Hoosier Hills Estate Planning Council
Continuing Professional Education Meeting

presents

2019 Estate Planning Day

May 9, 2019

Hoosier Hills Estate Planning Council

The Hoosier Hills Estate Planning Council ("HHEPC") is an interdisciplinary organization for professionals involved in estate planning.

The purposes of the HHEPC are:

(1) to promote cooperative efforts among all professionals in the field of estate planning represented by the members, always keeping in mind the best interests of their clients;

(2) to engage in study, discussions, meetings, and additional activities which will continuously improve the services the members deliver to their clients;

(3) to promote respect and understanding of the relationship among the professions represented by the members, and the role each serves on the estate planning team; and

(4) to advance public knowledge of the concept of estate planning.

The Hoosier Hills Estate Planning Council provides education and networking opportunities to attorneys, accountants, insurance professionals, trust and investment managers and financial counselors in south central Indiana. HHEPC presents 2-hour programs four times a year in Bloomington, Nashville, and Columbus, Indiana on topics in estate, financial and trust planning. These programs are generally pre-approved for CE credits. After the presentations there is an opportunity to network with other professionals. New members are welcome at any time. For membership information contact Erin Martoglio at erin@bloominglaw.com

Hoosier Hills Estate Planning Council

Board of Directors

David Maschino
Lighthouse Advisors, Inc., Indianapolis, Indiana
President

Steve Boltz
Schwab Financial Planning, Indianapolis, Indiana
Vice-President

Cheyenne Riker
Clendening Johnson & Bohrer PC, Bloomington, Indiana
Secretary

Jessica Hidalgo
Blue & Co. LLC, Seymour, Indiana
Treasurer

Committees of the Board

Brad Minor
Blue & Co. LLC
Carmel, Indiana
Past-President

Michelle McCrory, Attorney
Like Law Group LLC
Bloomington, Indiana
Program Facilities

Lynda Garber
First Financial Wealth Management
Columbus, Indiana
Special Projects

Dave Maschino
Lighthouse Advisors, Inc.
Indianapolis, Indiana
Program Speakers
Communications/Public Relations

Steve Boltz
Schwab Financial Planning,
Indianapolis, Indiana
Newsletter

Lora Mount, Attorney
Voelz, Reed & Mount, LLC
Columbus, Indiana
Program Speakers

Christina Richardson
Circle-Prosco, Inc.
Bloomington, Indiana
At-Large

Erin Martoglio
Freitag & Martoglio LLC
Bloomington, Indiana
Membership

Disclaimer

The information and procedures set forth in this practice manual are subject to continual change. The enclosed should only be considered as guidelines for further investigation and study. Keep in mind that the forms were developed for particular circumstances and are samples only.

The Hoosier Hills Estate Planning Council and contributing authors hereby disclaim any and all responsibility or liability, which may be asserted or claimed arising from or claimed to have arisen from reliance upon the procedures and information or utilization of the forms set forth in this manual, by the attorney or non-attorney.

Attendance at HHEPC presentations does not qualify a registrant as an expert or specialist in any discipline of the practice of law. HHEPC does not certify its registrants as specialists or expert practitioners of law.

Use of the HHEPC logo or name without HHEPC's express written permission is prohibited. HHEPC is an equal opportunity provider of continuing education that does not discriminate on the basis of gender, race, age, creed, handicap, color or national origin. HHEPC reserves the right to refuse to admit any person or to eject any person, whose conduct is perceived to be physically or emotionally threatening, disruptive or disrespectful of HHEPC registrants, faculty or staff.

Table of Contents

Agenda 7

Sponsors 9

8:30 Rodney Retzner, Avoiding Estate Litigation 17

9:40 Marvin Hills, What Estate Planners Need to Know about Tax Planning for Shareholders of S Corporations 29

11:00 Susan Hunter, Insights for Successful Practice Management 79
Articles 85

1:00 Polly Dobbs, How Estate Planning is Different for Farmers – What You Need to Know 89
Articles 111

2:15 Brian Melvin, Savvy Social Security Planning 145
Article 171

3:25 Patrick Olmstead, Jr., Ethics Issues in Estate Planning and Administration 173

Agenda

- 7:30 – 8:20 Registration/Continental Breakfast/Sponsor Booth Visitation
- 8:30 – 9:30 Rodney Retzner, Attorney , Kreig DeVault– *Avoiding Estate Litigation*
- 9:40 – 10:40 Marvin Hills, CPA – Crowe LLP– *Life Cycle of an S Corporation*
- 10:40 – 11:00 Break – 20 minutes
- 11:00 – 12:00 Susan Hunter, Attorney, Hunter Law Office – *Insights for Successful Practice Management*
- 12:00 – 1:00 LUNCH
- 1:00 – 2:00 Polly Dobbs, Attorney, Dobbs Legal Group, LLC – *How Estate Planning is Different for Farmers – What You Need to Know*
- 2:00 – 2:15 After Lunch Break – 15 minutes
- 2:15 – 3:15 Brian Melvin, Senior Wealth Manager, United Capital – *Savvy Social Security Planning*
- 3:25 – 4:25 Patrick Olmstead, Jr. Attorney, Patrick Olmstead Attorney at Law – *Ethics Issues In Estate Planning and Administration*
- 4:25 – 4:35 Closing Comments

