CliftonLarsonAllen

Farm Retirement & Transition Planning Webinar

Rod Mauszycki, JD, MBT
Paul Neiffer, CPA

July 20, 2016

Disclaimers

The information contained herein is general in nature and is not intended, and should not be construed, as legal, accounting, or tax advice or opinion provided by CliftonLarsonAllen LLP to the user. The user also is cautioned that this material may not be applicable to, or suitable for, the user's specific circumstances or needs, and may require consideration of non-tax and other tax factors if any action is to be contemplated. The user should contact his or her CliftonLarsonAllen LLP or other tax professional prior to taking any action based upon this information. CliftonLarsonAllen LLP assumes no obligation to inform the user of any changes in tax laws or other factors that could affect the information contained herein.

Housekeeping

Technical Difficulties	• Call **800-422-3623**
Q&A session	• Submit questions in Q&A box anytime during presentation • Speakers will answer questions at end
Presentation Recording	• The presentation will be recorded. • You will receive link to recording within 10 days.
Survey	• Please complete survey at end of session.

About CliftonLarsonAllen

- A professional services firm
  - Wealth Advisory
  - Outsourcing
  - Audit, Tax, and Consulting
- More than 4,500 employees
  - More than 100 agribusiness professionals

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC.

Agribusiness Focus

FarmCPAtoday.com
Blog

5000+ Producer Clients

250+ Cooperative Clients

400+ Processor Clients

550+ Farm Input Clients

CliftonLarsonAllen

Farm CPA Today

BY: PAUL NEIFFER | TRACKBACK LINK | NO COMMENTS JULY 10TH, 2016

Wheat Growers to get 61 Cents From 2015 PLC

Art Barnaby of Kansas State University released his latest information on the MYA prices for the major crops for the 2015/16 marketing year. The corn and soybeans marketing year ends August 31, however, wheat (and other cereal grains) ends May 31. For the 2015 harvested wheat crop, the final MYA price is determined for the [...]

More

BY: PAUL NEIFFER | TRACKBACK LINK | NO COMMENTS JULY 7TH, 2016

Will CCC Loans Limit My Farm Loss

The tax laws require excess farm losses to be limited if the farmer receives an applicable subsidy or has a loan from the Commodity Credit Corporation (CCC). Applicable subsidies were direct, counter-cyclical and ACRE payments under the old 2008 Farm Bill. These payments were repealed by the 2014 Farm Bill, however, loans from the CCC [...]

More

We Help Farmers Succeed

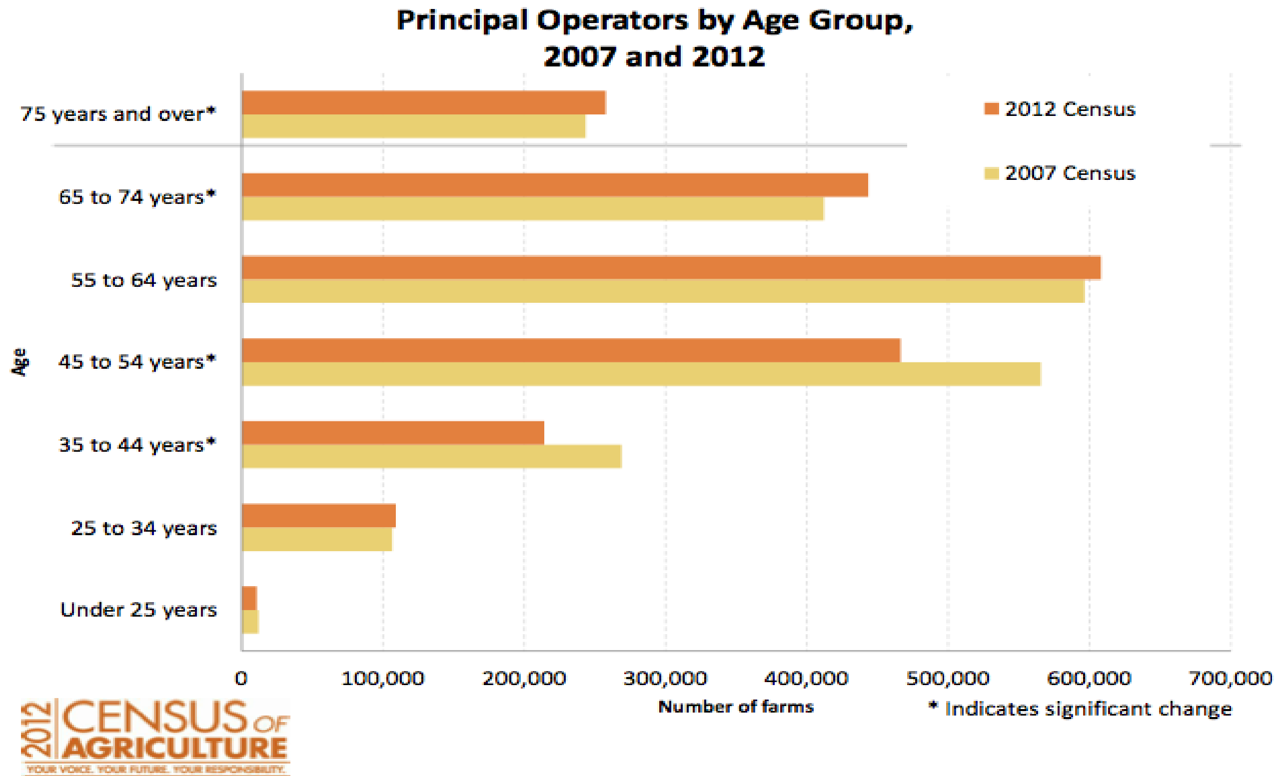
Speakers

- **Rod Mauszycki, JD, MBT**
  - 612-397-3076
  - Rod.Mauszycki@CLAconnect.com

- **Paul Neiffer, CPA**
  - 509-823-2920
  - Paul.Neiffer@CLAconnect.com

Why Succession/Transition Planning?

