



SCHOOL OF LAW

# “ESTATE AND SUCCESSION PLANNING – KEY CONCEPTS FOR A SUCCESSFUL TRANSITION”

*Women Managing the Farm Conference*

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# Washburn University School of Law Courses That Relate to Agricultural Law

- **Advanced Oil & Gas Law**
- **Agricultural Law**
- **Agricultural Contracts**
- **Drafting Contracts and Conveyances**
- **Energy Regulation**
- **Environmental Regulation of Agriculture**
- **Environmental Regulation of the Oil and Gas Industry**
- **Estate and Business Planning for Farmers and Ranchers**
- **Estate Planning and Taxation**
- **Farm Bankruptcy**
- **Farm and Ranch Taxation**
- **Farm Income Tax Planning and Management**
- **Federal Indian Law**
- **Independent Readings in Natural Resources Law**
- **Independent Study in Oil and Gas Law**
- **International Petroleum Arbitration**
- **International Petroleum Transactions**
- **Kansas Legal Research**
- **Mineral Title Examination**
- **Mining Law**
- **Oil and Gas Conservation Law and Practice**
- **Oil and Gas Joint Operations**
- **Oil and Gas Law**
- **Oil and Gas Taxation**
- **Property Law Issues Related to Rural Land**
- **Public Land Law**
- **Real Estate Transactions**
- **Renewable Energy Law: Wind and Solar**
- **Rural Practice Externship**
- **Secured Transactions**
- **Tribal Law and Government**
- **Water, Environmental, and Regulatory Law Impacting Agriculture**
- **Water Rights**



# Overview

- **Many farm/ranch families desire to keep the business operating in the family into the future**
  - What actions help facilitate a succession plan?



# Key Transfer Tax Changes Under ATRA (The Changed Landscape)

- **Permanence**
- **Indexing**
- **Unification**
- **Portability**



# Post-2012 Estate Planning Landscape

- **Lower transfer tax costs**
- **Higher capital gain costs**
- **Higher income tax rates**
- **New tax on passive income**
- **Greater disparity among states between transfer taxes and income taxes**
- **Income tax issues have greater role**



# Tax Cuts and Jobs Act

- **Estate/Gift tax unified credit exemption**
  - Exemption set at \$11.58 million/person for 2020
    - Adjusted for inflation through 2025



# Some States Still Tax Transfers at Death

- **Notes:**

- Only a few states that have an estate tax have an exemption that mirrors the federal exemption
- Five states have an inheritance tax
- Connecticut has a gift tax





# Focusing Estate Planning

- **Life expectancy**
- **Lifestyle**
- **Long-term health care needs**
- **Size of potential gross estate**
- **Type of assets decedent owns and potential for appreciation in value**
- **Preserving eligibility for special use valuation (ag estates)**
- **Will a basis increase be essential/beneficial?**
- **State of domicile at death**
- **Succession planning**
- **Multiple entities?**
- **Asset protection**
- **Economic conditions**



# Impact of Coupling (and Portability)

- **Planning point:**
  - Use little-to-none of the applicable exclusion during life to cover taxable gifts
    - Exclusion will often cover entire value of gross estate and inclusion in estate gets the property a basis increase for heirs
    - But, consider business succession planning



# The Portability Election

- **Basic points**

- Must file Form 706 in first spouse's estate to make election
  - Nine months after death with six-month extension possible
- Surviving spouse uses the ported-over DSUEA before their own exemption is used.
  - Can use the DSUEA to shelter lifetime gifts from gift tax or reduce estate tax liability upon death
    - Arbitrage possibilities? The “Black Widow” dating service?



# Impact of Portability

- **Since it is now “permanent,” the use of traditional bypass trusts for all but the wealthiest of families might be reduced**
- **But, there are still reasons to use bypass trusts:**
  - Protect assets from creditors
  - Surviving spouse might remarry
  - Assets might go down in value
  - Plan might already use a bypass trust
  - Bypass trusts avoid administrative pitfalls



# Estate Planners Not Irrelevant

- **Many non-tax reasons to see an estate planner:**
  - Remaining role for traditional bypass/credit-shelter trusts
  - Asset protection through entities, trusts, pre-nups and post-nups
  - Planning for long-term health care
  - Powers of attorney
  - Reviewing beneficiary designations and coordinating them with estate plan
  - Business succession



# Compare Transfer Tax Cost With Basis Step-Up

- **In general**
- **Benefiting from basis step-up**
- **Exceptions to basis step-up rule**
  - Alternate valuation
  - Special use valuation
  - Qualified conservation contribution
  - IRD
  - Gift within one year of death and donor receives property back



# Practical Estate Planning

- **Under \$11.58 million (single) or \$23.16 (married)**
  - Estate tax irrelevant
  - Continual need for planning
    - Income tax basis planning
    - Identify and eliminate common errors
    - Asset protection planning
    - Succession planning
    - Family entity??
    - Insurance?