Hoosier Hills Estate Planning Council Thanks Our Sponsors

Gold
Old National Wealth Management

Meal Sponsor
Indie Asset Partners

Bronze:
Blue & Co., LLC

Community Foundation of Bloomington and Monroe County

German American Bancorp

Indiana University Foundation

Supporting Sponsors:
American Red Cross

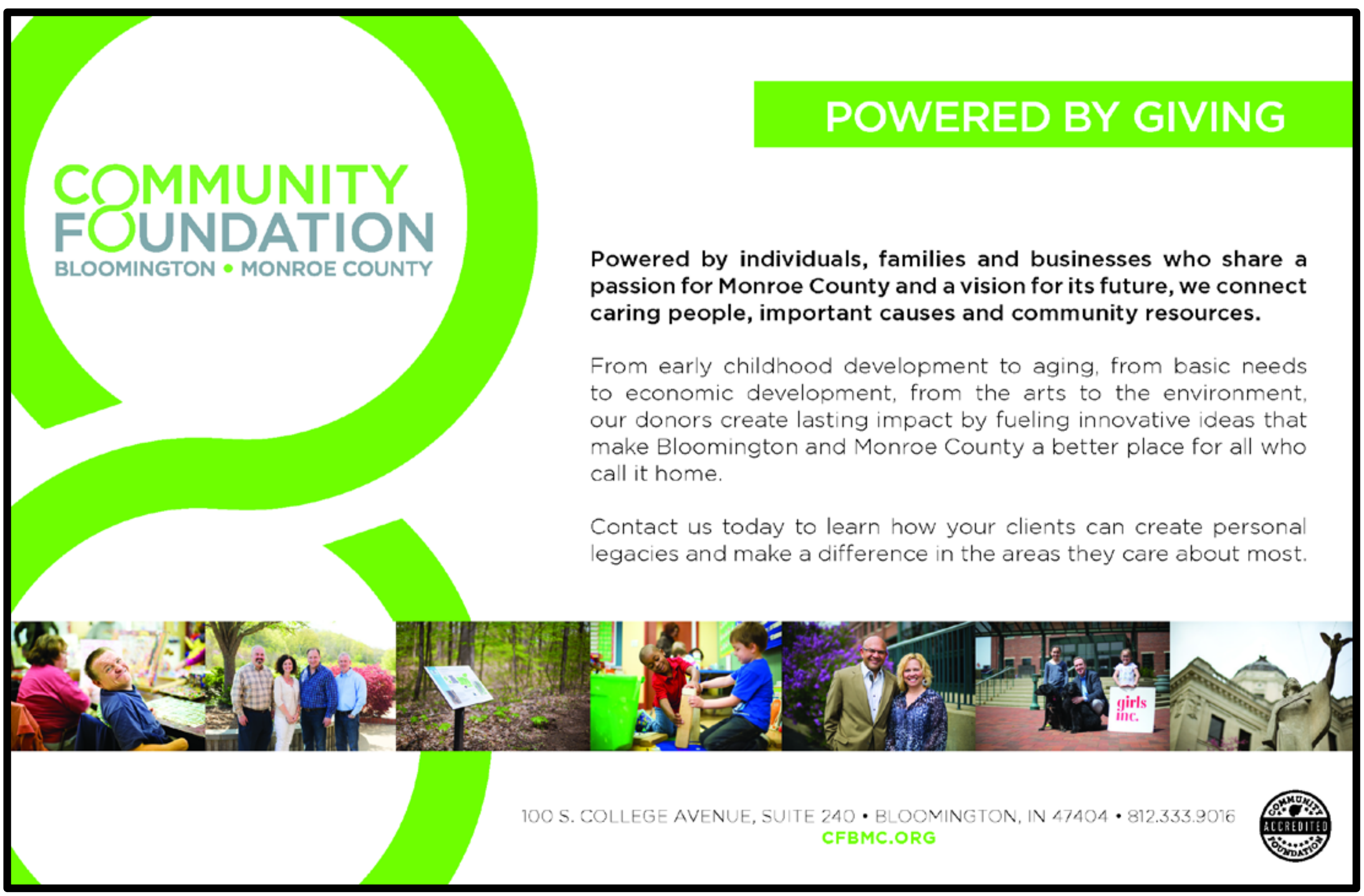
Crowe LLP

Clendening Johnston & Bohrer, P.C.

Mass Mutual

The Salvation Army – Indianapolis


CPAS / ADVISORS
blue
We are responsive.
We are caring.
We are advocates.
SERVICE OVERVIEW
• Estate Planning
• Estate Tax Planning
• Agreed-Upon Procedures
• Mergers and Acquisitions Consulting
• Forecasts and Projections
• Employee Benefits Administration
• Employee Benefits Plan Design
• Outsourced Accounting Solutions
• R&E Tax Credit
• Audits, Reviews, and Compilations
• Due Diligence
• Tax Return Preparation
• Tax Projections and Planning
• Retirement Planning
• Cost Segregation
• Payroll Services
• Property Tax Return Preparation
• IT Risk & Advisory Services
812-522-8416 | 813 West Second Street | Seymour, IN, 47274
blueandco.com


COMMUNITY FOUNDATION
BLOOMINGTON • MONROE COUNTY
POWERED BY GIVING
Powered by individuals, families and businesses who share a passion for Monroe County and a vision for its future, we connect caring people, important causes and community resources.
From early childhood development to aging, from basic needs to economic development, from the arts to the environment, our donors create lasting impact by fueling innovative ideas that make Bloomington and Monroe County a better place for all who call it home.
Contact us today to learn how your clients can create personal legacies and make a difference in the areas they care about most.
100 S. COLLEGE AVENUE, SUITE 240 • BLOOMINGTON, IN 47404 • 812.333.9016
CFBMC.ORG

Rodney S. Retzner

Partner

P: (317) 238-6256
F: (317) 636-1507
E: rretzner@kdlegal.com

Carmel Office
12800 North Meridian Street
Suite 300
Carmel, IN 46032-5407

Rodney Retzner is the Chair of the firm's Estate Planning and Administration Practice Group. His practice is concentrated in the areas of estate and business succession planning, estate and trust administration and estate and trust litigation. In the practice of succession planning, Mr. Retzner has worked with many closely-held family businesses in order to assist in the transition of the business to future generations with the least amount of impact as possible from taxation as well as family relationships. Mr. Retzner's practice in the area of estate planning has included work with individuals with nominal estates up to individuals with over a billion dollars in net worth.

PRACTICE AND INDUSTRY TEAMS

- Business, Acquisitions & Securities
- Energy and Public Utilities
- Estate Planning and Personal Services
- Fraternities and Sororities
- Tax
- Trust and Estate Litigation

REPRESENTATIVE EXPERIENCE

- Represented purchaser in negotiation and acquisition of a telecommunications company valued in excess of $10 million.
- Responsible for the creation/transformation of a large trust holding interest in a closely-held company into a private foundation with assets in excess of $20 million; thereby allowing for greater impact on the communities served by that company through the private foundation.
- Representation in the estate and business succession planning of a successful nursing home developer with excess of $20 million in assets and successful representation of the personal representative of the estate in transitioning the assets through estate administration and estate litigation through the ultimate beneficiaries.
- Worked with various financial institutions and other creditors in the filing and prosecution of

claims against deceased estates and trusts as well as against non-probate transferees, including opening estates and administering estates as a creditor and defending creditors against various asset protection devices implemented by debtors.

- Involved in litigation involving disputes with respect to will contests and trust litigation representing both plaintiffs and defendants' estate and trusts in litigation of all types related to the contest of trusts and wills as well as disputes involving distribution and other prosecution and defense of claims. Mr. Retzner has navigated clients through such disputes up to and through the Indiana Court of Appeals.

EDUCATION

- University of Cincinnati College of Law, Cincinnati, Ohio (J.D., 1998)
  - Moot Court: Moot Court Board, 1996-1998; Corporate Law Fellowship, 1995-1998
- Rose-Hulman Institute of Technology, Terre Haute, Indiana (B.S. in Mechanical Engineering, *cum laude*, 1990)
- Navy Nuclear Power Program (M.S. in Nuclear Power, 1991)

BAR & COURT ADMISSIONS

- Indiana, 1998
- U.S. District Court for the Northern District of Indiana
- U.S. District Court for the Southern District of Indiana
- Florida, 2017

PROFESSIONAL ASSOCIATIONS

- Children's Museum of Indianapolis (Planned Giving Committee)
- Indiana University Robert H. McKinney School of Law (Adjunct Professor - Trust and Estate Planning)
- Indianapolis Bar Association (Member)
- Executive Council of Estate Planning and Administration Section, Indianapolis Bar Association
- Indiana State Bar (Member)
- Council of Probate and Real Property Section, Indiana State Bar Association
- Probate Review Committee, Indiana State Bar Association
- Indianapolis Estate Planning Council (Member)
- Fishers Advisory Plan Commission and Board of Zoning Appeals, legal counsel
- United States Navy Reserve, previous Commanding Officer of several reserve units