- Aging demographics
  - Average age 58.3 years (2012)



Why Succession/Transition Planning?

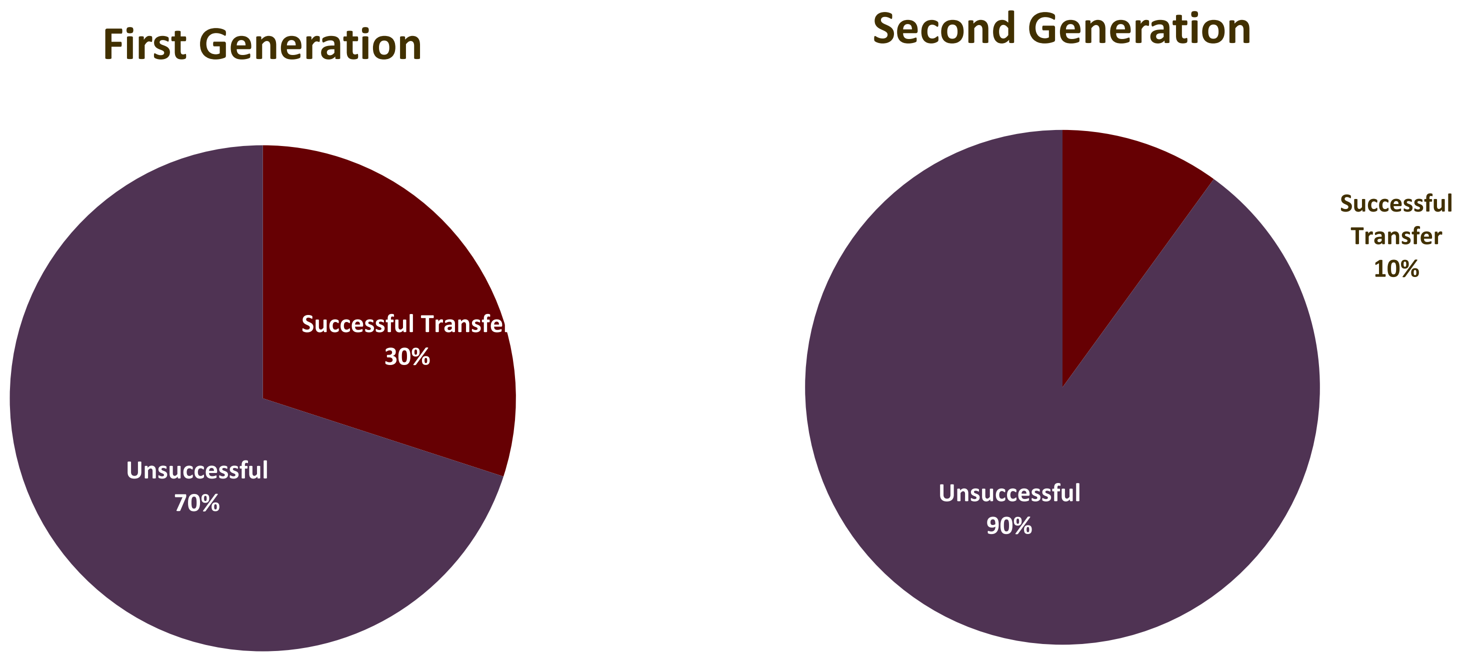
- Disturbing trend – number of beginning farmers is shirking!
  - More farmers over the age of 75 than between the ages of 35-44

- Why???
  - High cost to enter farming?
  - Opportunities away from the farm

- What is the result… end of a culture/way of life?????

Why Succession/Transition Planning?

- Its difficult to transition a family business!
  - 33% survive Gen 1 to Gen 2
  - 10% survive Gen 2 to Gen 3



Why is This so Hard?

- History and work ethic
  - How many of your parents worked into their 70s or 80s?
  - How many of you will work into your 70s or 80s?
- Mindset
  - How many of you inherited or purchased your parents farm in your late 40s or 50s?
  - How many of you have the mindset that your kids have not paid their dues?

Why is This so Hard?

- Types of assets make it difficult to transition smoothly
  - Grain/livestock
  - Depreciable equipment
- Added complexity due to debt/leverage

Why is This so Hard?

- Reinvestment in farming operation
  - Little retirement savings, net worth tied up in the farm
  - Need $ in retirement

- Probably the most challenging… "Fair but unEqual?"
  - How to treat on farm versus off farm kids

Questions to Ask Yourself…

- Where are you at in your career as a farmer?
  - Growth
  - Sustain
  - Wind down
- Have you had discussions with your kids?
  - Do any want to farm?
- How well do you know your financials?
  - Can the farm support another family?
  - Can the farm generate enough income for your kid(s) to buy you out?

Questions to Ask Yourself…

- How important is a legacy farm?
- Are you willing to give up some control?
- What is “fair” and does it have to be “equal?”