# Practical Estate Planning

- **Between \$11.58 million and \$23.16 million**
  - Historic estate planning concepts
  - Consider use of portability
  - Gifting
  - No “clawback”





# Practical Estate Planning

- **Over \$11.58 million (single); \$23.16 million (married)**
  - State of domicile?
  - Portability
  - Creditor protection
  - Succession planning
  - GSTT planning



# Common Succession Planning Objectives

- **How to bring in the next generation**
- **Establish a base for a financially successful business into the future**
- **Exit plan for current generation**
- **Fairness for on-farm and off-farm heirs**
- **Minimize income tax**



# Possible Ways for Children to Become Involved in a Farming Operation

- **Long-term acquisition of assets/control with supplemental off-farm income**
- **Off-farm employment coupled with a rental arrangement**
- **Sharing of labor and capital**
  - Partnership??



# Advantages/Disadvantages of Various Entity Forms

- **What works best is highly dependent on the facts**
- **What is the impact of altered structure of the tax law?**
  - Lower (and flat) C corporate rate
  - 20 percent pass-through deduction
  - New individual rates and brackets are on page



# Social Security Planning

- **No limit on Medicare portion of tax (2.9%)**
- **12.4 percent on first \$137,700 of earnings (2020)**



# Continuity and Transferability

- **Generally easier to transfer partnership interests, LLC interests and corporate interests than it is to transfer individual assets**



# FSA Payment Limitation Rules

- **AGI Limitation New Farm Bill replaces with one overall \$900,000 limit for all programs**
  - Based on trailing three year average (2020 based on 2016-2018 average).



# Payment Limits

- **Farm programs now have one \$125,000 limit per entity/person**
  - Entity level first, then to owners to four levels
  - Partnerships and joint-ventures have no limit
- **CRP retains the old \$50,000 limit**
- **EQIP and other conservation programs have various annual/total limits**





# Payment Limitation Illustration

Farm Entity Structure

General Partnership V. LL()

General Partnership	Totals	25.00% Owner 1	25.00% Owner 2	25.00% Owner 3	25.00% Owner 4
Total FSA Payment for entity	\$ 500,000				
General Partnership	\$ 500,000	\$ 125,000	\$ 125,000	\$ 125,000	\$ 125,000
Joint venture	\$ 500,000	\$ 125,000	\$ 125,000	\$ 125,000	\$ 125,000
C corporation	\$ 125,000	\$ 31,250	\$ 31,250	\$ 31,250	\$ 31,250
S corporation	\$ 125,000	\$ 31,250	\$ 31,250	\$ 31,250	\$ 31,250
Limited partnership	\$ 125,000	\$ 31,250	\$ 31,250	\$ 31,250	\$ 31,250
Limited liability company	\$ 125,000	\$ 31,250	\$ 31,250	\$ 31,250	\$ 31,250
Limited liability partnership	\$ 125,000	\$ 31,250	\$ 31,250	\$ 31,250	\$ 31,250
Limited limited liability partnership	\$ 125,000	\$ 31,250	\$ 31,250	\$ 31,250	\$ 31,250



# Attribution Limitation Illustration

	ABC LLC	DEF S Corp	XYX GP
Ownership %			
John	33.33%	50.00%	25.00%
Paul	33.33%	0.00%	50.00%
Jones	33.33%	50.00%	25.00%
Gross payment earned	\$ 225,000.00	\$ 300,000.00	\$ 150,000.00
Payment allowed to be allocated	\$ 125,000.00	\$ 125,000.00	\$ 150,000.00
Allocation of payment			
John	\$ 141,667	\$ 41,667	\$ 37,500
Paul	\$ 116,666	\$ 41,666	\$ 75,000
Jones	\$ 141,667	\$ 41,667	\$ 37,500
Totals	\$ 400,000	\$ 125,000	\$ 150,000

John and Jones would have to give up \$16,667 each allocated between ABC LLC and DEF S Corp