AWARDS AND RECOGNITIONS

- Mr. Retzner is a Certified Estate Planning and Administration Specialist, certified by the Indiana State Bar Association's Estate Planning and Administration Specialty Certification Board
- Indiana Super Lawyers, 2009-2019
- Best Lawyers® 2018 Trusts and Estates "Lawyer of the Year" in Indianapolis

- Best Lawyers In America©, Trusts and Estates, 2010-2014; 2016-2018
- Chambers USA: Leader In the Field of Private Wealth Law, 2018
- Forty Under 40 Award Recipient - Indianapolis Business Journal
- Martindale-Hubbell AV Rating
- Stanley K. Lacy Leadership Series, Class XXVIII
- Community Quarterback Award Recipient - Indianapolis Colts
- Numerous medals and ribbons in connection with U.S. Navy
- Five Star Wealth Manager Award

SEMINARS AND PRESENTATIONS

- Presenter, Trust and Estate Planning Matters, Indiana Bankers Association Annual Conference
- "Fundamentals of Will and Trust Drafting," ICLEF, 2008
- "Back to the Future: Business Succession Planning," Indianapolis Bar Association, 2006
- "How to Protect Assets During Life and Avoid Estate Tax at Death in Indiana," National Business Institute, 2005
- "Estate and Trust Planning Beyond the Acronyms," Indiana State Bar Association, 2005
- "What's New in Estate Planning & Administration & Medicaid," Indianapolis Bar Association, 2005
- "Untrustworthy Non-Probate Transfers," ICLEF, 2005
- "Private Foundations and Other Avenues of Planned Giving," Lorman Education Services, 2003
- "Charitable Wealth Transfer Techniques," Bowling Green State University, 2003
- "Estate Planning for Married Couples in an Era of Tax Uncertainty," Old National Trust Company, 2002
- "Planning Opportunities with Qualified Tuition Programs in Indiana," National Business Institute, 2002
- "Basic Will Drafting and Planning," Indiana Continuing Legal Education Forum, 2002
- "Changing from Wide Angle to Zoom Lens: Estate Planning for the Surviving Spouse," Indiana Continuing
- Legal Education Forum, 2002
- "What's New in Estate Planning," Indianapolis Bar Association, 2000, 2001, 2002
- "Top Ten Practice Tips for Young Lawyers & General Practitioners – Estate Planning and Administration," Bank One, 2000
- "Dealing with Your Stock," Community Bankers Association of Indiana, Inc. Education Seminar, 2000

PUBLICATIONS

- Co-Author, "Tidying Up for 2019: Are Your Estate Planning Documents in Order?", Krieg DeVault Health Care Newsletter (March 2019)
- "Practical Law Materials - Indiana Wills and Trusts," Thompson Reuters Westlaw
- "Estate Planning in a Changing Tax World," Inside the Minds: New Strategies in Estate Planning, 2008

TRUST LITIGATION AND RECENT LEGISLATION THAT MIGHT HELP (OR HURT)

Rodney S. Retzner
Krieg DeVault LLP
12800 N. Meridian Street, Suite 300
Carmel, Indiana 46032
317-238-6256
rretzner@kdlegal.com

"WHITE BELT" DEFENSE

Rogue Beneficiary   Trustee

"WHITE BELT" DEFENSE

(a/k/a things you should already be doing . . . whether you know it or not)

- Annual account or statement
- Notice to all beneficiaries (especially when Revocable Trust becomes Irrevocable)
  (Trust Contest . . . 90 days after notice . . . I.C. 30-4-61-4)

Accountings

- I.C. 30-4-3-6(b)(6) a trustee has a duty to maintain clear and accurate accounts
- I.C. 30-4-3-6(b)(7) a trustee has a duty to keep the beneficiaries reasonably informed about the administration of the trust and of the material facts necessary for the beneficiaries to protect their interests
- I.C. 30-4-5-12 states that the trustee shall deliver a written statement of accounts to each income beneficiary annually
- Note that under I.C. 30-4-5-13 the requirements for a verified written statement of accounts filed with the court are more extensive than those for the written statement to be given to the income beneficiaries annually
- Trustee needs to keep additional records that will allow it to prepare a formal accounting according to the requirements of I.C. 30-4-5-13, <u>going all the way back to the inception of the trust</u>

KRIEG | DEVAULT

4

Waiver and Release

- I.C. 30-4-3-3(a)(16) a trustee has the right to have its expenses of administration paid out of trust property
- Beneficiaries still have a period of time three (3) years under I.C. 30-4-6-12 unless previously barred by adjudication, consent or limitation, any right against a trustee for breach of trust
- A trustee is entitled to docket a trust and seek court protection in the form of an approval of an accounting under I.C. 30-4-3-18(b) and I.C. 30-4-5-14(d). This entitlement by the trustee is the trustee's right regardless of whether the trust's governing document states that accountings are required
- The Trustee has the power to seek advanced approval of distribution under I.C. 30-4-3-3(e)
- Trustee can be released from liability for any breach under I.C. 30-4-3-19
- I.C. 30-4-5-12(a) allows waiver of accounting by Trustees
- Annual written statement required by I.C. 30-4-5-12(a), a beneficiary or his personal representative will be deemed to have discharged the trustee from liability as to that beneficiary for all matters disclosed in the statement if he approves in writing the trustee's statement

KRIEG | DEVAULT

5

Non-Judicial Settlement of Accounts

- I.C. 30-4-5-12(a) but I.C. 30-4-5-14.5 (This is <u>not</u> the proposed I.C. 30-4-5-25 dealing with settlement of litigated matters).

KRIEG | DEVAULT

6

Bifurcation of Duties

- Professional fiduciary in place as trustee but maintain the ability to invest the assets with a second unrelated investment advisor
- Trustee is responsible for overseeing the investment of the assets and requiring investments to be made in accordance with prudent standards and keeping in mind the goals and objectives of the trust and the various beneficiaries I.C. 30-4-3-3
- Under I.C. 30-4-4-3(a)(16), the trustee becomes responsible for that investment advisor and, without some indemnification language
- Investment advisor would be an "agent" and, under I.C. 30-4-3-11(d)
- Delegation under I.C. 30-4-3.5-9
- Under I.C. 30-4-3-9(a)(if the terms of the trust give a person a power to direct the trustee in the administration of the trust and those terms expressly direct the trustee to rely, or relieve the trustee from liability if he does rely, on that person's directions, the trustee may do so and will incur no liability for any loss to the trust estate
- In addition to drafting trusts in this manner before funding, there is the ability to have such language added to trusts after trusts are already in place and irrevocable. I.C. 30-4-3-24.4 allows for modification of trusts by the Court if, because of circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust

KRIEG DEVAULT

7

Directed Trusts

- I.C. 30-4-3-9(a) but I.C. 30-4-9

KRIEG DEVAULT

8

Decanting

- A decanting statute provides flexibility by statutorily expanding the discretion already granted to the trustee to permit the trustee to modify the trust by distributing its assets to another trust with updated terms
- Indiana's decanting statute became effective as of July 1, 2010 (I.C. 30-4-3-36)
- The second trust must be for the "current benefit" of one or more persons who are the objects of the exercise of the power of invasion
- It is sufficient that the trustee may invade principal for the benefit of one or more persons who are current beneficiaries under the first trust, provided that any mandatory income interest is retained. Other than these specific limitations, there are <u>no restrictions on the terms of the second trust</u>
- Trustee must notify all "qualified beneficiaries" in writing at least 60 days prior to the effective date of the decanting
- No method of service is provided in the statute and nor is there any requirement for court filings
- Decanting is a useful alternative to a judicial or non-judicial modification

