

# **Farm Transition Workshop**

**Sponsored By  
Pennsylvania Department of Agriculture  
and  
Pennsylvania Farm Bureau**

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Weaver's Banquet Facility**

## **Business, Legal & Tax Considerations in Farm Transition and Estate Planning**

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## • **Federal Estate and Gift Taxes**

- The federal estate and gift tax applicable exclusion amount for 2016 is \$5.45 million plus the deceased spouse's unused, preserved exclusion (annual, calendar year inflation-adjusted).
- The federal annual gift exclusion amount is \$14,000 for 2016, and tied to inflation with changes in \$1,000 increments.
- The federal estate and gift taxes impact few taxpayers with \$5M+ applicable exclusion amount.



## Fundamentals of Estate Planning

- **Stepped-Up / Carryover Basis**

- Tax basis of assets acquired from decedent is adjusted at death.
- Tax basis of assets transferred during lifetime by gift is carried over.



## Fundamentals of Estate Planning

# • Pennsylvania Inheritance Taxes

### – Rates

- spouse – 0%
- direct beneficiaries – 4.5%
- siblings – 12%
- others – 15%



### – Ag Exemptions/Elections (effect. 7/1/2012)

- lineal descendants/siblings
- members of same family
- Clean & Green counterpart

### – Family Business Exemption (effect. 7/1/2013)

## Fundamentals of Estate Planning

- **Liquidity Needs at Death**  
**(\$3,500,000 Estate)**

1. Funeral .....	\$20,000
2. Miscellaneous .....	\$10,000
3. Attorney.....	\$70,000
4. Executor.....	\$70,000
5. PA Inheritance Tax.....	\$150,000*
6. Fed. Estate Tax .....	\$ <u>    0</u>
<b>CASH NEEDED.....</b>	<b>\$320,000</b>

\*With ag exemptions/elections this inheritance tax may be much less.

## Fundamentals of Estate Planning

- **Cash Needs of Farm Child**

Farm/Business Assets  
\$3,000,000

Liquid Assets  
\$500,000

3 Children

1 Farm/Business Child

Assume Equal Division

Farm/Business Child Needs  
\$1,940,000



## Fundamentals of Estate Planning

- **Will**

- Distribution Arrangements
- Fiduciaries – Executor/Trustee/Guardian
- Tax-Saving/Disclaimer Will
- Key Safety Net for Transition Plan



## Fundamentals of Estate Planning

# • **Non-Tax Considerations**

### – Powers of Attorney

- New Requirements in PA, effective January 1, 2015
- Financial and Health Care combined?
- Sole/Multiple/Joint Agents?

### – Health Care Declarations (Living Wills)

- Same or different agents than under power of attorney?
- Organ donation?



## Fundamentals of Estate Planning

### • **Non-Tax Considerations (cont'd.)**

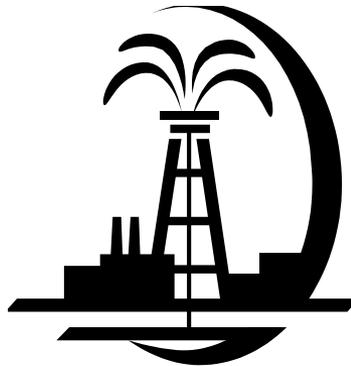
- Marital Issues (i.e. divorce)
- Probate/ Non-Probate
  - Will/Living Trust
- Oil/Gas Interests
- Elder Law Issues



## Fundamentals of Estate Planning

### • **Non-Tax Considerations (cont'd.)**

- Oil/Gas Interest Planning
  - Surface/Subsurface Separation
    - Sale/Conveyance
    - Exception and reservation by owner
    - Perpetual/lifetime/specific term
    - Define the oil, gas and mineral rights to be severed



## • Nursing Home Care and Costs

- Daily gift penalty divisor = \$302.42 (\$110,000 + annual) (changes yearly)
- Resource allowance - \$2,400 (to \$8,000 for lower income)
- Minimum \$23,844/Maximum \$119,220 - Community Spouse Resource Allowance (changes yearly)



- **Nursing Home Care and Costs (cont'd.)**

- Personal Residence Equity – generally up to \$552,000 (2016)
- Installment Notes – must be Medicaid compliant
- Long Term Care Insurance



- **Nursing Home Care and Costs (cont'd.)**

- Special Needs Trusts/Trusts for Disabled Persons – no period of ineligibility
- Family Caregiver Agreements – agreement must be in writing
- Transfer of Assets to Community Spouse
- Re-Write Community Spouse's Will
- Possible Annuity Purchase to Accelerate Qualification



- **Nursing Home Care and Costs (cont'd.)**

- Transfers for less than fair market value within 60 months of Medicaid application.
- An individual may gift up to \$500/month total (not per donee) without a period of ineligibility.



