SECURING THE FUTURE
2022 FARM SUCCESSION PLANNING

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Over 40 Years of Providing Dedicated Client Services to the Agriculture Community

Jeffrey M. Fetter is admitted to practice law in the State of New York, and the Commonwealth of Pennsylvania. The information contained in these materials is not intended to be legal advice, but is for discussion purposes only and is intended to merely convey general information related to legal issues commonly encountered in estate and business succession planning. Legal counsel should be consulted with respect to any specific issues on which advice is desired.

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Jeffrey M. Fetter is President and Chairman of the Business Practice Group of Scolaro Fetter Grizanti & McGough, P.C. in Syracuse, New York. Jeff's practice focuses on business, estate, tax and succession planning for closely held and family owned enterprises. Services Jeff also offers his clients include: state, federal and international tax and business planning; estate and long term care planning; business and succession planning; e-commerce planning; employee and shareholder/principal relations and employee benefits; protection of intellectual property; transactional planning; acquisitions, dispositions, mergers, tax-free reorganization of business entities; entity structuring; contract negotiation, dispute resolution and the dissolutions of business entities.

He is a 1983 graduate of the Ohio Northern University College of Law. Clients Jeff represents are involved in agricultural businesses, professional service, manufacturing, communications and retail.

Jeff is a frequent lecturer in the area of business, estate and succession planning. He has authored several articles on business and estate planning for various periodicals including Ag Banking and Top Producer.

Jeff has been rated AV Preeminent by Martindale-Hubbell in both legal and ethical standards by the Bar and Judiciary and has been listed in Best Lawyers in America and the Upstate New York edition of Super Lawyers for the past several years.

AGRICULTURE-RELATED SERVICES

Scolaro Fetter Grizanti & McGough, P.C. has established itself as a leading provider of legal and counseling services to the Agriculture community. The firm represents farms, farm families and farm related businesses such as equipment dealers, equipment and product manufacturers, consultants and other service organizations in such diverse area as:

- Estate, Asset Protection and Trust Planning and Estate Administration
- Business Entity Selection, Organization and Representation
- Farm Succession and Transition Planning
- Farm Sales, Acquisitions, Mergers, Reorganizations and Development of Strategic Alliances and Partnerships Among Farm Businesses
- Tax Planning for Farms, Farm Related Businesses and their Owners
- Contract Negotiation, Dispute Resolution and Litigation
- Real Property Purchases, Leases, Sales, Subdividing and Dispute Resolution between Adjoining Landowners
- Representation of Farms in Stray Voltage Matters
- Personal Injury Matters for both Plaintiffs and Defendants
- Governmental Support Program Applications and Disputes
- Employment and Labor Matters
- Establishment of Retirement Plans for Owners and Employees
- Long Term Care Planning for Purposes of Protecting the Family Farm

The firm has participated in thousands of successful farm transfers, each case presenting unique facts and circumstances that must be addressed. When representing farms and farm families, it is important to not only understand the general principles of business, estate and tax planning that are applicable to all businesses, but to also have a very clear understanding of the specific needs of the farm and its owners. Many farms and farm related businesses remain within the same family for many generations. As a result, it is necessary to understand and address the needs of multiple generations within and without the operation. Special emphasis is needed on ensuring that both the senior generation and the junior generations objectives are met when developing and implementing a farm succession plan. In many cases, there are both farm and non-farm heirs within the family and care must be taken to properly provide for everyone while protecting the primary asset of the family - the family farm.

Although there are many similarities within various farm businesses, each has unique and diverse needs. In most cases, this depends on the structure of the family, the structure of the farm business and the present state of the agriculture industry and the economy in general. Today's farm economy presents many challenges to the farm business and to its advisors. Farm income and expenses may vary greatly year to year and unlike many non-agriculture businesses, are influenced by factors outside the control of the farm's owners and management. It is important that the farm advisors work together as a team to address these challenges and to best serve the farm client. Over the past several years, the firm has established itself as an integral part of that team.

<u>Agricultural Business and Estate Planning Team</u>

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Farm Estate and Business Transfer Planning

PREAMBLE

A few initial planning thoughts

Regardless of whether your plan is simple or complex, involves merely a will or sophisticated agreements among family and nonfamily members, the most important part of any plan is to ***get it in writing!!!***

Remember, the only time you need to use an agreement is if you cannot agree or if you're not there to speak for yourself. The parties to an agreement can always agree to something else but, ... if you cannot agree you need to go back to what you put down in writing.

Having your plan in writing helps to avoid disputes, confusion, tension, deterioration of the farm and the time and expense of having to end up in court.

Finally, the best time to implement a plan is yesterday!!

I. INTRODUCTION

A. **Business Objective and Purposes.** In any closely held corporation, limited liability company or partnership, the ongoing health of the business largely depends on keeping ownership of the business in the hands of those employees and/or family members who actually conduct the business. This is especially true in farm businesses where steps should be taken with respect to the business and estate plan to assure the owners' interest and investment in the business is protected and the interest is passed to the next generation or to the surviving owners with as little difficulty as possible. The objectives to be attained in a farm succession plan are:

1. Develop management and decision making structure for operation.

2. Minimize income taxes during operation and an estate tax as to both transferor and transferee upon transfer.

3. Establish terms under which plan will operate in the future to avoid need for future negotiations and to give all parties comfort that plan will be implemented.

4. Minimize personal liability and protect assets from third party claimants, including plaintiffs in legal actions, creditors and spousal claims in matrimonial actions in which farm embers are parties.

II. SUCCESSION PLANNING STRATEGIES

In implementing a farm succession plan it may be appropriate to utilize entity selection, estate planning documentation and agreements to establish the basis on which the succession plan will be structured, to provide retirement income to senior owners, to provide benefits, including incentive benefits to key employees and to establish a tax favorable means for passing the farm to the next generation whether family or non-family.

A. Senior Generation's Objectives.

1. Retirement income and security.
2. Farm continuation after retirement and death of parents.
3. Equitable or non-equitable treatment of farm and non-farm heirs.
4. Minimizing estate and income taxes for the parents and the next generation.
5. Reduction or elimination of management responsibilities for the parents (or the surviving spouse).
6. Protect assets for children and grandchildren with little if any exposure to creditors or spouses of children.

B. Junior Generation's Objectives.

1. Assumption of management responsibilities.
2. Attain or increase ownership.
3. Assure income needs of parents in retirement do not impair junior generation's earning capacity on farm.
4. Avoid involving nonfarm heirs in management of operating entity.
5. Avoid unnecessary imposition of estate taxes/plan for payment of estate taxes through insurance policies on parents and/or partners.
6. Deductibility of retirement income payments to parents.
7. Establish credibility in community and with lenders/vendors/customers.
8. Establish operating agreements with partners setting forth terms under which operations will be managed and how an owner's interest will be transferred upon the occurrence of certain triggering events (e.g. death, disability, termination).

C. These documents and agreements may include the following:

1. **Buy Sell Agreements**. The buy sell agreement among the owners of the farm sets forth not only the terms under which owners will hold their interest while employed or

associated with the farm, but also sets forth the terms and conditions under which an owner's interest will be transferred upon the occurrence of certain triggering events such as death, disability and termination of the owner's relationship with the farm.

Critical to the structure of a buy sell agreement is ensuring that the cost of any potential buyout is properly anticipated and the plan is appropriately funded, whether through life insurance or other assets. In some cases, operations believe that the obligation can be taken care of through cash flow which can be a dangerous gamble. The uncertainties of a farming operation such as milk and crop prices can quickly make a manageable obligation an impossible obligation.