KRIEG DEVAULT

9

Unitrust Conversion

- Battle between an income beneficiary and a remainder beneficiary
- "Income Trust" – trust that has terms that describe the amount that may or must be distributed to a beneficiary by referring to the trust's income
- General Powers of Trustee
- Notice of Trustee's Proposed Actions
- Petition to Court to take action, objections, decision not to proceed, or inability to proceed
- Petition to Court to take action; Uniform Principal and Income Act
- Unitrust Amount for Current Valuation Year; First Two Years of Trust
- Unitrust Amount for Current Valuation Year; Third Year of Trust and After
- Marital Deductions or Generation-Skipping Transfer Taxes

KRIEG DEVAULT

10

Spendthrift Protection

- I.C. 30-4-3-2(a)

KRIEG DEVAULT

11

Voidable Transfers

- I.C. 32-18-2 (but see I.C. 32-18-2-14)

KRIEG DEVAULT

12

Domestic Asset Protection/Legacy Trusts

- I.C. 30-4-3-2(b)
- I.C. 30-4-3-8

KRIEG DEVAULT

13

Quiet Trusts/Silent Trusts

- I.C. 30-4-3-6(b)
- I.C. 30-4-3-6(c)

KRIEG DEVAULT

14

Multiple Will Contest

- I.C. 29-1-7-17.5

KRIEG DEVAULT

15

Devolution of Real Estate

- I.C. 29-1-7-23

KRIEG DEVAULT

16

Electronic Wills and Electronic Documents Registry

- I.C. 29-1-21
- I.C. 29-1-22

KRIEG DEVAULT

17

No Contest Provisions

- I.C. 30-4-1-2(11)

KRIEG DEVAULT

18

TOD Real Estate

- I.C. 32-17-14

KRIEG DEVAULT

19

Non-Probate Claims Changes

- I.C. 32-17-13

KRIEG DEVAULT

20

Trust Interpretation

- The Court and Trust Code dictate that a court should look to the four corners of a will document to determine settlor's intention
- The point . . . If you don't know 100% what the document means, docket and throw up the jump ball! Trustee not required to act at its own peril!
- Indiana courts have done away with the distinction between patent and latent ambiguity and allow for admission of all extrinsic evidence – both direct and circumstantial – relevant to determining a settlor's intent. Extrinsic evidence includes things like testimony of the settlor, list of assets, correspondence of settlor and drafter, and other relevant associated documents

KRIEG DEVAULT

21

Irrevocable Life Insurance Trusts

- I.C. 30-4-3.5-2 a trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution
- Under I.C. 30-4-3.5-3 a trustee is directed to diversity the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying
- I.C. 30-4-3.5-5 requires the trustee to invest and manage solely in the interest of the beneficiaries
- I.C. 30-4-3-.5-6 requires the trustee to act impartially in investing and managing the trust assets, taking into account any differing interests of the beneficiaries
- I.C. 30-4-3.5-8 states that compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a trustee's decision or action and not by hindsight
- Clearly in the case of Matter of Stuart Cochran Trust, 901 N.E.2nd 1128 there is no hindsight in the ability for a trustee of an irrevocable life insurance trust ("ILIT") to worry about allowing a policy to lapse and then having a death shortly occur after the policy lapses
- Duty that the trustee has to monitor the trust assets
- Industry studies reveal that insurance portfolios rarely receive the required vigilant fiduciary oversight routinely associated with other assets held in a trust
- Without regular review by an insurance expert, policies – especially older ones – can pose very significant risk or not achieve their original goals
- If the client no longer needs the insurance coverage

KRIEG DEVAULT℠ 22

Potpourri

Common areas for dispute by beneficiaries of an accounting include:

- Reasonableness of fees
- Investment performance
- Improper payments or distributions
- Improper allocation of receipts and disbursements between income and principal
- Conflict of interest
- Theft
- Accounting required by I.C. 30-4-5-12
- Timely distributions
- Where's my situs? I.C. 30-4-6-4 and I.C. 30-4-6-2
- Trust validity and defense of same I.C. 30-4-2-10(c)
- Conflict of interest I.C. 30-4-3-5
- Self dealing I.C. 30-4-3-7
- Multiple trustees I.C. 30-4-3-4

KRIEG DEVAULT℠ 23

ULTIMATE DEFENSE

GET COUNSEL

Rogue Beneficiary

Legal Counsel

KRIEG DEVAULT℠ 24

Mr. Marvin D. Hills, CPA/PFS, CLU, ChFC

Crowe LLP

Mr. Hills graduated summa cum laude from Anderson University, Anderson, Indiana in 1981. He then joined Crowe Horwath in South Bend Indiana, where he is currently Partner-in-Charge of the Private Client Services division of the Tax Services Group. He is a member of the American Institute of Certified Public Accountants, the Indiana CPA Society, the Personal Financial Planning Division of the AICPA and the Society of Financial Services Professionals. (Although Mr. Hills has obtained the Chartered Life Underwriter (CLU) and Chartered Financial Consultant (ChFC) designations, he is not licensed to sell any insurance or securities products.) He is a past President and current member of the Michiana Estate Planning Council, and served 8 years on the Board of Directors. He is a frequent speaker for professional and civic organizations on estate planning and fiduciary income taxation topics, including seminars taught for the AICPA Advanced Estate Planning Conference and the AICPA National Tax Conference, the Notre Dame Tax and Estate Planning Institute, for Foxmoor Continuing Education (formerly Professional Education Systems, Inc.), the Indiana Bankers' Association, the Michigan Banker's Association and the Illinois Banker's Association, as well as presentations to the Indiana Continuing Legal Education Forum (ICLEF), the Illinois CPA Society, the Young Lawyer's Section of the Chicago Bar Association, the National Auto Dealers Association, the RV Dealers Association and various Estate Planning Council meetings throughout Indiana, Kentucky and Southwest Michigan. He has written articles on various topics for publications including Estate Planning, The Tax Adviser, Hoosier Banker, TAXES-The Tax Magazine, Kentucky Banker, and has been quoted in the Wall Street Journal.

Marvin D. Hills – Partner

Crowe LLP
320 E. Jefferson Blvd
P.O. Box 7
South Bend, IN 46624-0007
Tel: (574) 236-7605
Cell: (574) 360-8300
Fax: (574) 236-8692
Email: Marv.Hills@Crowe.com

NOTE: Not all materials below will be covered during the actual presentation.

