preserve or hoping?

• Get with people that can work with you!
GOALS

A. KEEPING FARMS IN THE FAMILY

B. SPECIFIC HEIRS TO OPERATE

C. REALISTIC CASH FLOW AND APPROACHES

D. WHAT NOT TO DO

E. PRACTICAL PLAN
The Agriculture Industry

– Market Value of Land/Unit Size
– Management/Business Technology
– Participation by both Husband/Wife
– Children Entering Management
– Non-Farm Children
– Farm as a Way of Life
– Preservation of Operating Unit
– Balancing the interest of Children
– Impact of Agriculture Policy on Estate Planning
Evaluating Your Estate Plan

• Language of Estate Planning
• Property Ownership
• Use of Business Entities
• Transferring Decision Making Control
• Gift, Estate & Income Taxes
• Calculating Retirement Costs
• Setting Goals for Retirement of Farm Transition
• Steps for Implementing Your Estate Plan
Estate Planning Documents

- Wills/Trusts
- Power of Attorneys
  - Financial
  - Health Care
- Living Will
- Community Property Agreement
- Out of State Trusts
- Long Term Care Insurance
STRUCTURING YOUR ASSETS

• Asset Protection
• Tax Planning
• Transition Planning
• Always Evolving
ENTITY CHOICES

- SOLE PROPRIETORSHIP
- GENERAL PARTNERSHIP
- LIMITED PARTNERSHIP
- CORPORATION
  - TAXED AS A REGULAR “C CORPORATION”
  - TAXES AS AN “S CORPORATION”
- LIMITED LIABILITY COMPANY
- TRUSTS
CORPORATION

• USE A CORPORATION TO HOLD THE OPERATING ASSETS

• DO NOT PUT LAND INSIDE A CORPORATION
What is a Corporation?

• A separate legal entity
• Replaces the farmer as the operator
• Opens a bank account
• Obtains a Federal I.D. Number
• Collects the operator’s share of farm income and pays the operator’s share of farm expenses
• Does operator’s business with the grain elevators, CFSA office, Treasurer, etc...
• Choose any fiscal year end and files a corporate tax return
TRUSTS

• IRREVOCABLE
  • Life Insurance
• REVOCABLE
  • Dynasty Trusts- GST
• USE TO HOLD TITLE TO LAND
• FIDUCIARY ISSUES
• WHAT IF I WANT TO CHANGE
DYNASTY TRUSTS

- Estate Tax levied at each death
- Create a “Second Estate” with GST
- Tax savings occur at deaths of descendants
- Accumulate significant wealth- TAX FREE
- Can be very flexible
ASSET PROTECTION

GOALS

- PRESERVE ASSETS
- PROTECTION FROM LAWSUITS
ASSET PROTECTION

• PROTECTING BUSINESS ASSETS
• USE LLC’S, CORPORATIONS
• INTERNAL/EXTERNAL PROTECTION
• SEPARATE DANGEROUS/VALUABLE ASSETS
ASSET PROTECTION-ADVANCED

• USING MULTIPLE LLC’S & LAYERS
• TRANSFER “C” CORP STOCK TO LLC
• BUY-SELL AGREEMENTS
• FOREIGN VS DOMESTIC ASSET PROTECTION TRUSTS
THE HANSON FARM FAMILY

Roger and Helen Hanson are 55

They have three children, Tim who is involved in the family farm operation, and two daughters, Gladice and Sally. Their children are all married and the Hansons are blessed with five grandchildren.
## HANSON’S FINANCIAL STATEMENT

<table>
<thead>
<tr>
<th>Asset</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farm Realty</td>
<td>$5,000,000</td>
</tr>
<tr>
<td>Keough/IRA/Stocks</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>95% interest in R &amp; H Hanson Farms, Inc. (operating Corp.)</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Life Insurance/Roger (Cash Value) (Death Benefit - $300,000)</td>
<td>$100,000</td>
</tr>
<tr>
<td>Life Insurance/Helen (Cash Value) D.B - $100,000)</td>
<td>$50,000</td>
</tr>
<tr>
<td>Lake Property/Idaho</td>
<td>$500,000</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$7,650,000</strong></td>
</tr>
</tbody>
</table>
Farm Business Transfer Process