In addition, in many cases, the buying out of an owner is coupled with the need to replace the services of the deceased or departed owner. Again, the impact on cash flow must be carefully managed and the obligation must be regularly reviewed through updated valuations, meetings with lenders, advisors, etc.

If life insurance is to be utilized for funding an obligation under a buy sell agreement, ownership of the policies is critically important. Failure to have the policies properly owned may result in unintended income as well as estate taxes. In some cases, owners own policies on each other and in some cases the entity owns policies on the owners. Both of these structures can have their advantages, but both structures can cause unanticipated problems with income taxes, estate taxes, alternative minimum taxes and even the problem of retrieving a policy on a living owner from the estate of a deceased owner. Careful consideration must be given to how the policies are owned and in many cases utilization of an insurance partnership is the most beneficial structure. This is discussed below.
[See BCL §620 (Shareholder Agreements)]

2. **<u>Management Agreements</u>**. Setting forth how decisions will be made and the authority each of the managers and owners may have assures all principals that the decisions are being made by the appropriate individual or individuals.

3. **<u>Prenuptial/Postnuptial Agreements</u>**. **[DRL §236, Part B 3F, DRL §250]** Keeping the family farming operation out of an owner's personal matrimonial proceeding not only reduces expenses to the farm operation, but can greatly reduce the emotional impact such an action may have on the entire enterprise.

4. **Estate Planning Documents**.

The Absolutely, Positively Essential Estate and Health Care Planning Documentation (and then some).

a. **The Will**. An owner's will sets forth the terms under which the owner's "estate" will be distributed upon death. Included within the "estate" is all assets owned by the owner at the time of death. Because the farm owner has both business and personal assets, it is important that a properly prepared will is in place to insure that the business assets pass in accordance with all the farm members' intentions.

Without a properly prepared will, assets will be transferred in accordance with the applicable statutes [See EPTL §4-1.1-4-1.6]. For example, if a farmer dies without a will and leaves a wife and three children, the applicable state law may provide that the wife will receive only a portion of the assets. The remaining assets will be divided equally among the children (regardless of who is involved in the farm and who is not).

The estate plan should specifically address how farm assets as well as nonfarm assets are to be handled at the time of death. In many farms, the active farm members do not want to have to involve their nonfarm siblings in the day to day decisions that have to be made on the farm and what could be even worse is when the nonfarm siblings have a financial stake in the operations. Properly prepared estate planning documents together with business planning agreements avoid these problems.

b. **Updated Health Care Power of Attorney**. Sometimes known as a health care proxy, this document ensures that people you have appointed are making health care decisions on your behalf in the event you are unable to do so on your own. An "updated" proxy is necessary that (1) specifically grants your agent authority to obtain records that are considered private under recently enacted "HIPAA" privacy regulations and (2) appoint an alternate agent as well as a primary agent. [See www.nysba.org for Health Care Proxy Forms; See Public Health Law - PBH §2981 [Authority to Appoint Agent] [Statutory Form at Article 29-C of the PPH]

c. **Living Will**. The burden of having to make a decision as to whether life continuing measures should continue is a tremendous one. The living will sets forth your own wishes if such a situation arises and relieves your family and friends from having to be faced with such a decision. The living will sets forth your wishes and the conditions under which such a decision will be made.

d. **Updated Durable Power of Attorney**. A durable power of attorney appoints your agent or "attorney in fact" as the person who can take care of personal, business, financial and legal matters on your behalf. A power of attorney may be an "immediate power" or a "springing power". An immediate power of attorney grants this authority (which is great) in the hands of a person immediately. A "springing power" states the conditions under which such a power will come into place at some point in the future. E.g. in the event of your disability or illness which renders you unable to act on your own.
[Powers of Attorney signed after June, 2022 must be in compliance with NYGOL with regard to new statutory form.]

Because of the great power given under such documents, they should be carefully thought out before signing, but they are critically important to have in place to ensure that bills are paid, checks are cashed, assets are managed, children are provided for etc. in the event you are unable to act on your own.

Similar to the health care power of attorney, the durable power of attorney should also be updated if you already have one to include specific references to HIPAA and also to authorize your agent to make transfers of assets on your behalf in excess of $16,000.00 if those are your wishes. Under the form that is usually signed, there is a limitation on the amount of gifts that may be made. In some situations gifts in excess of that amount may be appropriate for medical, estate and financial planning. Again, care needs to be taken in designing the document that meets your wishes and expectations.

e. **The Sometimes Essential Trust Documents**. Trusts may also be used in connection with a farmer's estate and succession plan. These trusts may be created during lifetime or at the time of the farmer's death. In both cases, the documents should be structured with the farm succession plan in mind.

(i) Revocable Trusts - purposes
A. For avoidance or minimization of probate
B. For asset management(ii) Irrevocable Trust Purposes
A. estate tax planning
B. asset protection planning
C. long term care planning
D. special needs planning
E. income tax planning

(ii) Irrevocable Trust Purposes

A. Estate Tax Planning
B. Asset Protection Planning
C. Long Term Care Planning
D. Special Needs Planning
E. Income Tax Planning

Although "Irrevocable Trusts" are identified as "Irrevocable" they are in many cases able to be modified, amended, terminated and/or replaced with updated trusts. They are "irrevocable" or "irreversible" to the Grantor or the creator of the trust. That is, once funded by the Grantor he or she cannot get it back. This is unlike "Revocable Trusts" which the Grantor may amend, terminate, etc. and receive back the assets placed in the Revocable Trusts. In many cases the changes in an Irrevocable Trust are referred to as "decanting". As to whether a trust may be amended or replaced, there are statutory provisions which address this ability. [See EPTL 7-1.9 Revocation of Trusts; EPTL 10-6.6 Rules Governing Exercise of a Power of Appointment]. The trust instrument itself may contain provisions which allows transfers to other trusts as well [a/k/a trust to trust transfers] which would prevail.

These strategies may be utilized if there has been a change in circumstance which warrant a change in the trust plan. For example, the nature of the assets of the trust may have changed, with a farm or business succession plan the beneficiaries who were intended to continue with the farm or business may have changed or there may be additional beneficiaries that should be included,

5. **Operating/Retirement Agreements**.

a. **Deferred Compensation Wage Continuation Agreements**. It is not unusual to provide a reasonable amount of compensation to the withdrawing shareholder/ employee or partner/employee in the form of a nonqualified deferred compensation agreement. Payments under a deferred compensation plan may avoid unnecessary FICA payments if properly structured. [See IRC §3121(v)(2); 2016 Chief Counsel Memorandum at w.w.w.irs.gov/pub/Ianoa/am-2017 - 01.pdf]

b. **Consulting Agreements**. Similar in tax substance to an employment agreement. However, consulting agreement payments will be subject to self-employment tax.