Agenda: Life Cycle of an S Corporation

- **Formation** of the S Corporation Entity
- **Eligibility and Elections** for S Corporation Status
  - S Corporation Status of Company
  - QSST or ESBT Status of Trust Shareholders
- **Solutions for Inadvertent Termination** of S Corp Status
- **20% Pass-Thru Deduction (§199A)** – New in 2018
- **Transfer of Ownership** of the S Corporation
- **Liquidation** of the S Corporation

Agenda: Life Cycle of an S Corporation

- **Formation** of the S Corporation Entity
- **Eligibility and Elections** for S Corporation Status
  - S Corporation Status of Company
  - QSST or ESBT Status of Trust Shareholders
- **Solutions for Inadvertent Termination** of S Corp Status
- **20% Pass-Thru Deduction (§199A)** – New in 2018
- **Transfer of Ownership** of the S Corporation
- **Liquidation** of the S Corporation

Choice of Entity (Governance, Creditor Protection, etc.)

	Entity Formed Under State Law As:		
Can Be Taxed as:	Partnership (GP, LP, LLLP)	Corporation	Ltd Liability Co. (LLC)
Partnership (Form 1065)	**YES**	**NO**	**YES**
C Corporation (Form 1120)	**NO**	**YES**	**YES**
S Corporation (Form 1120-S)	**NO**	**YES**	**YES**

Agenda: Life Cycle of an S Corporation

- Formation of the S Corporation Entity
- **Eligibility and Elections** for S Corporation Status
  - S Corporation Status of Company
  - QSST or ESBT Status of Trust Shareholders
- Solutions for Inadvertent Termination of S Corp Status
- Reporting Requirements – New in 2016
- Transfer of Ownership of the S Corporation
- Liquidation of the S Corporation

Eligibility for S Corp Status - TWO TESTS:

1. Must be a domestic "small business corporation"
   - Not be an "ineligible corporation"
   - Not have an "ineligible shareholder"
   - Not have more than 100 shareholders
   - Not have a nonresident alien shareholder
   - Not have more than one class of stock

2. Must make a **valid** S Corporation Election **Properly** **Timely**

Two Examples of Making S Corp Election Incorrectly

- Form 2553 must be signed by each shareholder.

  PLR 201240012 involved stock owned by married persons as Community Property. The Form 2553 was signed by one spouse, but not both spouses.

- PLR 201516009 had a Form 2553 signed by Trustee of a Grantor Trust, rather than the Grantor himself.

  (Likewise, PLR 201528017)

Failure to qualify as "Small Business Corporation"

- Corporation will not qualify if it has a "Second Class of Stock"
- Difference in voting rights are allowed (§1361(c)(4))
- Primary test is whether the "governing instrument" provisions are identical. Buy-Sells or Redemption Agreements generally disregarded (Reg. §1.1361-1(l)(2)(iii))
- Annual dividends must be proportionate to ownership.
- IRS has granted many PLR's waiving inadvertent terminations: 201214001, 201217009, 201232007, 201234001, 201351017

Failure to qualify as "Small Business Corporation"

- Non-Resident Alien as Shareholder (PLR 201408011)
  - Shareholder was a RESIDENT alien (i.e. eligible), but moved out of the U.S., thus terminating S Corp status.
    (See PLRs 199924018 and 201032034)
  - Shareholder renounced US citizenship (PLR 200006041)

NOTE: Same issues can occur for beneficiary of QSST, since a QSST cannot have a non-resident alien beneficiary
(See PLR 201238017)

S Corporation Eligibility Rules

- Definition of "eligible shareholder" (per IRC §1361(b)(1)(B))
  - An individual (other than a non-resident alien)
  - An estate (incl. §645 Qualified Revocable Trust)
  - Qualified retirement plan described in §401(a)
  - Charitable organization described in §501(c)(3)
  - Six Specified Types of Trusts
    (CANNOT be a "Foreign Trust" per §1361(c)(2)(A))

Permitted TRUST shareholders (§1361(c)(2)):

1. Grantor Trust (must have only one US person as 100% grantor)
2. Former Grantor Trust – Only for 2 years post-death
3. Testamentary Trust – Only for 2 years post-funding
4. Electing Small Business Trust (ESBT)
5. Voting Trust
6. IRA Trust – (but only for bank stock in IRA on 10/22/04)

NOTE: A Qualified Subchapter S Trust (QSST) election causes the trust to be treated as if it is a Grantor Trust to the beneficiary

Permitted TRUST shareholders (§1361(c)(2)):

1. Grantor Trust (must have only one US person as 100% grantor)
2. Former Grantor Trust – Only for 2 years post-death
3. Testamentary Trust – Only for 2 years post-funding
4. Electing Small Business Trust (ESBT)
5. ~~Voting Trust~~
6. ~~IRA Trust –~~ (but only for bank stock in IRA on 10/22/04)

NOTE: A Qualified Subchapter S Trust (QSST) election causes the trust to be treated as if it is a Grantor Trust to the beneficiary

Trust Shareholders – Grantor Trust

Qualifications:

- Revocable trust is most common, but any grantor trust (even if irrevocable) qualifies **Must file Form 1041 for QSST**
- US citizen / resident must be deemed owner of entire trust
- Qualifies only while the sole deemed owner is alive
- Continues to qualify as an eligible shareholder for the 2-year period following grantor's death.
- Q.R.T. can extend eligibility if trustee makes §645 election

Trust Shareholders – Testamentary Trust

<u>Qualifications:</u>

- A Trust created pursuant to a Will, or by a Qualified Rev. Trust (QRT) while a §645 election is in place.
- Trust can hold S Corp stock for up to 2 years following transfer of the stock to the trust

Note: the estate / QRT can hold S Corp stock until estate is settled, then the trust receiving the stock can hold the stock for an additional 2 years.

Trust Shareholders – ESBT Eligibility Qualifications

- Can only have individuals, estates, or certain charities as a beneficiary (whether present, remainder or reversionary)
    - Non-Resident Aliens OK as "beneficiary" after TCJA.
    - Every "potential current benef." counts as a shareholder
- No "interest in the trust" has been acquired by purchase
- Cannot be: a QSST or a C.R.T., or a tax-exempt trust.

- Election must be made to treat the trust as an ESBT

Trust Shareholders – ESBT election procedures

- ESBT election is filed (timely) and signed by the Trustee.
- Only one ESBT election made, regardless of the number of S Corporations whose stock is owned by the trust.
- File with Service Center(s) where S Corp returns are filed
- No additional elections needed if new stock transferred to trust
- Must provide info specified by Reg. §1.1361-1(m)(2)(ii)
- Election causes the trust's S Corporation earnings to be taxed at the trust level, at the maximum income tax rate.

Which rule overrides: ESBT vs. Grantor Trust?

- A Grantor Trust is authorized to "make" an ESBT election (per Reg. §1.1361-1(m)(8), Example 3), but the election does not cause the income to be taxed at the trust level (compare Reg. §1.641(c)-1(l), Example 1).
- In other words, the Grantor Trust Rules override the ESBT election result.