- A dynamic process
- Length of the process
The Transfer Stages

1. The Testing Stage
2. The Commitment Stage
3. The Established Stage
4. The Withdrawal Stage
AGRICULTURAL INDUSTRY GOALS

A. Minimize Federal Estate Tax and State Estate Tax Costs
B. Provide for Succession Planning
C. Protect Income to Roger and Helen
D. Provide for Safeguards from Divorce, Bankruptcy and non-approved transfers (non-lineal Heirs)
E. Maintain CONTROL to Roger/Helen and then to their children
GOALS (continued)

F. Purchase and/or operate additional land
G. Maintain 960 limitation issues
OPERATING STRUCTURE

Hansen Family Farms Partnership

Mom/Dad Corp

Kid Corp

Land LLC

• Operating Entity - Hansen Farms

• Not Changing How Farming

• The Why
How to Accomplish Goal of Minimizing Federal / State Estate Tax

A. Need to Gift Several Hundred Thousand Dollars of Asset Equity over the Next 15-20 years.

B. Utilize $14,000 (2016)Annual Gift Tax Exclusion Per Done Per Year
USES OF A LLC

• TRANSITION PLANNING
• CONTROL OF ASSETS
• LAND HOLDING – RENTAL OF LAND ISSUES
• APPROPRIATE LEASES
• NEXT GENERATION FAMILY MEMBER COMING BACK TO FARM
What is a LLC

• A separate legal entity
• Not a Corporation
• By owning the Farm Realty, Replaces Roger/Helen as the Landlord
• Opens a Bank Account
• Obtains a Federal ID #
• Collects the Landlord’s share of Farm income/pays LL’s share of Farm Expenses
• Does the Landlord’s Business with the Elevators, FSA Offices, Treasurer, etc.
• Has a 12/31 Year End and Files a 1065 Partnership Return
Taxation of a LLC

• Partnership Not a Taxpayer – It is a Pass Through Entity
• Partners Report Their Distributive Share of Profits/Losses as Shown on K-1
• Assume Hanson Family LLC Nets $50,000 of Income
  – If Roger/Helen own 100% - Report all on their individual Tax Return
  – If Children own 2% - then they each would report 2% ($1,000 on their Tax Return and Roger/Helen report theirs at 94% ($47,000))
Estate Tax Issues

- Federal - $5,450,000.00 (2016)
- Washington State - $2 Million
- $2,054,000 Exemption (2016)
- Farm Exemptions
- This typically goes away for “Retired Farms”
Formation of the LLC

- Roger and Helen Transfer Farm Real Estate

- Hanson Family LLC
  - Farm Real Estate - $2,000,000

- 500 Units of Preferred LLC Membership Interest
- 24,500 Units of Common LLC Membership Interest
- Value - $200/Unit based on FMV of Contributed Assets

- Roger and Helen are the LLC Managers
# The Gifting Process
Roger and Helen Gift from Their 24,500 Common Units

<table>
<thead>
<tr>
<th>Year</th>
<th>Units</th>
<th>Value</th>
<th>Discount</th>
<th>Net Gift</th>
<th>Tim</th>
<th>Gladice</th>
<th>Sally</th>
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<tbody>
<tr>
<td>2016</td>
<td>200</td>
<td>$40,000</td>
<td>40% ($16,000)</td>
<td>$24,000</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>2017</td>
<td>200</td>
<td>$40,000</td>
<td>40% ($16,000)</td>
<td>$24,000</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>2018</td>
<td>200</td>
<td>$40,000</td>
<td>40% ($16,000)</td>
<td>$24,000</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>2019</td>
<td>200</td>
<td>$40,000</td>
<td>40% ($16,000)</td>
<td>$24,000</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
</tr>
</tbody>
</table>