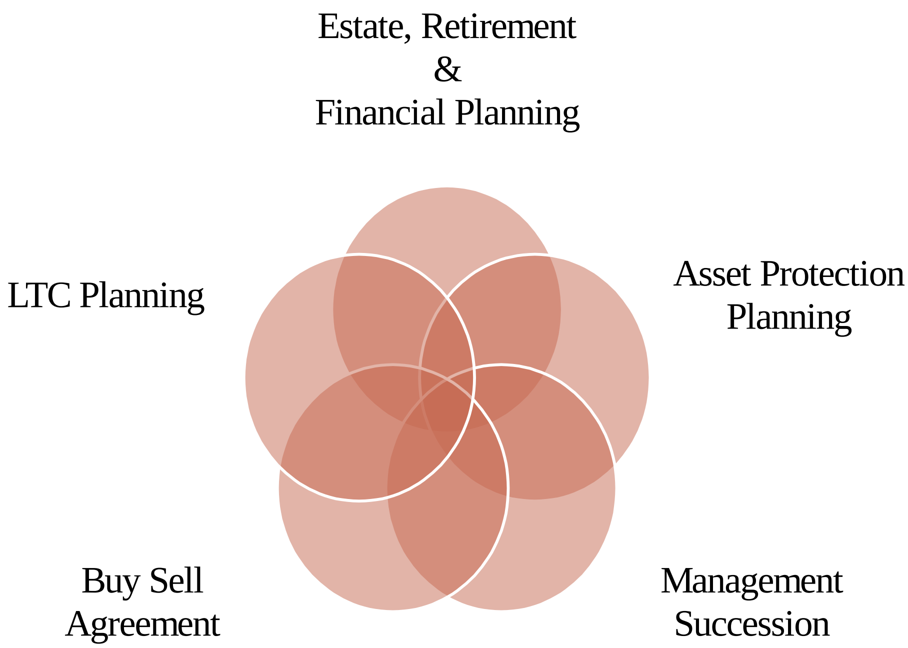
c. **Employment Agreement**. In some cases, an employment agreement with the parent may be appropriate for security purposes; e.g., if the father wants to be assured he will receive guaranteed income, health insurance, etc., during his "active" and retirement years, an employment agreement would be a contractual obligation on the part of the farm to provide these benefits.

d. **SIMPLE Plans, 401(k) Plans, IRA Options, etc.** [Such plans are governed under the complex rules of The employee Retirmenet Income Security Act of 1974 (ERISA). [Pub.L.93-406, 88 Stat. 829, enacted September 2, 1974 (29 U.S.C. ch18)]

c. **Retiring Partner Election vs. Purchase of Ownership Interest.** If stock in a corporation is purchased, the Seller generally has capital gains implications, and if the installment method is elected, taxes on gains are payable as payments are received. However, if the entity is a partnership or a limited liability company taxed as a partnership, the unique nature of certain assets in a farm known as "hot assets" can result in an immediate taxation of the value of these hot assets regardless of the terms of payment. Section 736(b) of the Internal Revenue Code may provide relief for this problem. This "retiring partner election" may allow the taxation on the sale to be paid out over the period of payment. However, there are certain requirements which must be met and the retiring partner election may not always apply. Therefore, like every transaction, the tax advisors must be consulted as an integral part of the transition team.

The term "hot assets" include "Unrealized Receivables" (IRC § 751 (c)) and "Inventory" (IRC § 751(d)). In the farming context, "Unrealized Receivables" include, among other items, some machinery/equipment, livestock such as raised cows, certain buildings, fences, tile, etc. "Inventory" includes harvested crops, supplies, seed, feed, etc. tax advisors can determine which "hot assets" may apply to a specified transaction.

It All Comes Together as One Coordinated Comprehensive Plan



II. ESTATE TAX PLANNING

A. **Traditional Planning**. An estate plan primarily involves taking steps so that in the event of your death, your assets (whatever they may be) pass in the manner that you desire. However, estate planning also needs to take into consideration the possibility of estate taxes being due at the time of your death. These taxes are not paid by the decedent but by the estate of the decedent. If not planned properly, there may be the need to liquidate assets in order to pay estate taxes. In a typical farming entity this is not a desirable option because there is very little liquidity in the assets owned by the farmer.

With properly structured estate planning documentation in place and the proper steps taken to reduce an estate during lifetime, estate taxes can be minimized or even avoided (legally). However, without the proper documentation and plan in place, it is possible that there will need to be a liquidation of assets in order to pay estate taxes. Although the IRS has payment plans, they are not always available and are not necessarily beneficial to the taxpayer.

Presently, federal law provides that the exemption is $12,060,000. As discussed below, there is also the unexpected and unique opportunity to make gifts in amounts up to $12,060,000 without incurring a gift tax. Both are subject to an index for inflation through 2025. This presents unique planning strategies that may only be with us for a short period time. [26 USC Subtitle B §2001-2210 - Estate Tax; §2501-2524 - Gift Tax] Present law provides that in 2026, the exemption will return to the exemption in place in 2017 ($5,490,000) adjusted for inflation.

Several states still impose an Estate Tax and/or an Inheritance Tax on Estates and Beneficiaries. The following states still have an Estate Tax and the implications of the estate tax on a succession plan should be carefully analyzed in structuring the plan:

Connecticut, Delaware*, District of Columbia, Hawaii, Maine, Maryland, Massachusetts Minnesota, New Jersey*, Oregon, Rhode Island, Vermont, Washington, New York, Illinois

*** Repealed 2018**

The following States have an Inheritance Tax (which in some cases is in addition to the Estate Tax): Indiana, Iowa, Kentucky,Maryland, Nebraska, New Jersey*,Pennsylvania

*__Note: Estate Tax Repealed - Not Inheritance Tax__

Estate taxes are assessed on the value of the deceased owners estate, including in most cases, both probate as well as non-probate property such as retirement accounts, life insurance policies, annuities and other assets that pass by beneficiary designation rather than through a will. In most cases, there are exemptions for transfers to spouses at death. Each state has its own level of estate tax exemption. E.g. New York is $6,110,000 as of January 1, 2022. However, New York also has a "cap" on its exemption. If the estate is 105% or more of the exemption (i.e., $6,415,500 in 2022), the exemption is for the most part lost. Therefore, each state's rules must be carefully examined. New York's rates are between 3.06% to 16% for estates greater than $10.1 million. [New York Tax Law, Article 26, Parts 1 §951-961]

An inheritance is similar to the estate tax, but may differ significantly from state to state. Generally, the inheritance tax depends on who receives or inherits the property. Depending on whether the beneficiary is a child, sibling, etc. the rates may be different. Again spousal transfers are generally unlimited. But, again careful analysis must take place because in some states certain assets are not taxable. E.g. Pennsylvania has an inheritance tax exemption, but does not tax family farms or in most cases, life insurance policies.

Because of the possible difference between the State and the federal exemptions, any estate plans that were previously put in place should be reviewed to ensure that State estate taxes are not unnecessarily due and payable upon the death of a person who leaves a surviving spouse.

A "portability" feature was added to the estate and gift tax laws in 2013 that has continued to be in effect through the changes in the law [See 26 USC §2010(c)(4)]. Portability essentially means that if one spouse passes away and does not utilize his or her full federal estate tax exemption, the surviving spouse is able to have that remaining exemption passed to him or to her. This is accomplished through filing a federal estate tax return and making the appropriate elections. There are very strict time limitations and very specific rules regarding how the exemption may be used and or retained by the surviving spouse which should be carefully reviewed in the event of the death of the first spouse to pass away. **Portability is for federal estate and gift tax purposes only, not state.**

Relying on "portability" is not generally advisable in a succession plan for a number of reasons. Should everything be going to the surviving spouse at the first death? The answer is many times "no" for a number of reasons including asset protection, long term care issues, future appreciation of value leading to greater estate taxes at the second death, etc.

Although estate taxes should not be the sole factor in structuring a farm succession plan, when structuring such a plan, it is important to at least know what the possible implications are and how they can be minimized. Advance planning is certainly necessary to avoid surprises.