Trust Shareholders – QSST Eligibility Qualifications

- During current income beneficiary's lifetime, trust can only have **one** beneficiary (must be a U.S. citizen or resident)
- Any corpus distributed can be paid **only** to that beneficiary
- Beneficiary's income interest in the trust must terminate on earlier of **death** of beneficiary or termination of the trust
- If trust terminates during beneficiary's life, all trust assets must be distributed to **that** beneficiary

- **All the "income" (per §643(b)) is either distributed, or required to be distributed to the income beneficiary**

Trust Shareholders – QSST election procedures

- QSST election is filed (timely) and signed by beneficiary.
- Separate QSST election is required for each S Corporation whose stock is owned by the trust.
- Filed with Service Center where the corporation return is filed.
- Additional election needed if new corp is transferred to the trust
- Must provide info specified by Reg. §1.1361-1(j)(6)(ii)

- QSST election causes the trust to be treated as a §678 Grantor Trust to the beneficiary (per IRC §1361(d)(1)).

Three Examples of Faulty QSST or ESBT Elections:

- QSST election signed by Trustee, not beneficiary
  (See PLR 201144018)

- QSST owned shares when S Corp election initially made, but Trustee signed Form 2553, not beneficiary
  (See PLRs 201516009, 201442014; 201217008; 201151004)

- Single Trust document created multiple ESBT's for grandchildren, but only one ESBT election was filed.
  (See PLR 201209005)

ESBT and QSST Election Procedures

	ESBT 1.1361-1(m)(2)(i)	**QSST** 1.1361-1(j)(6)(i)
Election Made By:	Trustee	Beneficiary
Multiple S Corps: # of elections required	One For Trust, regardless of number of S Corporations owned	One for each Corporation
Election Filed At:	Each IRS Service Center where a Corp files a return	IRS Service Center where Corp files its return
New election required if additional Corporations transferred to trust?	No 1.1361-1(m)(2)(i)	Yes 1.1361-1(j)(6)(iii)(A)

Actual Owner — Deemed Owner For:

	Eligibility purposes (Code Sec. 1361(b)(1))	Taxation Purposes (Code Sec. 1366, 1367, 1368)
Estate	Estate 1.1361-1(b)(1)(ii)	Same
Grantor Trust	Grantor 1.1361-1(h)(3)(i)(A)	Same
Former Grantor Trust ("2 year")	Estate of Grantor 1.1361-1(h)(3)(i)(B)	Trust Itself (Eligible for Distribution Deduction) 1.1361-1(h)(3)(ii)(A)
Testamentary Trust ("2 year")	Estate of Testator 1.1361-1(h)(3)(i)(D)	Trust Itself (Eligible for Distribution Deduction) 1.1361-1(h)(3)(ii)(B)

Actual Owner — Deemed Owner For:

	Eligibility Purposes	Taxation Purposes
Voting Trust	Each Beneficial Owner 1.1361-1(h)(3)(i)(E)	Same
ESBT	Each potential current beneficiary or if none, then the ESBT itself 1.1361-1(h)(3)(i)(F)	Trust itself, with no Distribution Deduction 1.641(c)-1
QSST	Beneficiary 1.1361-1(j)(7)(i)	Same
Former QSST	Estate of Beneficiary 1.1361-1(j)(7)(ii)	Trust Itself (Eligible for Distribution Deduction) 1.1361-1(j)(7)(ii)

ESBT and QSST Election due date (3 scenarios)

(1) If trust already owned shares at the time of new S election, a QSST or ESBT election must be filed within 2 months and 15 days after the earlier of:

A) date on which the S election is effective, or

B) date on which the S election is filed.

(2) If S election was already in effect, the QSST / ESBT election must be made by 2½ months after stock goes into the trust.

(3) Can be made during (or by 2½ months after the end of) the "two-year" eligibility periods. (Reg. §1.1361-1(m)(2)(iii) & (iv))

S Corporation Eligibility Rules

- Definition of "eligible shareholder"
  - An individual (other than a non-resident alien)
  - An estate (incl. §645 Qualified Revocable Trust)
  - Qualified retirement plan described in §401(a)
  - Charitable organization described in §501(c)(3)
  - **Six Specified Types of Trusts**
    (CANNOT be a "Foreign Trust" per §1361(c)(2)(A))

Trusts that are NEVER “eligible shareholders”

- Foreign issues:
  - A Foreign Trust (per IRC §7701(a)(31))
  - QSST that has a non-resident alien beneficiary.
    - Note: ESBT <u>can</u> have foreign beneficiaries after 2017 TCJA
- Charitable Remainder Trust (See PLR 199908046)
- Roth IRAs (even if structured as a trust)

  See: *Taproot v. Comm* (2012 CA9, 109 AFTR 2d 2012-1446)

Definition of “Foreign Trust”

- ANY trust that is not a “U.S. person” (IRC 7701(a)(31)
- Two Tests must both be met to be a US Person:
  - <u>Court Test</u>: A U.S. Court is able to have primary supervision over the administration of the trust, and
  - <u>Control Test</u>: one or more U.S. persons have the authority to control all substantial decisions.

  Thus: Need US court jurisdiction AND majority of trustees

Be careful not to trigger by replacing a US co-trustee with a foreign one

Examples of trusts ineligible for QSST election:

- QSST document did not require income to be distributed (which is OK), except that it also did not **actually** distribute "all income" annually.
  (PLR's 200839008, 200925031 and 201228009)
- QSST beneficiary had a "power to appoint" income to someone else of his choosing, in addition to himself.
  (PLR's 201233014, 201419009 and 201426001)

Examples of trusts ineligible for QSST election:

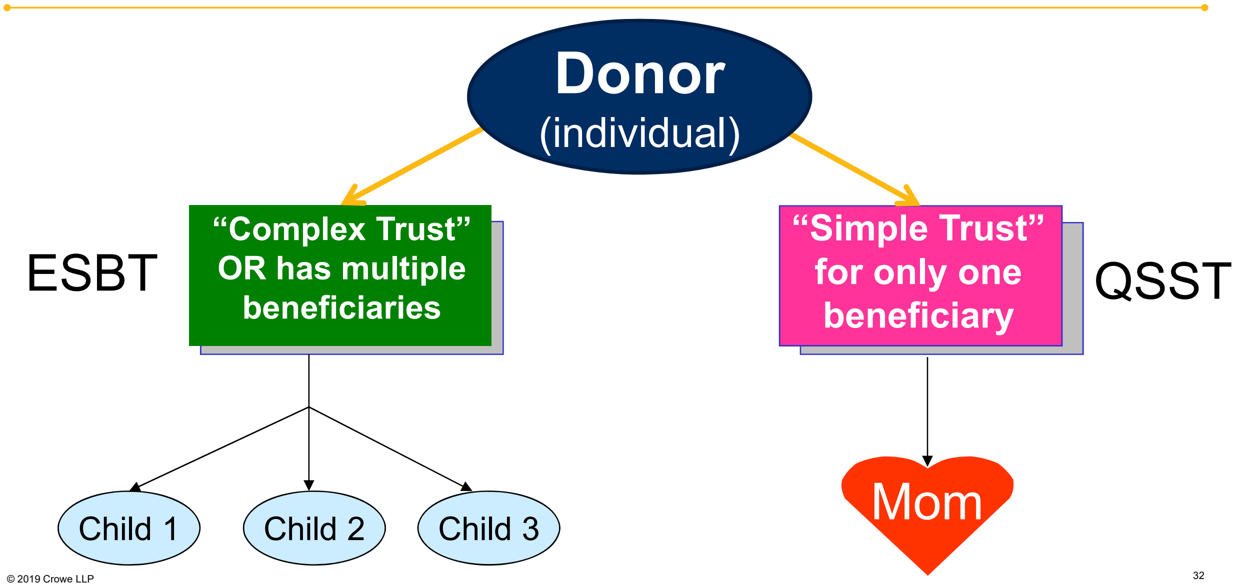
- Trust could add new grandchildren as beneficiaries.
  (See Rev. Rul. 89-45)
- Trust contained a provision that if the assets were included in the Grantor's taxable estate, the trust corpus could be used to pay Grantor's estate tax. Thus, the trust potentially had two "beneficiaries."
  (See PLR 201451001)