# Other Key Issues When Deciding Entity Form

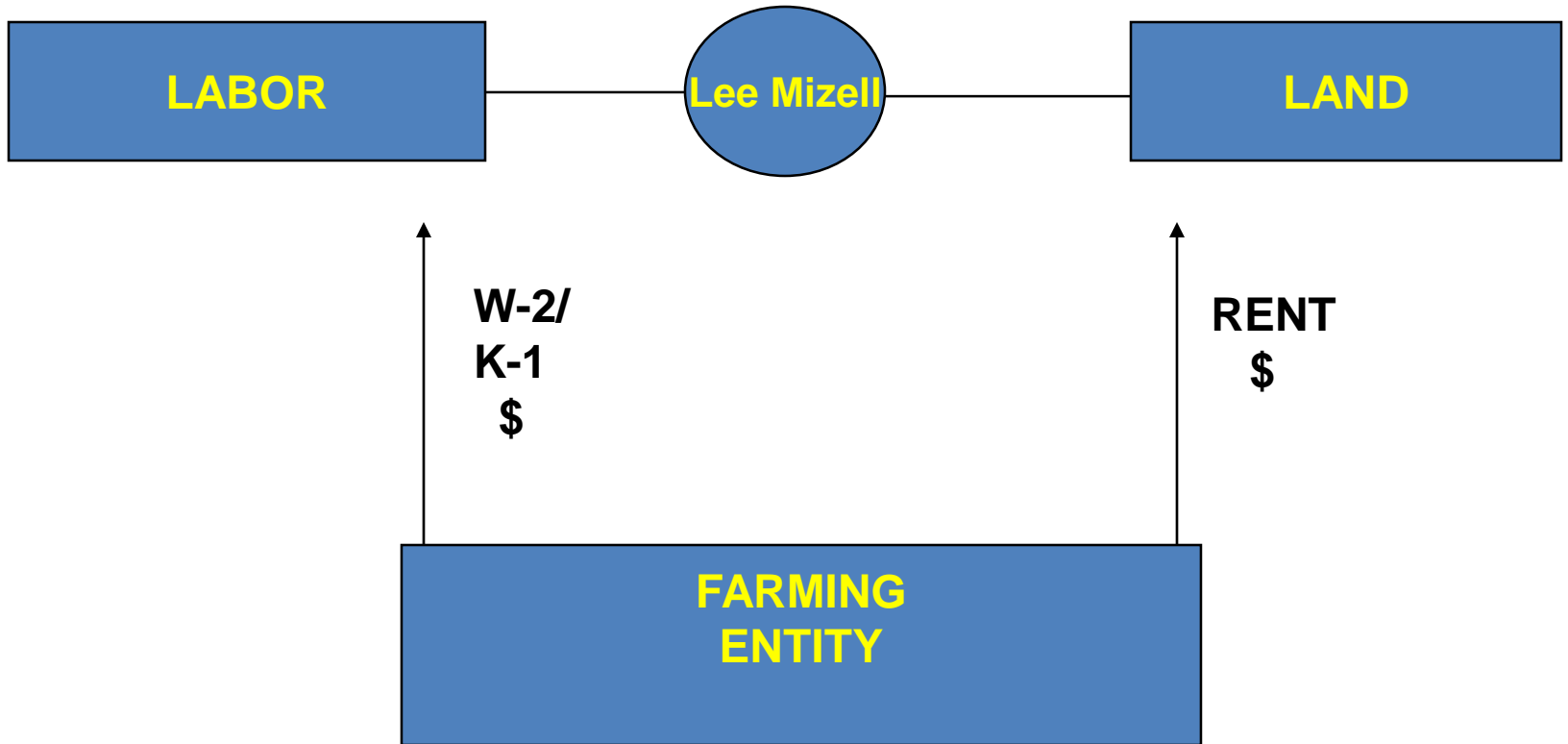
- **Management structure**
- **Liability of owners**
- **Fringe Benefits**
- **Liquidation costs**
- **Ability to finance**
- **NIIT**