B. **Long-Term Care Planning**. Family farm businesses are for the most part more likely to pass from one generation to another than nonagricultural business operations. In addition, unlike many non-farm businesses there is significant value in the assets of the farm, but very little liquidity. These unique characteristics of a farm business present very challenging obstacles in one or more family members require long-term care assistance, whether at home or in a long-term care facility. It is important to consider the disastrous impact these expenses can have on a farm and a farm succession plan. Early planning is needed. State law sets forth how the federal Medicaid program will be administered within the State. Under federal legislation implemented in 2006 [Deficit Reduction Act of 2005], the ability to transfer assets through gifting in order to qualify for Medicaid has become significantly limited. In most cases, transfers made within five (5) years of the date on which a Medicaid application is submitted will be disregarded.

There are, however, planning opportunities that may be available depending on the facts and circumstances. In addition, consideration should be given to obtaining long-term care insurance while still healthy. The annual cost of such insurance is in most cases less expensive than the cost of one month's stay in a nursing home. In addition, the insurance expense may be partially or fully deductible at the federal level.

It is important that the rules for "eligibility" for Medicaid may be different than whether assets a are still protected in the event of the death of the Medicaid recipient. Personal business assets and real property utilized in a business may be excluded in determining whether a person is eligible for Medicaid assistance, but that does not mean that the best plan is to have the person retain ownership because under federal and state law there is an estate recovery mandate that requires states to pursue reimbursement from the probate estate of a Medicaid recipient at death. In other words, although the farm or the winery may not interfere with the person's ability to qualify for Medicaid assistance during lifetime, at the person's death, those same assets may be at risk of being claimed by the government for reimbursement for the expenses provided the recipient during lifetime - which can be substantial.

C. **Gifting**. As noted above, the estate tax exemptions have been increased to $12,060,000 (indexed for inflation) until January 1, 2026 at which time the exemption is scheduled to be reduced to the 2017 levels ($5,740,000) again indexed for inflation. Historically, gift tax exemptions were not 'unified' with the estate taxes but now they are for federal purposes. Most states have repealed their gift tax legislation, but Connecticut still imposes a. gift tax after Minnesota and Tennessee recently repealed their gift tax statutes. Some states do not have a gift tax, but still impose an estate tax based on Gifts Made In Contemplation of Death and the rules differ state to state.

The "lifetime" gifting exemption can be utilized at any time and the amounts in excess of any "annual exclusion" are then charged against the remaining estate tax exemption of the grantor. The "annual exclusion" gift is presently $16,000.00 per "grantee" and may be used for as many "grantees" as desired each year.

Example: If a grantor gifts $116,000.00 to his son in either cash or other asset value, $16,000.00 is ignored for gift tax purposes and the remaining $100,000.00 would be credited against the $12,060,000 lifetime exemption thereby reducing the remaining exemption to $11,960,000.

In cases where a gift is in excess of $16,000.00 a gift tax return must be filed with the Internal Revenue Service setting forth details of the gift, how its value was determined, etc. If the gift is made utilizing any "discounts" in valuation a gift tax return must be filed regardless of the value. "Discounts" that may be utilized in valuing family or closely held businesses include "lack of marketability" (i.e. the asset is non-marketable because of its nature or because it is subject to a buy sell agreement among the owners of the business) or "minority interest" discounts which apply if the interest being conveyed does not carry with it control of the entity (e.g. nonvoting stock, minority ownership being transferred etc.).

With increased gifting, opportunities exist for "freezing" the value of an asset in a person's estate. E.g. If $500,000.00 worth of land is transferred from parents to child, the future increase in the value of that land is outside the parents' estate. This then has been an effective "estate reduction" strategy because although a portion of the parents' lifetime exemption was utilized in making the gift, the increase in the value after the gift will no longer be charged against the parents' estate tax exemptions. Of course, asset selection is important because if the value of the "gift" decreases, there is no future recovery of the exemption that was unnecessarily utilized.

As with any strategy there are advantages and disadvantages to making gifts during lifetime either to individuals or to trusts, including the following:

1. Once a gift has been made it may be outside the future control of the grantors (exceptions may exist if the gift does not consist of a controlling interest).

2. If a gift is made outright to an individual, that asset is now subject to the creditors of that individual, possibly spouses in matrimonial matters, plaintiffs, etc. If transferred to trust, there is much greater protection.

3. From a tax perspective a lifetime gift results in the forfeiture of a "step up" in basis upon death (which could have considerable tax savings in the future).

Any gifting plan should be carefully incorporated into the overall operations, management, estate and succession plan of the family farming operations.

D. **Key Man Protection/Profits Interest**. In many cases, "key employees" represent the next generation of the family farming operation even if not related. There are many strategies that can be considered in ensuring that the key employees are properly compensated and have an incentive for the future growth of the operations and in many cases are able to share in the ownership in the future. Some of these plans include the following:

1. Employee incentive plans based on profits, revenue, etc.

2. Deferred Compensation Plans that offer a retirement plan to key employees. These can be structured in a manner so that there are "vesting schedules" which

provide that the longer an employee stays with the farm, the greater the benefit upon his or her retirement or departure.

3. Key man life insurance protection for the families of the key people.

4. "Profits Interests" in partnerships of LLC partnerships, pursuant to which the key employee can share in the growth of the value of the operations with very little if any up front tax consequences.

5. Restricted "stock" or "ownership" plans under which a key person is entitled to the issuance of ownership in the operations over a period of years.

These types of "key man" plans are not necessarily limited to non-related employees of the operation and can be utilized with family members as well. In such an event they are coordinated with the retirement plans of the "senior generation".

E. **Health Care Powers of Attorney, etc**. Although not technically "estate planning" documents, it is important to have up to date health care powers of attorney, living wills, and financial powers of attorney in place to ensure that in the event the "principal" is not able to make decisions involving personal or health matters that the agent appointed by the principal is making these decisions on their behalf instead of some other third party.

Also because of HIPAA regulations, it is important to have properly prepared and signed health care powers of attorney in effect for any individuals over the age of 18 to ensure that parents, family members, appointed agents, etc. are able to have access to medical information to provide assistance to the person. Otherwise, HIPAA does not allow the sharing of information vital to making decisions on behalf of an injured or incapacitated person.

F. **Funding the Buy Sell Agreement - The Insurance Partnership**.

UTILIZATION OF LIFE INSURANCE PARTNERSHIPS IN BUSINESS SUCCESSION PLANNING

The following reflects the current status of the law, regulations and IRS pronouncements on establishing a partnership for holding life insurance policies. The historical concern is whether a partnership established for the holding of life insurance policies is respected by the IRS as being a viable business purpose. Secondly, is what benefits are derived from having partnership owned policies as opposed to individual, cross owned policies or corporate owned policies on the lives of the shareholders.

1. **IRS Position**. Priv. Ltr. Rul. 93-09-021 (Dec. 3, 1992) expressly approves of a partnership created for the sole purpose of receiving and maintaining insurance policies. The ruling indicated that the life insurance proceeds would be reflected in the surviving partner's distributive share under I.R.C. § 705(a)(1)(B) as tax-exempt income. The rulings also hold that any proceeds of the life insurance policies distributed to the surviving partner would not be taxable. See also Priv. Ltr.Rul. 96-25-013 (Mar. 20, 1996) and Priv. Ltr. Rul. 96-25-019 (Mar. 20, 1996). For this to work, it is important that the partnership contain two critical provisions:

    a. a special allocation of the proceeds (in excess of cash values) to the remaining members or partners under I.R.C. § 704(b); and

    b. a prohibition against the insured exercising any "incidents of ownership" over the policy.