Succession Planning Techniques - Family Farm

- **Timetable for Farm/Business Transfers**

Description

Child's Age

Non-Real Estate

30

Real Estate [core tract(s)]

40

Succession Planning Techniques – Family Farm

• **Bargain Sale – Farm/Business**

(2016 Example)

Fair Market Value ..... \$1,800,000

Sale Price ..... 600,000

Gift ..... 1,200,000

F & M to S & D-in-L (annual exclusions). 56,000

Gift Credits Used ..... \$1,144,000

- \$572,000 of Father's with \$4,878,000 remaining
- \$572,000 of Mother's with \$4,878,000 remaining

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Death Credits Remaining ...\$9,756,000 (under most circumstances)

## Succession Planning Techniques – Family Farm

### • **Taxes Affecting Transfers**

- Federal Estate and Gift Taxes
- Pennsylvania Inheritance Taxes
- Income Taxes
- Capital Gains



- **Taxes Affecting Transfers (cont'd.)**

- FICA and Self-Employment

- Realty Transfer Taxes

- Capital Stock (repealed)

- Sales/Use Taxes

- Real Estate Taxes / Clean and Green Issues



## Succession Planning Techniques – Family Farm

- **Tools for Lifetime Transfers**

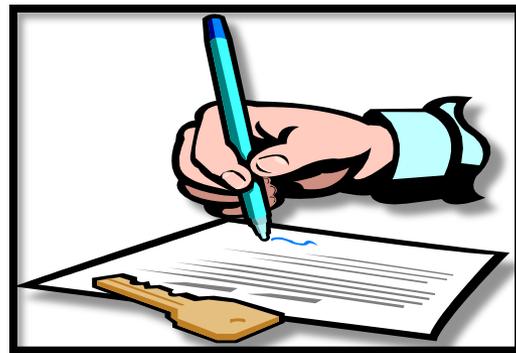
- Deed of Gift
- Lease
- Sale with lump-sum payment
- Sale with installment payments



## Succession Planning Techniques – Family Farm

- **Tools for Lifetime Transfers (cont'd.)**

- Sale through private annuity
- Sale through self-cancelling installment obligation
- Buy/sell agreements
- First right to purchase and option agreements



- **Tools for Lifetime Transfers (cont'd.)**

- Irrevocable trust (usually life insurance)
- Transfer of ag conservation easements
- Life insurance
- Charitable gifts – outright or trust
- Legal entity for joint ownership



## Succession Planning Techniques – Family Farm

### • **Choice of Entity Planning**

- Sole Proprietorship – Dairy/Crop
- Partnership – general or limited or limited liability
- Corporation – C or S status
- Limited liability company (LLC) – member-managed or manager-managed/taxed as individual or partnership or corporation
- Trusts – revocable / irrevocable / dynasty / asset protection / statutory / common law



- **Choice of Entity Planning (cont'd.)**

- **Sole Proprietorship**

- Simple
- Most common farm business form
- For sole owner/operator
- No liability protection
- Form 1040 tax return
- Possibly multiple sole proprietorships if >1 owner/operator, but co-ownership agreement with buy-sell provisions recommended
- Familial exemptions for realty transfer tax



- **Choice of Entity Planning (cont'd.)**

- **General Partnership**

- Owner is referred to as partner
- When >1 owner/operator
- All partners are general partners
- No limited liability protection
- Form 1065 for tax return
- Common farm business form when >1 owners/operators, but giving way to LLCs
- Partnership agreement with buy-sell provisions recommended
- Realty transfer tax family farm exemption if qualify



- **Choice of Entity Planning (cont'd.)**

- **Limited Partnership**

- Unlike general partnership, also has limited partner(s)
- Owner owns either limited partner or general partner interests
- Limited liability for limited partner(s), not for general partner(s) (unless LLC or corp. as general partner)
- Form 1065 for tax returns



- **Choice of Entity Planning (cont'd.)**

- **Limited Partnership (cont'd.)**

- Historically used for real estate ownership for non-active owners, such as extended family members, but this will likely change now that capital stock tax is repealed
- Partnership agreement with buy-sell provisions recommended
- Realty transfer tax issues, but Act 85 of 2012 eliminated some roadblocks for family farms



- **Choice of Entity Planning (cont'd.)**

- **Corporation**

- Owner is referred to as shareholder
- C cf. S corporation – tax, not legal difference
- Available for sole owner/operator
- Limited liability for each shareholder
- Form 1120 for C and Form 1120S for S corporations
- Less common with farm operations due to potentially severe tax consequences upon dissolution, but some Social Security/FICA advantages possible for high income businesses



## Succession Planning Techniques – Family Farm

- **Choice of Entity Planning (cont'd.)**

- **Corporation (cont'd.)**

- Buy-sell agreement recommended
- No longer subject to capital stock tax
- Realty transfer tax family farm exemption if qualify



- **Choice of Entity Planning (cont'd.)**

- **Limited Liability Company**

- Owner is referred to as member
- Can be member-managed or manager-managed
- Available for sole owner/operator
- Limited liability for each member
- Either 1040 for single member or 1065 for >1 member, but can elect to be taxed as a corporation and use Form 1120
- Presently the entity of choice in farm operations, especially if >1 owner/operator



- **Choice of Entity Planning (cont'd.)**

- **Limited Liability Company (cont'd.)**

- Operating agreement/buy-sell provisions recommended
- No longer subject to capital stock tax
- Realty transfer tax family farm exemption if qualify
- Self-employment/Social Security tax planning for a corporation also available to LLC if taxed as a corporation



## • **Choice of Entity Planning (cont'd.)**

### • **Trusts**

- Trustee is usually non-owner - - - the manager
- Beneficiary is person(s) entitled to receive the financial benefits of the trust
- There are many types and purposes of trusts, such as revocable trust, irrevocable trust, asset protection trust, dynasty trust, statutory trust, common law trust
- Form 1041 for tax returns
- Not common for farm business operations
- Prudent investor/fiduciary issues
- Principal and Income Act issues





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