How Do You View Your Estate?

Assets and Liabilities

Savings

Farm Operation

Land

Equipment

Life Insurance

Debt (Equipment, Land, Operating)

- **Land (and debt)**
  - Land Partnership
- **Farm Operation (and debt)**
  - To Farm Kids – Sell or Gift
- **Equipment (and debt)**
  - To Farm Kids – Sell or Gift
- **Homestead (not farm buildings)**
  - To Farm or All Kids?
- **Other Assets (Savings, IRAs)**
  - Perhaps Non-farm Kids
- **Life Insurance Trust (pay taxes)**
  - To Farm Kids to Buy Out Non-farm Kids or to Non-farm Kids to Balance Estate

Tax Consequences of Outright Sale

Disposition of Operating Assets

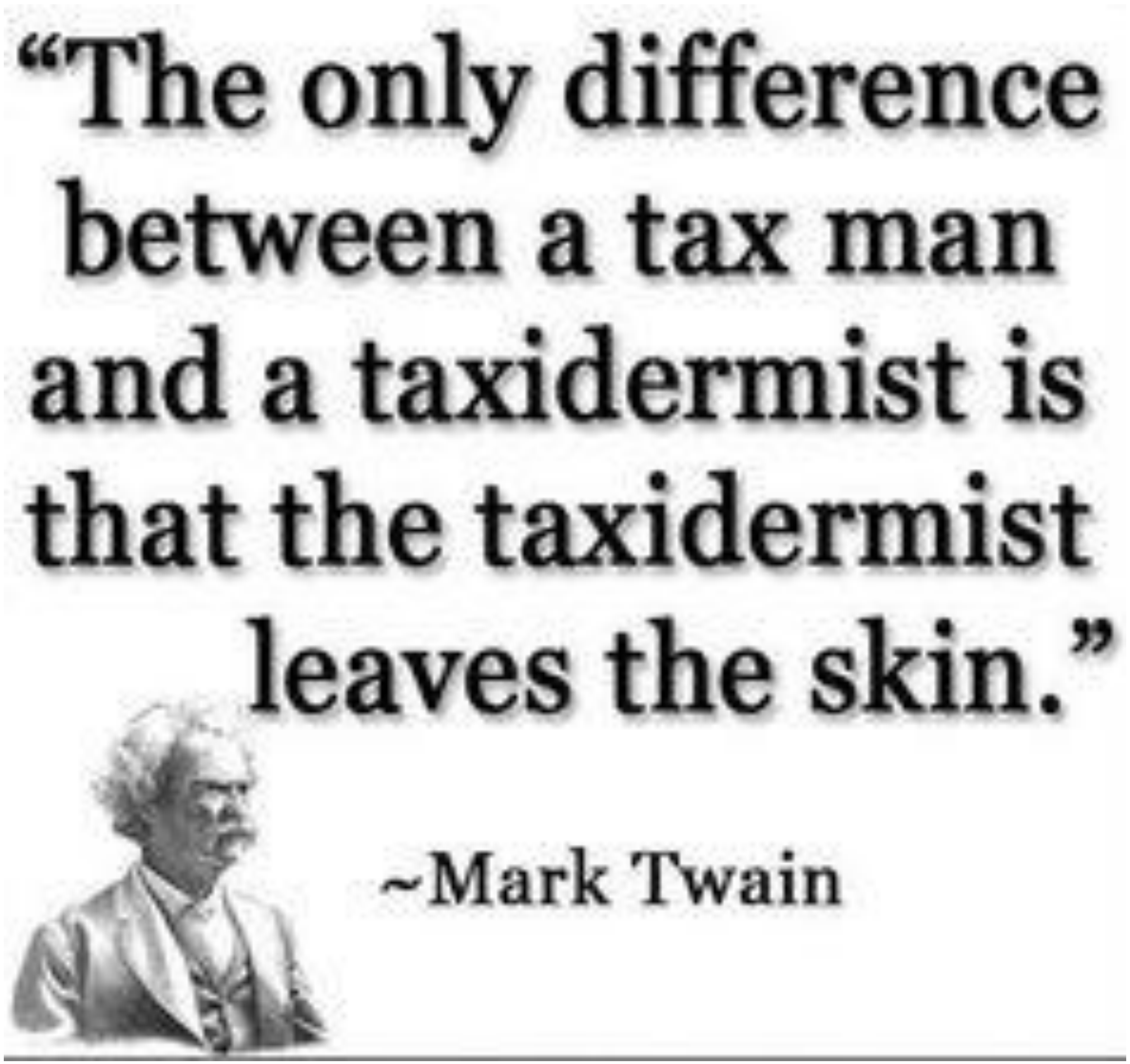
	Ordinary or Cap. Gain?	Installment Method?	SE Tax?
• Grain	Ordinary	Yes	Yes
• Livestock: Resale	Ordinary	Yes	Yes
• Livestock: Breeding-raised	Cap. Gain	Yes	No
• Depr. machinery/ breeding stock	Ordinary	No	No
• Bins, barns, tiling, irrig.	Ordinary	No	No
• Land	Cap. Gain	Yes	No

Income Tax Treatment

- Sell machinery for installment note?
  - Immediate ordinary income "depreciation recapture"
  - Lease alternative (but danger that IRS recharacterizes as a disguised sale)
- Disposition of grain?
  - Ordinary income and SE Social Security tax