If the deceased partner shared in the allocation of tax-exempt income, the surviving partners or members may not have enough basis to absorb the distribution of the policy proceeds, which would result in gain to the surviving partners upon distribution of the proceeds to them. Further, if the proceeds are allocated and distributable to all the partners or members (including the deceased), the value of the deceased's interest in the partnership would be increased, thus providing less money to the survivors to purchase the deceased's interest as well as increasing the amount necessary because of the cost of purchasing the deceased's interest in the partnership would go up.

2. **Other Benefits of Partnership Ownership of Policies**.

   a. Funding the premium payment is relatively easy with a partnership. Distributions from the corporation or other entities whether in the form of dividends, compensation or bonuses can be used by the partners to contribute to the partnership sufficient funds for the payment of premiums. Contributions can be made on an equal basis which avoids the problem that arises when premiums are not the same for different partners/shareholders. In some cases, a younger healthier partner may end up paying considerably more in premium payments for his or her partner if the policies are cross owned. This is avoided with a partnership.

   b. The buy-sell agreements will provide for the purchase of the deceased or terminating partner's interest in the partnership. This will also work ideally if and when another member of a family becomes a shareholder in the corporation or a member of the LLCs without having to acquire policies on the present owners or moving ownership around (which could in some cases have tax implications). If, however, the same shareholder leaves the corporation, it would not be necessary to retrieve the policy or policies on the remaining

   c. The use of a partnership avoids the necessity of multiple policies in those situations when there are three or more shareholders in an entity. That is, for example, when there are two owners, one may own the policy on the other, but when there are three, two of them own a policy on the third and this becomes circuitous. Another problem that arises with cross owned insurance is that the living partner needs to get back his policy from the estate of a deceased partner. This is not necessary with a life insurance partnership because the policies are owned by the partnership. Even if there are only two partners, it is easier for the surviving partner to distribute his policy out to himself or to a family trust without involving the deceased partner's estate.

d. The control of a partnership can be determined by the partnership agreement, thus governance and control is in the hands of select individuals including the insured without concern that the proceeds of the policies will be includable in the insured's estate. The extent of inclusion should be limited to the fair market value of the insured partner's interest in the partnership determined under § 2033 of the Code. That is, the value of the capital account for the most part. But, no one can have control over the policies. Otherwise, there could be inclusion in the estate of a deceased partner.

e. If insurance proceeds are owned by and payable to an entity such as one of the LLCs, a portion of such proceeds or cash values would be taken into account in determining the value of the insured's interest in the entity. In other words, the value of the deceased owner's interest in the corporations will be increased by the value of the proceeds which is an unintended result of having the insurance policies. Because the insurance partnership owns the policies and the proceeds are not allocated to a deceased partner, there is no inclusion.

f. Although with proper planning, policies owned by the LLC and having the LLC as a beneficiary will receive the proceeds tax free, if the intention is to pay out the deceased shareholder's /member's interest, this does not provide the best case for the remaining shareholders from a tax basis perspective. Also, if there is a desire to have proceeds from the life insurance used to pay out shareholders/members or their family members for other reasons, the entity may need to make taxable distributions out to them. When proceeds are payable to the partnership, the tax results are entirely different.

g. In cases where there is significant value in the entities and multiple entities, family trusts can be partners in the partnership. The benefit of this type of a structure for example would be if Shareholder A passed away, his interest should not be purchased by Shareholder B because all that does is result in increasing Shareholder B's estate. Another possible problem is that if Shareholder A's ownership interest is "separate property" for marital purposes, if proceeds are payable to A and he purchases B's interest, the purchase could be "marital property" because he or she is now married at the time of the purchase. The options would be to have Shareholder B's trust buy the interest or if Shareholder A's family was continuing on with the family operations, Shareholder A's family trust could acquire the interest. In that case, proceeds are available to the family and the works well with multiple families with no real intention to have a "buy out".

h. If life insurance proceeds are payable to a "C Corporation", they were previously subject to Alternative Minimum Tax ("AMT"). If payable to an "S Corporation" or an "LLC" or "Partnership" (i.e., any of the pass through entities), there was no AMT assessed. Under recent legislation the AMT issue has been repealed.

The partnership agreement will have a requirement that any proceeds that are received by the partnership will be first applied toward the purchase of a deceased owner's interest in the corporations. The remaining proceeds can then be distributed out to the deceased owner's estate or to the remaining partners or entities for key man purposes to the extent there are excess proceeds and this is the intention of all of you.

IV. CHOICE OF FARM BUSINESS ENTITY

A. **Objectives**.

1. Limited Liability and Protection of Assets.
2. Transferability of Interests.
3. Centralization of Management.
4. Minimizing Income Taxes.

Note that the 2017 tax legislation has changed many of the tax rates for entities as well as farmers who file under their own Schedule F as sole proprietorships. Whether there is an advantage to selecting one form of structure over another can only be determined after having a careful analysis of your own personal situation done by your tax advisors. Although on the surface, a tax rate may appear to be very favorable, your own operations may have an effect on whether such a rate applies to your operation and/or whether it is really favorable when taking into consideration all tax implications. It is important to be cautious when changing from one tax structure to another (e.g. from S status to C corporation status), because of in many cases, it cannot be reversed.

B. **Tax and Non-Tax Considerations in the Selection of a Farm Business Entity**.

Sole Proprietorships	**Corporations**
General Partnerships	**Limited Liability Partnerships**
Limited Liability Companies	**Limited Partnerships**

1. **Sole Proprietorship**. A sole proprietorship is a farm owned and operated by a single person. A business certificate may be filed in the county clerk's office if the business is operating under an assumed name. Income of the owner is reported on the

taxpayer's 1040, Schedule F. Eighty percent of farming operations are operated as sole proprietorships.

a. **<u>Advantages</u>:**

(1) Very informal operation.
(2) No formal requirements to organize.
(3) Owner makes all decisions without having to be accountable to others.
(4) No double taxation of an entity – all income reported on owner's returns.
(5) Owner bound by acts of others in entity.
(6) Ownership interest freely transferable.

b. **<u>Disadvantages</u>:**

(1) No limitation of liability for owner from contractual or tort liability.
(2) Reporting of all income on Schedule F may be disadvantage – i.e., no opportunity to shelter income or to allocate between Self-Employment (SE) Tax Income and non-SE Income.
(3) Limitation on ability to deduct certain benefits provided to owner and owner's family.
(4) Tax liability is at owner's rate. If separate entity utilized could be opportunity to have lower tax rate or to share tax liability with others who have lower tax rate.
(5) Unless preliminary steps are taken, entity disappears upon death of owner. Assets and real estate must be transferred individually.

2. **<u>General Partnership</u>**. A general partnership is an organization which is composed of two or more persons. A partnership can be created without a written agreement. However, it is advisable to have a partnership agreement. A certificate of doing business as partners must generally be filed in the county clerk's office. Partnerships are not taxed as a separate legal entity. They are "pass through" entities.

a. **<u>Advantages</u>:**

(1) Very easy to organize – few formalities, nominal operating costs.
(2) Decision making process may be very informal if desired.
(3) Detailed statute provides guidance on decisions making and on other matters concerning operation and dissolution if no agreement in place.
(4) Pass through tax treatment for owners avoiding double taxation on operating income on the sale of assets.
(5) Entity files Form 1065, not Schedule F.
(6) Partnership interests are not freely transferable.
(7) May generally be liquidated tax-free/no double taxation.