Two Problems with QSST / ESBT **Elections**

- Failure to make QSST or ESBT elections **properly**

- Failure to make QSST or ESBT elections **timely**
  - Upon Initial S Corp Election: 2 months, 15 days
  - Lifetime Gift to QSST or ESBT: 2 months, 15 days
  - Former Grantor Trust: 2 years after death
  - Testamentary Trust: 2 years after funding

Timeliness of Election for Lifetime Transfers:



Lifetime Transfers

Failure to make an ESBT or QSST election within two months, and 15 days after transfer causes "small business corporation" to now have an "ineligible shareholder".

- Private Letter Rulings (*number of trusts involved)

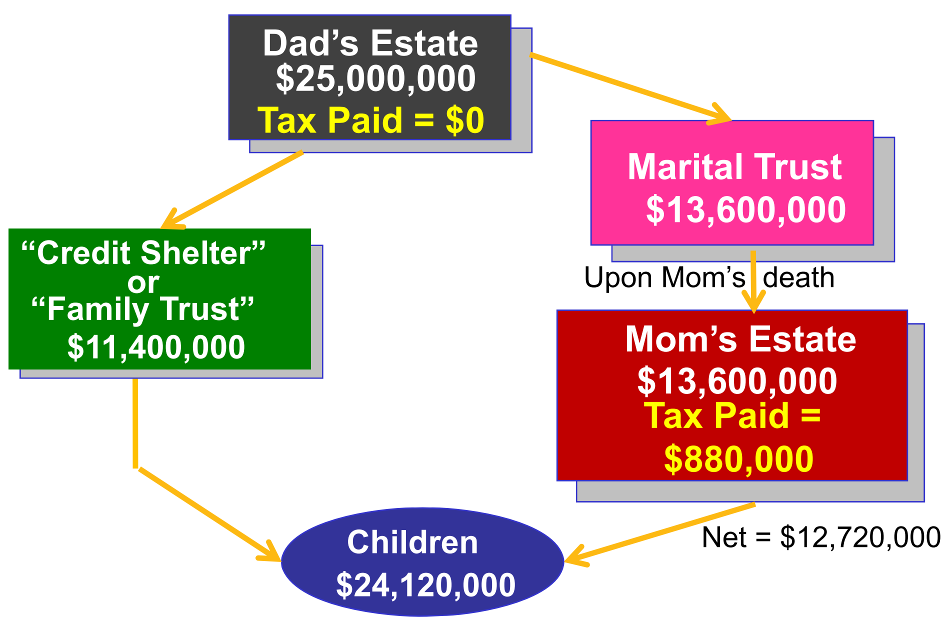
201211002 (*3)
201217006 (*2)
201217010 (*3)
201224013 (*8)
201234002 (*4)

201221009 and 010 (*1)

201211004 and 005
201211006 and 007 (*5)

33

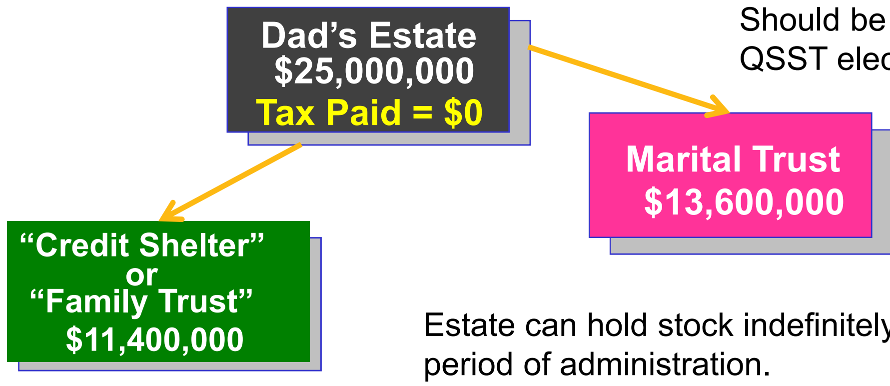
Generic Estate Plan



34

Testamentary Trusts

Should be eligible for QSST election



May only be eligible for ESBT election

Estate can hold stock indefinitely, for entire period of administration.

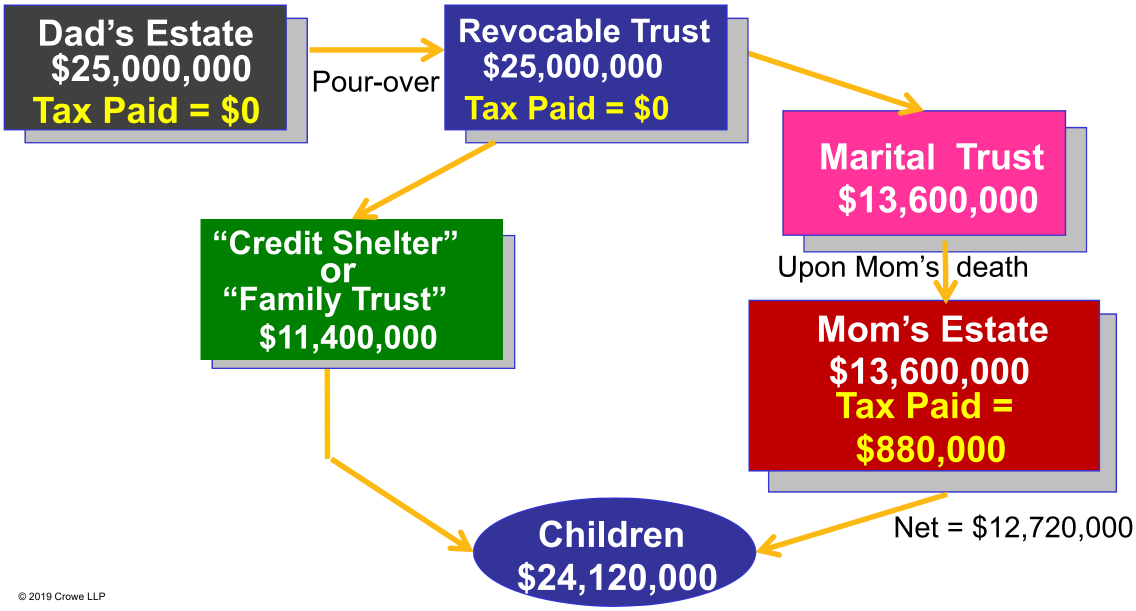
Trust must make ESBT or QSST election within 2 years, plus 2½ months after the transfer.