Tax Rates

- Federal Married Filing Joint
  - AGI over $464,850… 39.6%
- State income tax rates
  - 0% to 13.3%
- SE tax on earned income up to $118,500
  - 15.3% (with subtraction, 8-10%)
- Federal Phase Outs… starting at $259,400
  - Could add an additional 2%+ to your tax bill


"The only difference between a tax man and a taxidermist is that the taxidermist leaves the skin."
~Mark Twain

CliftonLarsonAllen

Tax Consequences of Gifting

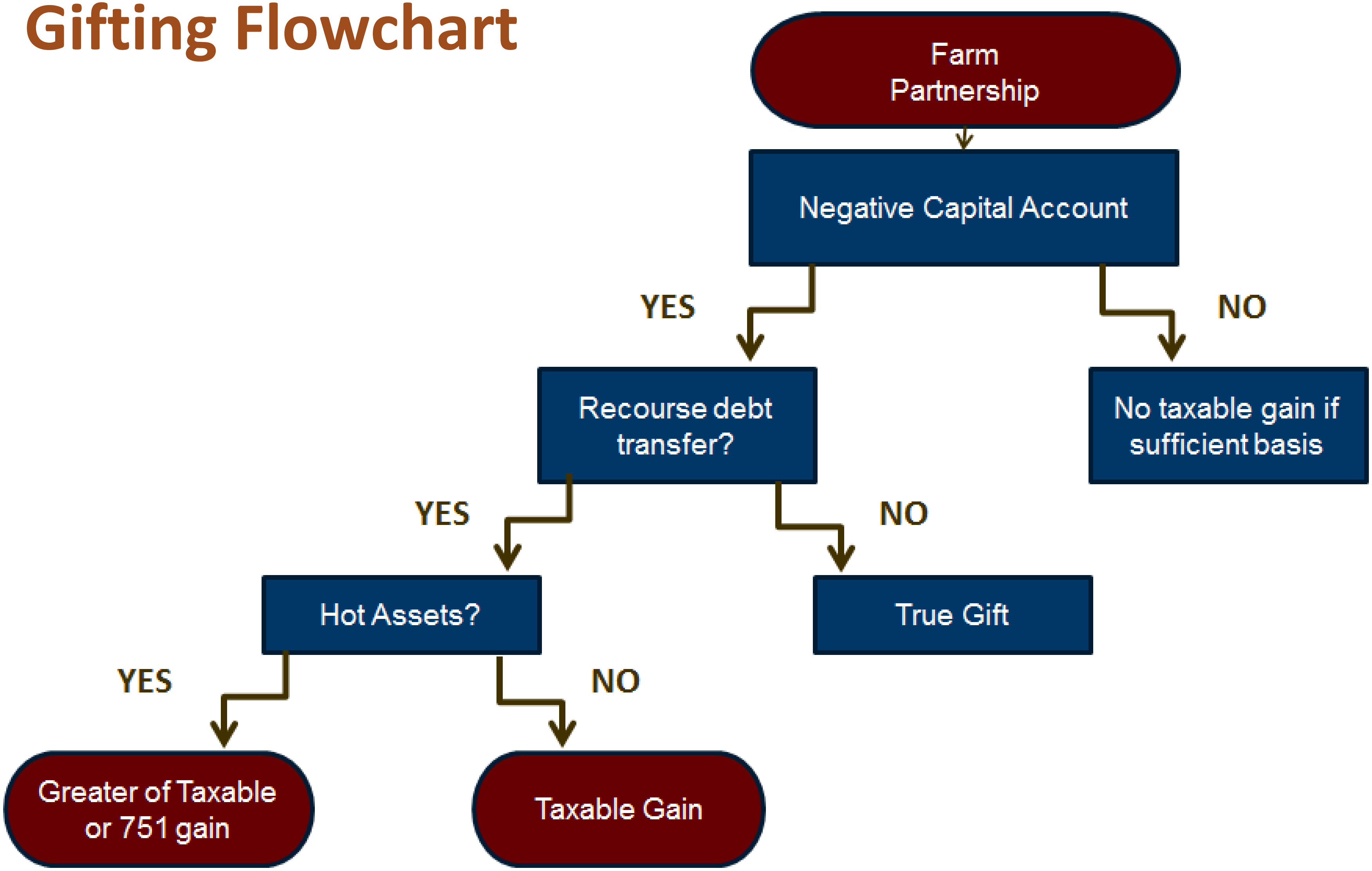
Gifting Partnership Interest

- Annual Gift Exclusion: $14,000 per person
- Federal Gift Exemption: $5.45M per person

When Does Gifting Create an Issue?

- Do you need the assets to generate $ for retirement?
- Transfers of property (including partnership interest) which is subject to recourse debt – potential taxable income.
- Huge issue in agriculture due to negative capital accounts and hot assets.