(8) Flexibility in capitalization.
(9) May be easily converted to another entity (e.g. LLC or Corporation LLC Law Section 1007).
(10) Farm partnerships can elect cash or accrual accounting.

b. **Disadvantages**:

(1) Unlimited personal liability for owners for acts of entity and acts of partners and employees acting in name of entity.
(2) Partnership interests are not freely transferable.
(3) Entity dissolves upon occurrence of certain triggering events (death, bankruptcy or withdrawal of a partner).
(4) Any partner may dissolve partnership by withdrawal.
(5) Each partner may obligate the partnership.
(6) Taxable year generally calendar year – partnership must conform taxable year to the taxable years of partners. I.R.C. §706(b)(1)(B)(i).
(7) Partners are not employees for purpose of deducting fringe benefits or for payroll tax requirements.
(8) Partnership return required even if no income. Exception for "small partnerships" under I.R.C. §6231(A)(1)(b) [ten or fewer partners, each of whom is natural person or an estate, and equal sharing of profits and losses].
(9) Partners taxable on income whether distributed to them or not. I.R.C. §701 (i.e., if a partnership has non-deductible expenses (e.g. mortgage principal or life insurance premiums), these may be taxable income although there is not necessarily cash to pay for those taxes to the partner.3. **Corporation**. A corporation is a legal "person" that is created by filing of a certificate of incorporation generally in the Secretary of State's office. A corporation generally has perpetual existence. The owners or shareholders of a corporation have limited liability for the corporation's activities. A corporation is taxed as an entity separate and apart from its owners (unless S status is elected by the entity and its shareholders). S Corporation status is for income tax reporting only – no statutory differences between S Corporation and C Corporation under most states' laws. With changes implemented through the Tax Cuts and Jobs Act of 2017 (TCJA), there are new favorable income tax rates for both C and S Corporations for what is known as Qualified Business Income (for pass through entities) subject to limitations based on income that should be reviewed with tax advisors.

a. **Advantages:**

(1) Limited liability of owners for tort and contractual liability of entity: liability limited to capital contribution that is utilized for purchase of shares. Exception: May also be state law exceptions for certain taxes (sales/payroll).

(2) Owners are not liable for acts of co-owners.
(3) Entity not terminated upon death, bankruptcy or withdrawal of owners (unless otherwise agreed in writing). Entity's existence may be perpetual.
(4) Interests (stock ownership) are freely and easily transferable (unless restricted by agreement).
(5) Ability to have centralized management (i.e., several owners but board of directors/officers selected to manage day to day operations.
(6) Ownership interests may be different among owners (i.e., voting/nonvoting interests, preferred/common interests)(there are limitations on S Corporations).
(7) If low profits, C corporation may allow use of lower tax bracket than pass through entity.
(8) C corporation offers the ability to deduct benefits payable to owners. S corporation's ability may be limited, similar to a sole proprietorship.
(9) Ability to retain profits and avoid taxation at personal level.
(10) Corporation laws throughout country are very similar and have long history of interpretation.
(11) Simple to create.
(12) Flexible capitalization requirements.
(13) Ability to select fiscal year.
(14) Corporation distributions not subject to self-employment tax. However, the IRS has announced it will begin review of wages and dividends paid through S corporations.

b. **<u>Disadvantages</u>:**

(1) Certain operating procedures must be followed to avoid piercing of corporate veil and resulting in personal liability for owners (i.e., annual meetings of shareholders, directors; maintenance of corporate minutes, etc.).
(2) Depending on tax structure (C vs. S) double taxation in operations and upon disposition of assets.
(3) S Corporation is restricted from having entities, certain trusts and nonresident aliens as shareholders. Maximum number of shareholders - 100.
(4) Upon incorporation, if liabilities assumed by the corporation exceed shareholders' basis in assets contributed, taxable gain results; I.R.C. §357(c). Otherwise, tax-free; I.R.C. §351. The basis of stock or securities received by the transferors is the basis of property transferred, less boot, plus gain recognized if any. I.R.C. §358(a)(1). If the corporation assumes a liability of the transferor or takes property of the transferor subject to any liabilities, the liability reduces the basis in the transferor's hands. I.R.C. §358(d). If there is debt in excess of basis, a taxable transaction results and gain is realized. I.R.C. §357(c).

(5) A corporate level tax is assessed against sales or exchanges of appreciated assets, that were acquired while the corporation was a C corporation, which are disposed of within 5 years after election of S corporation status. I.R.C. §1347(a). The rule does not apply to assets acquired after S election is made. This may reduce impact to agricultural operations if equipment, machinery are replaced. Except for land, most farm assets are replaced in three to six years (cattle, equipment, etc.). Therefore, built-in gains tax may not be a burden to a farm corporation.

(6) May be state-level assessments, minimum tax or filing fees applied each year.

4. **Limited Liability Company**. A limited liability company is a legal entity that offers its owners protection from personal liability but allows the entity's owners to be taxed as a partnership (unless the owners elect to be taxed otherwise). An LLC is created by filing "Articles of Organization" with the Secretary of State and entering into an operating agreement (LLCL §203) or by converting a general partnership to an LLC on a tax-free basis. [LLC Law §1007] Some states allow for a statutory conversion. In other states, an LLC is created and general partnership interests are transferred to it. An Operating Agreement is the equivalent of the Partnership Agreement LLC Law §417. LLC distributions may have favorable rates if they constitute "Qualified Business Income (QBI)" under the 2017 Tax Cuts and Jobs Act, but this should be carefully reviewed because of limitations.

a. **Advantages:**

(1) Owners enjoy limited liability for obligations and liabilities of entity and other owners.

(2) If Pass through entity – avoids double taxation.

(3) Flexibility in management and governance. Management may be by members or by managing members (similar to a board of directors).

(4) Ownership interests may be structured in a manner similar to corporation (i.e., voting/nonvoting interests, preferred/common interests).

(5) Common form of business operation internationally.

(6) Single Member LLC has annual filing fee of $25.00 but does not need to file separate tax return (report income on Schedule F).

(7) Simple to create. General partnership can convert to LLC tax-free. *NY LLC Law Section 1006 and Federal PLR 9618021* (Feb. 2, 1996).

(8) Multiple LLCs can provide allocation of income, protection of assets from liabilities of the other LLCs, etc.

(9) If taxed as a partnership, flexible allocation of income, distribution of assets, etc.

(10) LLC can elect whether to be taxed as a partnership, C Corporation or S Corporation.

b. **Disadvantages**:

(1) Similar to a corporation technical operating requirements must be followed in order to enjoy limited liability and to avoid piercing of the veil.
(2) Certain steps must be taken in operating agreement aid procedurally in order to avoid dissolution upon death, bankruptcy or withdrawal of an owner/member.
(3) May affect eligibility for ASCS/FSA payment programs.
(4) Must be careful to avoid unnecessary self-employment tax for those not active in farm. An LLC member is subject to self-employment tax or income of LLC if a member is a manager or if the LLC has no designated manager. Prop. Treas. Reg. §1.1402(a)-18.
(5) May be annual filing fees or minimum assessments imposed under state law. E.g. In 2007, New York state increased the annual filing fees for Limited Liability Companies and certain other entities by a significant amount depending on the "gross" revenues of the entity.
(6) May not be easily converted to another entity (e.g. corporation).

5. **Limited Liability Partnership**. A limited liability partnership is a general partnership, the owners of which are protected against tort and contract liability for acts of the other partners or acts of the partnership itself. In some states LLPs may be composed only of certain professional firms (i.e., architects, accountants, physicians, lawyers, etc.).