# Multiple Entities?

- The “*Mizell*” issue
  - The relief of *McNamara* and *Martin*

# Fact Pattern



**IRS POSITION**

**OWNER**

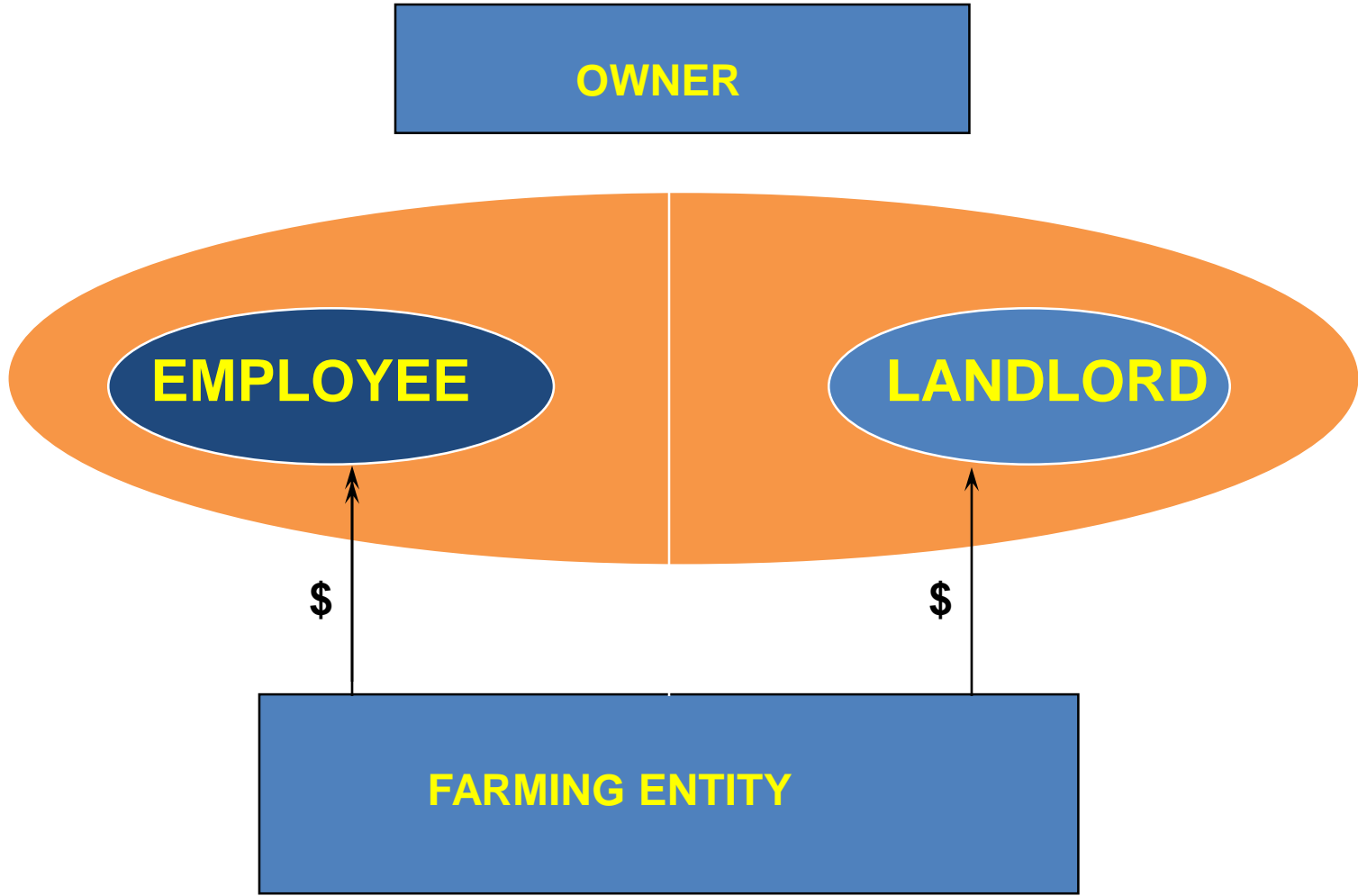
**EMPLOYEE**

**LANDLORD**

**\$**

**\$**

**FARMING ENTITY**



## Court Opinions:

### Self-rental SE Issue

- ***McNamara*, CA-8: Strong taxpayer victory**
- ***Johnson*, TC: Rents independent from salary**
- ***Solvie*, TC: Per head hog barn rent = SE**
- ***Martin*, 149 T.C. No. 12 (2017)**
- **Solutions on self-rental leases:**
  - Lease language: No landlord participation
  - Rent does not exceed market rate



# Equitably Treating Heirs?

- **Don't involve the off-farm heirs in day-to-day operation of the business**
- **Off-farm heirs should receive their inheritance by gift or as beneficiaries of life insurance, etc.**
- **Avoid joint ownership of real estate by the heirs**





# Strategies for Transferring Assets

- **Gift**ing
- **Rental**
- **Sale**
- **Inheritance**



# Social Security Planning

- **When is the optimal time to retire (for S.S planning purposes)?**
  - Maximize benefits
  - Minimize reduction



# Last Year of Farming?

- **Consider use of charitable remainder trust**
  - Minimizes income tax
  - Eliminates self-employment tax
  - Benefits a charity



# Importance of a Buy-Sell Agreement

- **Extracts the off-farm heirs from the business**
- **Carefully consider the events that will trigger the agreement and who has the right to buy the interest**
- **How will it be funded?**



# Succession Planning and Divorce

- **What if it happens after gifting has begun?**
- **What if it happens after an inheritance has been received?**
- **Trusts**
- **Buy-sell agreement**
- **Pre-nup agreement?**



# Planning for Long-Term Health Care

- **5-year transfer period**
- **Long term care insurance?**
- **What are the income items and liquid assets**
- **Know state law on spend down requirements**



# The Role of Life Insurance in Succession Planning

- **Providing for a spouse and/or dependents**
- **Funding a buy-sell agreement**
- **Key-man**
- **Pay debt off**
- **Pay estate settlement costs**



# Other Basic Succession Planning Issues

- **Providing income to parents in retirement**
- **Transferring leadership and management**
  - There is a difference
- **Utilizing outside advisors**





# Thank You!

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