Gifting Flowchart



CliftonLarsonAllen

Use of a Partnership or Corporate Entity to Transition the Operating Assets

Entity Choices

- Types of Farming Entities
  - SMLLC, Schedule F
  - General Partnership
    - ◊ Farm Bill payment limitations
  - LLC
    - ◊ More and more popular
  - S Corp
    - ◊ Legacy C Corps or leasing operations
  - C Corp
    - ◊ Legacy farming entity

Forming a Farm Partnership (LLC)

- Liability protection while providing flexibility
  - One in a millions do happen!
- Pass through taxation
- Simplifies farm transition process
  - Ease of gifting/sale
  - Profit Interest
  - Fair/Equal argument

Forming a Farm Partnership (LLC)

- Ways to transfer a partnership interest
  - Gift
    - ◊ Annual exclusion or federal gift exemption
    - ◊ Caution – potential tax consequences!
  - Sale
    - ◊ Buyer can get a step up basis in assets
    - ◊ Caution – depreciation recapture
  - Investment
    - ◊ Can buy into a partnership and receive equity interest
  - Inheritance
    - ◊ Transfer at death
  - Profit Interest

Profit Interest

- Great way to transfer through “sweat equity”
- Son/daughter gets a percentage of profits in the partnership.
- Over time, if they do not withdraw all of the profits allocated to them, their capital account increases.
- As capital account increases, equity percentage increases.
- Acquiring a profit interest is not a taxable event.
- CAUTION: Must not be a sham transaction – must have economic substance! Can’t be for tax avoidance.

Profit Interest

- Example: Frank is Nathan and Eric's father. Frank is winding down his career and wants Nathan and Eric to take over. As Nathan and Eric are key parts of his company, he provides each with a 20% profit interest.
- Assumptions:
  - Value of business: $1,200,000
  - Profits: $130,000/year, increase 3% per year
  - Tax distributions only (32% of profits)

Profit Interest

	Frank	Eric	Nathan		Frank's Capital Interest	Eric's Capital Interest	Nathan's Capital Interest		
Year 1	$1,200,000	$17,680	$17,680		97.14%	1.43%	1.43%		
Year 2	$1,200,000	$18,210	$18,210		94.36%	2.82%	2.82%		
Year 3	$1,200,000	$18,757	$18,757		91.65%	4.17%	4.17%		
Year 4	$1,200,000	$19,319	$19,319		89.03%	5.49%	5.49%		
Year 5	$1,200,000	$19,899	$19,899		86.47%	6.76%	6.76%		
Year 6	$1,200,000	$20,496	$20,496		83.99%	8.00%	8.00%		
Year 7	$1,200,000	$21,111	$21,111		81.58%	9.21%	9.21%		
Year 8	$1,200,000	$21,744	$21,744		79.24%	10.38%	10.38%		
Year 9	$1,200,000	$22,396	$22,396		76.96%	11.52%	11.52%		
Year 10	$1,200,000	$23,068	$23,068		74.75%	12.63%	12.63%		
Year 11	$1,200,000	$23,760	$23,760		72.60%	13.70%	13.70%		
	$1,200,000	$226,442	$226,442						

Profit Interest

- Tax savings –
  - Nathan and Eric probably at a lower tax bracket
  - Lowers Franks estate
- Within 10 years, Frank transfers over 25% of his business to Nathan and Eric.
- In theory, the amount kept in the business could be used to buy out Frank at a later date. As this is money Nathan and Eric already paid tax on, it is essentially a saving account.
- Great way to transfer ownership over a period of years.

Forming a Farm Corporation

- Capital gains treatment
- Option if limited time

Case Study 1: Active Operations to Successor

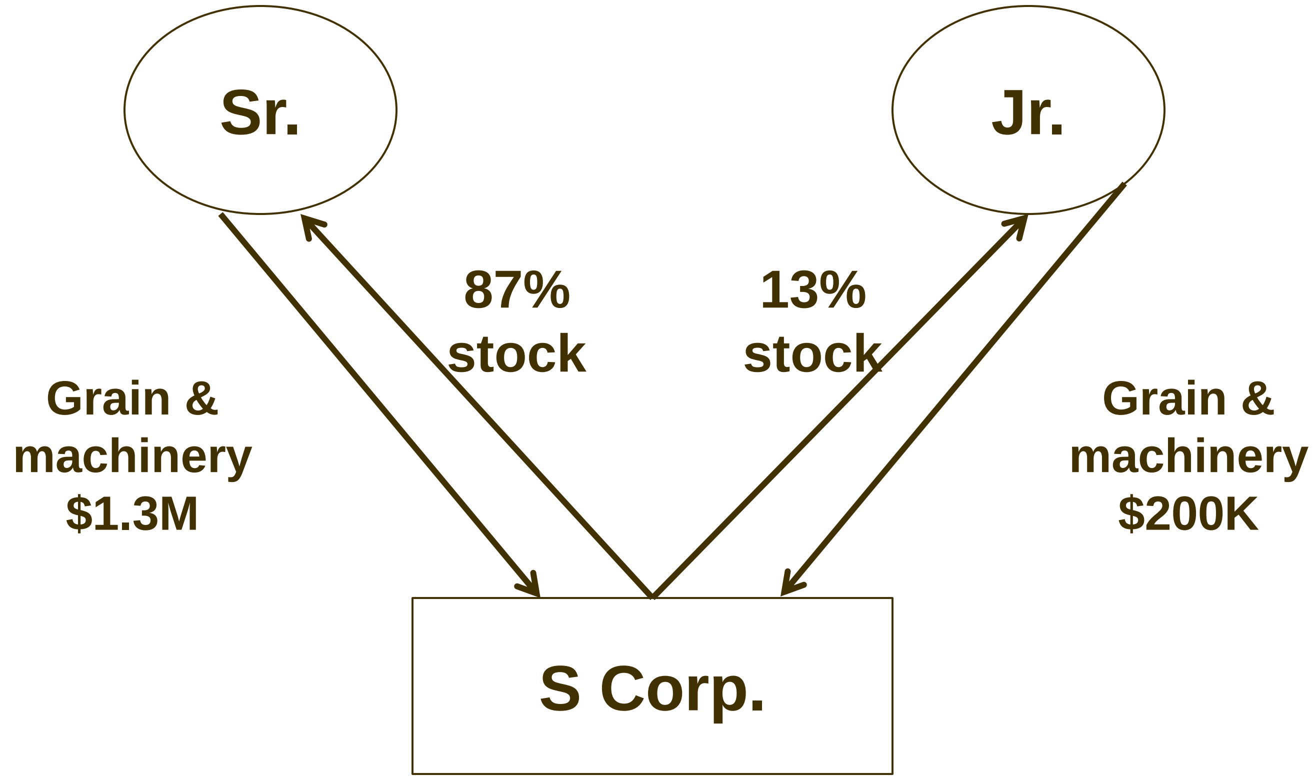
Plan A: Liquidate grain/lease & sell machinery to Jr.