6. **Limited Partnership [Revised Limited Partnership Act Sections 101-1300]**. A limited partnership is a partnership which has "general" and "limited" partners. General partners have unlimited liability for the acts of the partners and of the entity. Limited partners are not liable for the acts of the partners or of the entity itself and may not participate in management. LPs are taxed as a general partnership (i.e., a "pass through" entity). Limited Partnerships are created upon filing a certificate of limited partnership in the Secretary of State's office.

a. **Advantages**:

(1) Offers all advantages of partnership.
(2) Allows creation of interests that have limited liability (more attractive to investors).
(3) Having general and limited partners allows for centralization of management in the hands of the general partners.
(4) Flexibility as to allocation of losses and profits among general and limited partners.
(5) Limited partner interests are not subject to attachment by creditors – limited to charging order.

(6) Ability to transfer equity interests to others while retaining control by general partners. Note: IRS has recently been active in Tax Court challenging such arrangements.
(7) Form of entity may allow for greater valuation discounts to enhance ability to reduce estate values for owners' estate plans. Note: Entity must have a business purpose. It cannot be merely to discount value of interests.
(8) Only general partners may dissolve the partnership.
(9) A partner may be both a limited partner and a general partner at the same time.
(10) A limited partner's distributive share is not subject to self-employment income tax. 42 U.S.C. §411(a)(11), I.R.C. §77(c). Exception: If guaranteed payments are made as remuneration for services.

b. **<u>Disadvantages</u>:**

(1) General partners are personally liable for farm activities as in a general partnership.
(2) Limited partners may not participate in management or they risk loss of protection from liability for acts and obligations of entity and partners. A limited partner should have no participation in management. Personal guarantee of partnership's obligations could subject limited partner to liability for all partnership liabilities. Limited partner should not provide more than 500 hours of service per year. Prop. Treas. Reg. §1.1402(a)-2(h).
(3) Interests are not freely transferable.
(4) More costly and complex to organize than general partnership (filing requirements, publication requirements).
(5) May affect eligibility for FSA payments.
(6) General Partners subject to Self-Employment Taxes.

C. **<u>Issues to Consider in the Selection of an Entity</u>**.

1. Taxability of the entity and its owners.

2. Ability of owners to obligate the entity and other owners. Personal liability of the owners for actions and liability of themselves, each others and the entity.

3. Centralization of management within the entity.

4. Transferability of interests in the entity. Ability to restrict transferability by agreement.

5. Perpetual or limited existence of entity.

6. Expense of formation and technical requirements which must be followed in the operation of the entity.

7. Form of ownership interests; e.g., S corporations may not have entities and certain trusts as owners and number of owners is limited.

8. Flexibility with respect to allocations of profits and losses of entity.

9. Form of capital contributions being made, equity and non-equity, voting and nonvoting interests being created.

10. Does the entity fit within the owners' estate plans; e.g., only certain trusts may be shareholders of S corporations, may be desire to limit liability of estate for actions of entity etc.

11. What requirements are set forth in the statutes for resolution of shareholder, director disputes? (For example, the ability of a minority shareholder to petition a court for dissolution.) May a shareholders or partnership agreement govern instead of statute?

12. Events which may cause or result in dissolution and tax effects of dissolution.

13. Annual or other regular filing requirements are there for the entity? (For example, tax returns, filing requirements for state, confidentiality issues, etc.)

14. Need for keeping owners' participation on an anonymous basis.

15. Creation of multiple entities may meet family objectives (e.g., land held in one entity [e.g., LLC] with machinery, equipment, livestock in separate operating entity).

V. GETTING STARTED! - - THE ESTATE AND BUSINESS PLAN AUDIT

A. Estate Plan Audit.

1. Review, create or update wills, trusts, powers of attorney, health care planning documents **for everyone involved in the farm**.

2. Are distributions outright? **Consider distributions to trust for asset protection**.

3. Are farm assets specially provided for in the plan? Farm Trusts, Real Estate Trusts, **are Farm Assets for Farm Heirs?**

4. Do the "non-probate" assets reflect the overall intentions for farm and non-farm assets? Beneficiary designations need to be reviewed and/or updated to reflect senior generation's plan. i.e. Retirement plans, life insurance/annuities, jointly held assets - **none of these pass through the will**.

B. Business Succession Audit.

1. Review and update Operating Agreements, Partnership Agreements and Shareholder Agreements.

   a. Are management issues properly addressed? **Is there a procedure for appointing successors?**

   b. Does the agreement contain necessary tax related provisions to support the positions taken on the tax return? **Guaranteed Payment Provisions, Profit Interest Provisions, Allocation of Profits and Losses?**

   c. Are minutes and other governance documents up to date?

   d. Have entities been created to limit liability exposure?

   e. Are written leases in place between entities to support tax returns, minimize income, possibly payroll taxes, etc?

2. Review of Buy Sell Agreements.

   a. Are the parties correctly set forth?

   b. Are multiple generations properly reflected?

   c. Are triggering events correct? Death, disability, voluntary and involuntary termination? **All events may not apply to all owners.**

   d. Is the value for purchase properly stated and updated? Certificate of value, appraisal, etc.

   e. Is the agreement properly funded or do the terms protect cash flow of the entity? **E.g. life insurance should be obtained where possible. In cases where life insurance is not available or applicable are payment terms properly structured so as to not adversely affect the farm's cash flow?**

C. Entity Organization Discussion Checklist. The purpose of this section is to outline the issues that should be considered with respect to the formation and operation of limited liability companies for the operation and ownership of the farm operation. The issues presented in this outline are applicable to any entity which has more than one owner and/or manager. For reference purposes, this section will refer to Limited Liability Companies or LLCs.

Please note that this is for discussion purposes only and is intended to be presented as a discussion outline for the issues that are generally faced in structuring an entity for operation of an agriculture based business. This is primarily designed for purposes of creating and operating a limited liability company but many of the same issues may be presented regardless of the entity under which the operations will be structured.

I. **Formation Considerations**:

Member Contributions: Prior to formation, the members must determine what each will contribute to each LLC (assets, cash, services, etc.) in return for their membership interests.

II. **Liability Considerations**:

Members of an LLC are typically not liable for the LLCs debts and other obligations except to the extent of their investment in the LLC or as otherwise provided for in the LLC Operating Agreement and/or Articles of Organization. Is it intended that the members be personally liable for debts and other obligations (or specific debts and obligations) of the LLCs? Will the members be required to provide personal guarantees of LLC debts and obligations?

III. **Membership Considerations**:

a. **Who can be Members of the LLC?**

1. All equal owners? If not, how determined?

2. What will the cost be to get in? What assets, monies will be contributed?

3. How will each member hold title to his interest? Individually, in trust, jointly.

b. **Redemption of Membership Interests/Transfer of Membership Interests**: Can members freely transfer their membership interests in the LLCs? (i.e., may interests be transferred to spouses, trusts, third persons, etc.)

c. **What will the terms of the Buy/Sell Agreement be?**

1. Mandatory purchase in any case of someone leaving the business as a result of death, disability, voluntary withdrawal, involuntary withdrawal, retirement?

2. How is price determined? There are several methods for valuation. May want to consider having an agreed upon value that is reviewed periodically, but with a provision that states that if the value is not updated within a certain period of time, the value is determined by appraisal, fall back formula, etc. This avoids being bound by a value that is no longer applicable.

3. Will there be any discounts or penalties if a member voluntarily leaves or is terminated "for cause"?

4. If a member dies, will his estate be liable for the obligations of the LLC or will the remaining members indemnify the estate?

5. How will a buy out be funded?(i) Life insurance.

   (ii) Disability insurance.

6. What are the terms of a buy out?

   (i) Period of years? Should the term be different depending on the applicable triggering event?

   (ii) Does termination require a buy out from all entities? I.e. if there are multiple entities (real estate, operating, trucking, etc.) does the termination of the member's interest in the operating entity require a termination of the member's interest in all entities?