Over a 4 Year Period – 24% of LLC ($480,000) Transferred vs. $288,000 (difference of $192,000 in Value)
Cash Flow

A. Manager’s Complete Discretion
B. Normally distribute cash to pay Partner’s Income Tax
C. May make Disproportionate Distributions
D. Example – Assume 2016 – Net of $50,000

1. Roger and Helen (82%) $41,000
2. Tim, Gladice, Sally (6% each) $3,000 Each

Roger and Helen could distribute $1,000 of their distributive share to each child – and that leaves $2,000 allocated to each child’s capital account, but Roger/Helen could distribute the $6,000 cash to themselves.
Control – Control - Control

A. Hansons are the designated managers/may designate successor manager

B. Complete control over all farm decisions relating to the land – rent/sell/exchange, etc.

C. Complete control over cash flow/distribution decisions

D. As Complete Prohibition on transfer of ownership of units as possible – typically want transferability only to Hanson Family Lineal descendants without prior approval
OTHER BENEFITS

• PROPER STRUCTURING OF OUR FAMILY FARM IS ESSENTIAL TO A TRANSITION PLAN THAT WORKS FOR THE FAMILY.

• USE OF PROPER ENTITIES IS THE ESSENTIAL COMPONENT OF YOUR FAMILY TRANSITION PLAN.

• WHAT ABOUT A TRUST.
Transition Planning

• Keep control of farm operation while younger generation transitions into operation
  – Usually no means to buy out parents
  – Parents want to keep control
  – Avoid losing farm to in-laws; creditors

• Retire for Social Security purposes
  – Collect Social Security
  – Keep all the benefits of the Corporation as an employee of the Corporation

• No double taxation of dissolution planned for
GOALS

• What are your Goals;
  – Transition to the kids
  – Protect one of the kids so they can farm
  – Protect your wealth
  – Easy Transition – do not set the kids up for failure
  – Do not pay Estate Taxes to Uncle Sam
  – Treat the Kids fairly
Accomplish the Goals

• Just get started on the transition plan;
• The transition plan will change throughout your lifetime; so create it with flexibility
• The estate/probate is the very last thing, and is very simple

• JUST TELL ME YOUR GOALS, AND

• DON’T WORRY ABOUT THE PROCESS, I WILL GET YOU THERE, JUST GET STARTED
Use of LLC to Buy Land

- Set up LLC
- Set up Irrevocable Trust with children as Beneficiaries
- Transfer LLC interest to the Trust
- LLC buys new land
- Maintain Control
- Economics will change – watch out for the swings.
Split Interest Purchase

Paying for the Land Purchase with 15% After Tax Dollars

• Split-Interest Purchase
• Corporations acquired a temporary interest in the land with remainder held personally
• Remainder holder obtains full ownership after expiration of term
• Not advisable under current law for a corporation to purchase land
• Cannot use split-interest purchase with related individuals because of anti-freeze rules
• Remainder holder receives full basis at end of term
Split Interest Purchase

Example – Tax Effect of $100,000 Real Estate Purchase

• Hanson family purchases land for $100,000 on a ten-year note at 9%

• Purchase personally
  – Hanson family needs $175,000 of farm income to pay IRS his $75,000 of tax to leave $100,000 to Hanson’s to pay the principal

• Split Interest
  – The Hanson family and their corporation need $118,000 of farm income to pay IRS $18,000 of tax to leave $100,000 to Hanson’s to pay the principal
Split Interest Purchase

$57,000 Savings Into Your Pocket
WHAT NOT TO DO

- Do nothing
- One size does not fit all
- Create flexibility
- Watch out for TRUST TERMS.
- END
Final Thoughts

• New era of business
• Need a team for the future, not the past
• Create **YOUR** plan, not buy somebody’s product