	Federal tax		
	Income Tax	Soc. Sec. Tax	
Asset	(35% blended)	(9% blended)	Total
$800K grain	$280K	$72K	$352K
$500K machinery	$175K	$ -	$175K
$1.3M	$455K	$72K	$527K

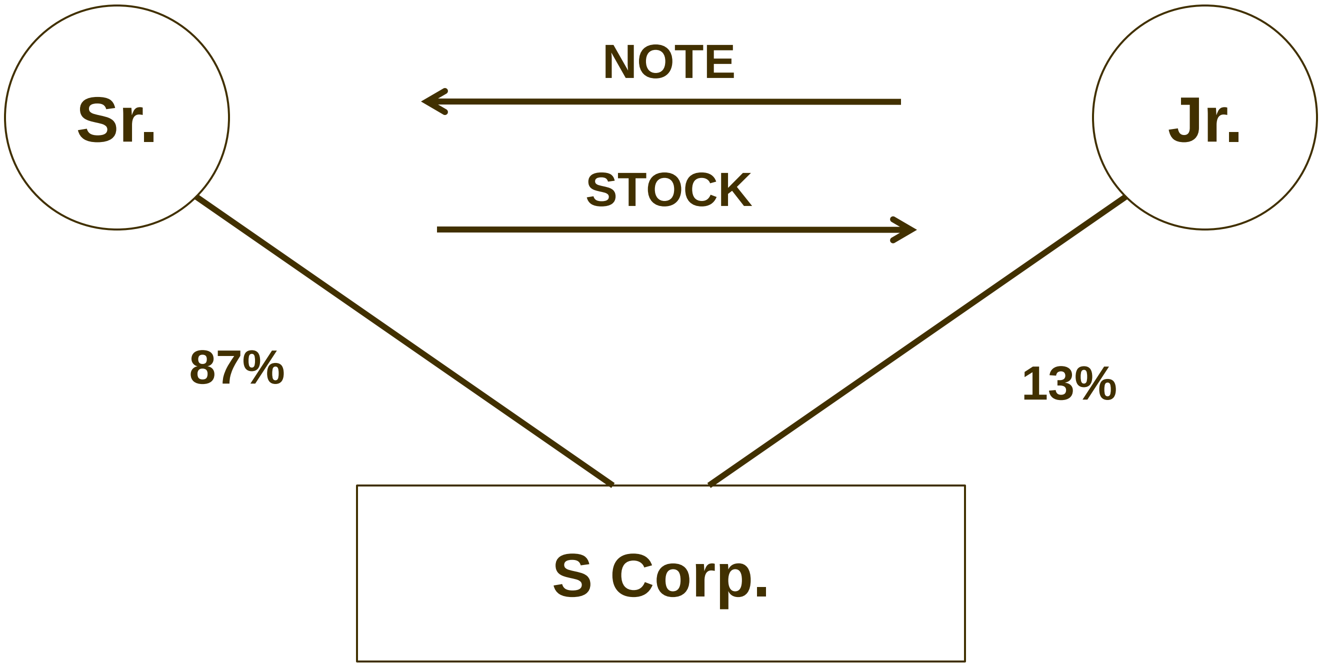
41% Combined Tax

Case Study 1: Active Operations to Successor

Plan B: Use an Entity to Transition Operating Assets



Case Study 1: Active Operations to Successor



$1.5M grain & machinery

Case Study 1: Active Operations to Successor

Strategies with corporate entity:

- Capital gain & no SE tax to Sr. on stock sale
  - Cuts effective tax rate from 40% to 20% (or lower)
  - Spread gain over term of note (e.g., 10 yrs.)
    - ◊ Low interest rates - AFR
- Sell stock in minority increments with discounts
- However, Jr. does not get fresh depreciation on assets
- Consider reorganizing into voting & non-voting shares
  - Sr. can dispose of most stock, but retain control if desired

CliftonLarsonAllen

Use of a Limited Liability Land Entity

Transitioning the Land

- Gift
- Sale
  - Outright
  - Seller-financed (installment sale)
- Combination gift-sale

[Same choices, whether transferring acres or entity shares]

Part Gift – Part Sale Strategy

<u>Example</u>

- Low basis (i.e., tax cost) in land
- Objective: Sell to a family member at a price that can be paid in an installment sale using annual cash rents
- Bargain element (full FMV less sale price) = gift

Part Gift – Part Sale Strategy

Example	Per acre	
• Full appraised FMV	$9,500	
		$4,500 gift
• Sale price (to family)	$5,000	
		$4,000 cap. gain
• Tax basis (cost)	$1,000	