   (iii) What interest rate should be used for deferred payments?

7. Should remaining member(s) have the option to liquidate and sell the farm rather than buying out the terminated member?

   (i) If so, when does the decision need to be made?

   (ii) All entities or just one or two?

8. Will the members have the option of transferring ownership interests to "Permitted Transferees" rather than being bought out at death. E.g. other family members, trusts created during lifetime or in wills, etc.

   If so, are there to be limitations on who can be a "permitted transferee":

   (i) May want to consider having any individuals who are to become members limited to those who have shown a commitment to the operation - e.g. family members who have been active on the farm for a specified period of time on a continuous basis and have attained a certain age.

   (ii) If trusts are allowed as "Permitted Transferee", trustee may need to be approved by other members. Also, terms may want to provide that ownership cannot be distributed out to individuals until they have met the requirements described in "(i)" above.

   (iii) If spouses of members are Permitted Transferees should there be similar requirements, should the interests be converted to "nonvoting" interests prior to transfer?

IV. LLC Operational Questions and Considerations:

The following list is intended to be an initial outline of the operational issues that should be considered when forming the limited liability companies:

a. **Additional Capital Contributions**:

   1. What if the entities requires additional capital in order to meet their operating expenses?

   2. How will the decision be made to contribute additional capital?

   3. Will contributions be required in proportion to membership interests or in proportion to your share of profits (losses)?

   4. May additional funds be "loaned" to the entity, as opposed to being considered an additional capital contribution?

   5. What will happen if a member fails to contribute additional capital? Will his interest be diluted or will he be required to forfeit his interest?

6. Will members be entitled to a return on their capital contributions? If so, will it be treated as a guaranteed payment?

b. **Management Decisions**:

1. How will the LLC be managed on a day-to-day basis?

(i) Will there be a managing partner? Is he to be compensated for those services?

(ii) Will the LLC be managed by a manager, board of managers or by the members voting on a percentage basis?

(iii) What will powers be? When will others have to be consulted? Should there be a dollar limit on decision making authority or on the length of leases, service contracts, etc. the manager(s) or members may enter into without the authority of the others? (see below)

(iv) What will voting requirements be?

(A) Simple majority?
(B) Greater than simple majority?
(C) Specific voting requirements for specific matters?2. How are *major* management decisions going to be made for the LLC (i.e., sale of assets, merger, bank financing, purchase of another farm, land, admission of a new member, etc.)? What will be considered a *major* management decision?

(i) any capital transaction (i.e., financing);

(ii) sell, dispose, trade, or exchange LLC assets outside the ordinary course of the LLC's business;

(iii) the LLC's expending or committing to expend in excess of $____________________________ in money, services or property for any one transaction, acquisition or other contractual obligation. Will any one person have the authority to make expenditures up to a certain amount?;

(iv) the LLC's borrowing of more than $______________________ for the creation, modification, amendment or extension of any borrowing facility;

(v) the LLC's modification of a loan or other extension of credit if such loan or other extension of credit is more than $__________ ;

(vi) the creation or the modification of the terms and conditions under which Preferred Membership Interests shall be issued by the LLC;

(vii) the admission of Members to the LLC;

(viii) approval of an acquisition, merger or consolidation of the LLC with or into another limited liability company or other business entity.

3. What if you cannot agree on a *major* management decision? How will such issues be resolved?

c. Allocation of Profits and Losses; Guaranteed Payments; Profits Interest:

1. How will the profits and losses of the LLC be distributed? Will the profits and losses be distributed equally among the members, based on pre-determined percentages or will they be distributed in proportion to each member's percentage interest in the company?

2. How will the expenses of the LLC be allocated? Will they be shared equally by the members or allocated based on percentages? Or, will they be shared based on a combination of the two methods?3. Will any of the members receive guaranteed payments from the LLCs? Will the guaranteed payments represent a return on the members' capital contributions?

4. Will any of the members be entitled to a profits interest different from their capital accounts?

d. **Termination of LLC**:

1. What events will require the termination of the LLCs? What vote will be required?

2. What happens in the event the business should terminate?

3. On a termination of the LLC, should there be a buy-out of the interests or an unwind of the business by means of a distribution of the assets initially contributed by a member?

4. How will jointly acquired assets be distributed?

e. **Real Estate Matters**:

1. How will real estate be treated? Will there be rental payments between the entities? If so, what will be the rental amount?

2. Are there to be leases with any of the members or other entities?

3. Do any family members live in residences owned by the operation or other members? If so, if the member terminates his or her relationship with the farm, should there be a termination of the right to reside on the farm property? How long before residence must be vacated?

   If a member dies and his family reside in the home, should the surviving spouse and the family be given an opportunity to continue to reside in the home? Permanently? Set period of time? Until the surviving spouse remarries or cohabits with another individual? Must ensure farm retains the right to change residences and/or terminate upon a certain number of months notice in order to preserve the right to make changes, sell the farm, etc.

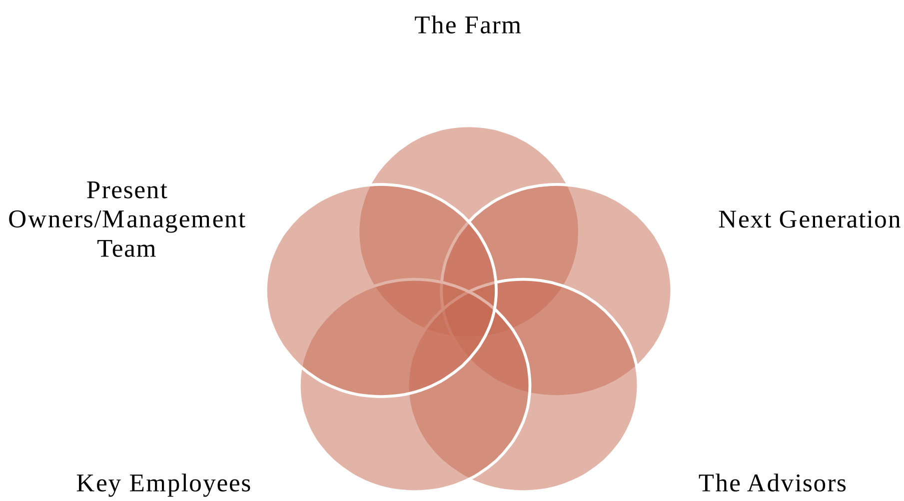
VI. SUMMARY – SELECTING THE ADVISORY TEAM

In a closely held agriculture business, generally the assets of the business make up most of the owners' estates. Although the objective of a family may be to perpetuate a family farming operation for as long as family members wish to farm, outside pressures weigh heavily on the ability to do so. Estate and income taxes, dealing with farm and nonfarm children, retirement issues, land value issues, long term care issues, commodity and input prices, etc. all add to the complexity of putting together a plan that can withstand these outside pressures and result in a successful multi-generational plan.

It is important to plan early in order to develop a comprehensive plan that can address all the "what ifs" that come along in the life of a family business. **Once implemented, the plan needs to be monitored and maintained in order to ensure that it continues to be up to date and reflect the intentions of the family and the owners**. Laws continually change as do the facts and circumstances surrounding a family and a family owned business. To ignore these changes can be as devastating as not having any plan in place at all.

Regardless of how large or small an operation is, it is imperative to have an advisory team working with the family and the family farm owners. These advisors can provide valuable insight not only to family members but to other members of the advisory team to ensure that the plan is properly structured and works well into the future.

The Successful Farm Succession Planning Team
Working Together for the Perpetuation of Farming



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