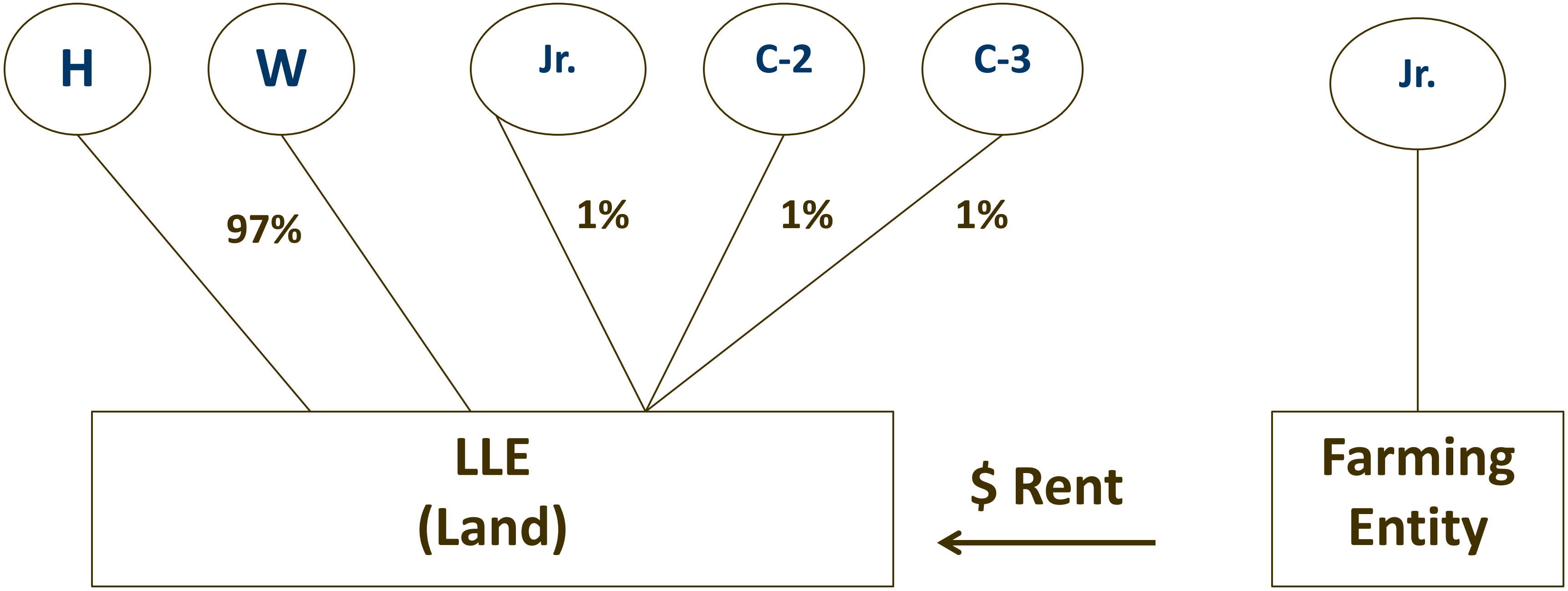
- Basis entirely allocable to offset gain

Example 1: Farming Successor

Facts:

- Dad and Mom ages 75 and 73; 1,400 acres of land
- Net worth about $13.5M ($12M land + $1.5M investments)
- Three children, Child 1 (Jr.) is a farmer who leases land from Dad and Mom
- Active farm assets (inventory & machinery) owned by Jr.; Dad and Mom are retired landlords
- Objectives: Hold land together and assure Jr. has access to lease and buy land

Example 1: Limited Liability Entity



Example 1: Limited Liability Entity

Additional LLE document issues if tenant-successor:

- Equal percentage to children?
- Define Jr. as having first right to lease and define terms
  - Example: 95% of county extension average lease rates
- Define right of Jr. to purchase land parcels from partnership (e.g., appraisal mechanism; seller-financed terms)

Example 1: Limited Liability Entity

Additional LLE document issues if tenant-successor:

- Consider specific designation of voting units
  - Example: 3 voting units: Dad, Mom and Jr.
  - At second parent's death, 1 unit to Jr. & 1 to non-farm child
  - Jr. has control (2 of 3 votes), but one child to monitor compliance with LLE document

CliftonLarsonAllen

1031 Exchanges

1031 Exchanges

- Exchanging farmland for farmland without recognizing gain (tax)
- Can exchange farmland for commercial property (estate planning idea?)

Issues with 1031 Exchanges

- Complexity
- State law dictates (waterway, ditch rights, growing crop)
- DOES NOT APPLY TO STOCKS AND PARTNERSHIP INTERESTS.
- 2 year rule for related party exchanges
- Land with 1245 assets (single purpose ag structures, irrigation, tiling, etc.)
  - Recapture if land acquired does not have sufficient 1245 assets attached.

CliftonLarsonAllen

Use of a Charitable Remainder Trust for Grain and Inventory Dispositions

Disposition of Low Basis Commodities

- Spread sales over several tax years
  - But multiple yrs. of first tier Soc. Sec. tax (15.3% on first $118,500; 2.9% on excess)
  - Medicare tax from 2.9% to 3.8% > $200K single/ $250K joint
  - Miss high grain prices by holding crop?
- Sell early at high price and take installment payments
  - Credit risk?
  - Multiple years of Soc. Sec. tax cost

Disposition of Low Basis Commodities

Strategies:

- Fund a qualified retirement plan to shelter high SE income
  - Reduces income tax but not SE tax
- Use a Charitable Remainder Trust
  - Sell in CRT; spread income tax over term of years; avoid SE tax!

Charitable Remainder Trusts (CRT)

Charitable Remainder Trusts

<u>Advantages</u>

- Defer income up to a 20-year term
  - Lower federal income tax rates
  - No SE Soc. Sec. Tax
- Commodity can be sold by Trust with no tax
- Less federal tax; trades off with residual to charity
  - 10% minimum net present value to charity

Charitable Remainder Trusts

- Annuity Trust
  - Fixed payout
  - No additional funding
- Unitrust
  - Payout is % of annual value
  - Additional assets can be contributed

CRT for Farmers

- Funding a CRT with ordinary farm assets (PLR 9413020)
  - No income or SE tax to proprietor for inventory or fully depreciated equipment (other than potential Section 179 recapture)
  - Expenses allowable for current year crop
  - CRT sells inventory tax-free
  - Distributions from CRT = ordinary income but not Self Employment income

CRAT

Year	Beginning Principal	7.00% Growth	Payment	Remainder
1	$1,500,000.00	$105,000.00	$84,150.00	$1,520,850.00
2	$1,520,850.00	$106,459.50	$84,150.00	$1,543,159.50
3	$1,543,159.50	$108,021.17	$84,150.00	$1,567,030.67
4	$1,567,030.67	$109,692.15	$84,150.00	$1,592,572.82
5	$1,592,572.82	$111,480.10	$84,150.00	$1,619,902.92
6	$1,619,902.92	$113,393.20	$84,150.00	$1,649,146.12
7	$1,649,146.12	$115,440.23	$84,150.00	$1,680,436.35
8	$1,680,436.35	$117,630.54	$84,150.00	$1,713,916.89
9	$1,713,916.89	$119,974.18	$84,150.00	$1,749,741.07
10	$1,749,741.07	$122,481.87	$84,150.00	$1,788,072.94
11	$1,788,072.94	$125,165.11	$84,150.00	$1,829,088.05
12	$1,829,088.05	$128,036.16	$84,150.00	$1,872,974.21
13	$1,872,974.21	$131,108.19	$84,150.00	$1,919,932.40
14	$1,919,932.40	$134,395.27	$84,150.00	$1,970,177.67
15	$1,970,177.67	$137,912.44	$84,150.00	$2,023,940.11
16	$2,023,940.11	$141,675.81	$84,150.00	$2,081,465.92
17	$2,081,465.92	$145,702.61	$84,150.00	$2,143,018.53
18	$2,143,018.53	$150,011.30	$84,150.00	$2,208,879.83
19	$2,208,879.83	$154,621.59	$84,150.00	$2,279,351.42
20	$2,279,351.42	$159,554.60	$84,150.00	$2,354,756.02
Summary:	$1,500,000.00	$2,537,756.02	$1,683,000.00	$2,354,756.02

CRUT optimized

Year	Beginning Principal	Principal Growth	Income Rec'd/Accr'd	Distribution	Remainder
1	$1,500,000.00	$96,389.48	$0.00	$164,010.00	$1,432,379.48
2	$1,432,379.48	$92,044.20	$0.00	$156,616.37	$1,367,807.31
3	$1,367,807.31	$87,894.82	$0.00	$149,556.05	$1,306,146.08
4	$1,306,146.08	$83,932.49	$0.00	$142,814.01	$1,247,264.56
5	$1,247,264.56	$80,148.78	$0.00	$136,375.91	$1,191,037.43
6	$1,191,037.43	$76,535.65	$0.00	$130,228.03	$1,137,345.05
7	$1,137,345.05	$73,085.40	$0.00	$124,357.31	$1,086,073.14
8	$1,086,073.14	$69,790.68	$0.00	$118,751.24	$1,037,112.58
9	$1,037,112.58	$66,644.49	$0.00	$113,397.89	$990,359.18
10	$990,359.18	$63,640.13	$0.00	$108,285.87	$945,713.44
11	$945,713.44	$60,771.21	$0.00	$103,404.31	$903,080.34
12	$903,080.34	$58,031.63	$0.00	$98,742.80	$862,369.17
13	$862,369.17	$55,415.54	$0.00	$94,291.45	$823,493.26
14	$823,493.26	$52,917.39	$0.00	$90,040.75	$786,369.90
15	$786,369.90	$50,531.86	$0.00	$85,981.68	$750,920.08
16	$750,920.08	$48,253.86	$0.00	$82,105.60	$717,068.34
17	$717,068.34	$46,078.56	$0.00	$78,404.25	$684,742.65
18	$684,742.65	$44,001.32	$0.00	$74,869.76	$653,874.21
19	$653,874.21	$42,017.73	$0.00	$71,494.61	$624,397.33
20	$624,397.33	$40,123.55	$0.00	$68,271.60	$596,249.28
Summary:	$1,500,000.00	$1,288,248.77	$0.00	$2,191,999.49	$596,249.28

Questions?

Contact Information

Rod Mauszycki
612-397-3076 (direct)
rod.mauszycki@CLAconnect.com

Paul Neiffer, CPA
(509) 823-2920 (direct)
paul.neiffer@CLAconnect.com

To receive future webinar invitations, subscribe at CLAconnect.com/subscribe.