Testamentary Trust: Election not filed timely

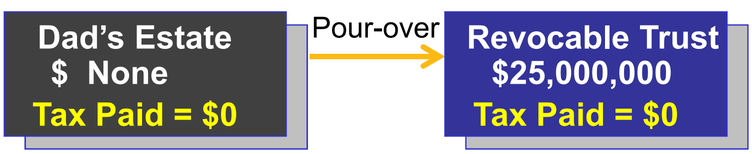
- Trust can own stock for two years after transfer from an estate (IRC §1361(c)(2)(A)(iii)). If no election is made during (or within 2 ½ months after) the two year period, the trust is an "ineligible shareholder" and corporation loses S Corp status as of the end of the two year period.

PLR's	201341009	201341014	201347003
	201347014	201418008	201418015
	201422006	201426018	201505034

Typical "Pour-over" Estate Plan



37



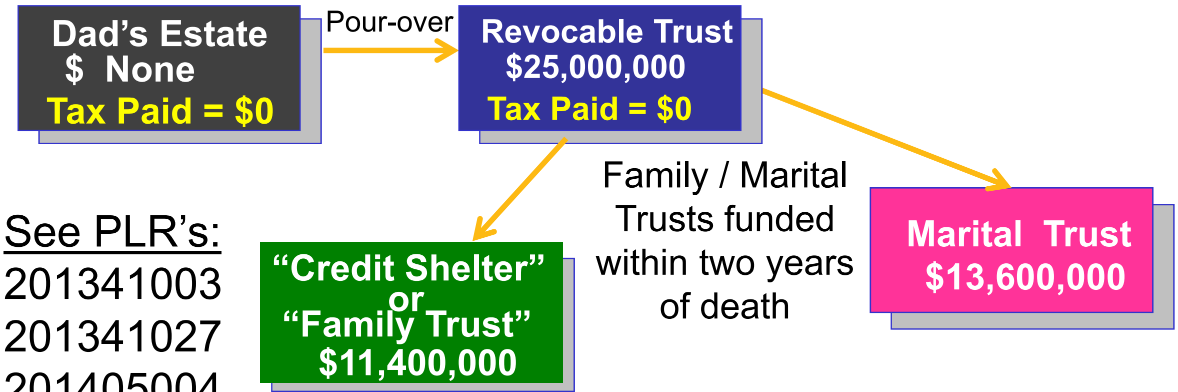
For any stock already held in the Revocable Trust pre-death, the trust is an Eligible Shareholder for only 2 years after death. If stock held over 2 years, S Corp status terminates.

- Private Letter Rulings requesting relief:

201223007	201238008	201343016	201437009
201232009	201238014	201350004	201445004
201234007	201238015	201404003	201508002

201516009

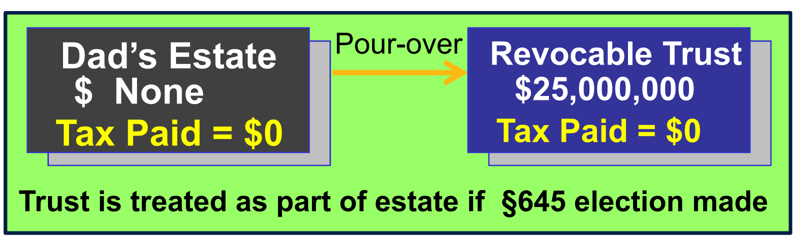
38



See PLR's:
201341003
201341027
201405004
201434010 to 201434014
201515010
201516003
201516017 201528028

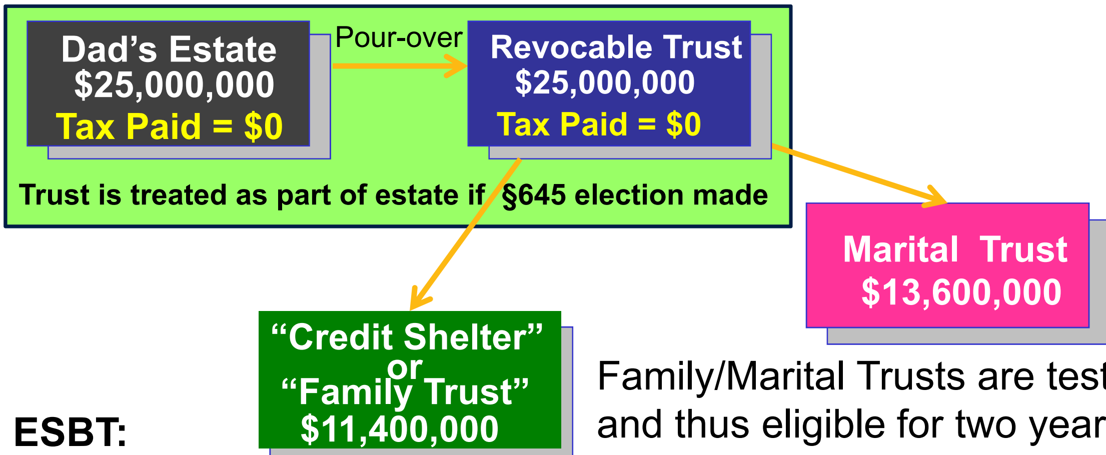
Family / Marital Trusts must make QSST or ESBT election before 2½ months after stock is transferred. (Reg.§1.1361-1(m)(2)(iii))

Sec. 645 Election



If the §645 election is made, the revocable trust remains eligible until the **earlier of**: the estate administration is complete or the §645 election ends.
(Reg. §1.645-1(a))
(Reg. §1.1361-1(h)(1)(iv))

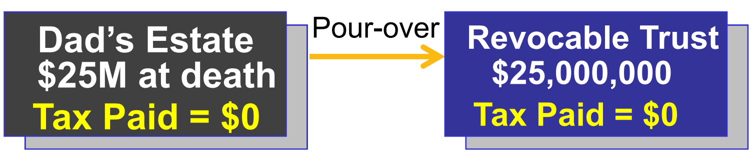
Sec. 645 Election



ESBT:
Reg.§1.1361-1(m)(2)(iv))
QSST:
Reg.§1.1361-1(j)(6)(iii)(d))

Family/Marital Trusts are testamentary and thus eligible for two years after transfer. Can make QSST or ESBT election any time before 2½ months **after** the two year period ends.

IRS got this one wrong?



Stock was held in Estate pre-death. Stock transferred to Rev. Trust after death. No §645 election was made. No QSST or ESBT election made for Revocable Trust.

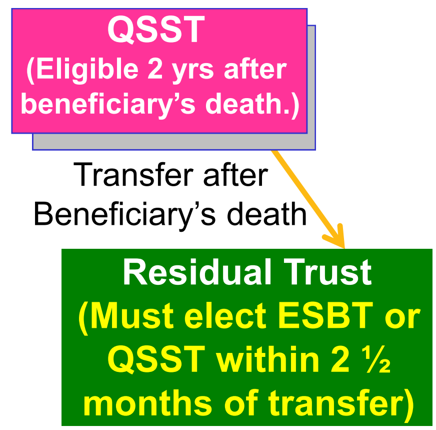
IRS said S Corp status ended 2½ mos. after transfer. But….could Rev. Trust qualify as "Testamentary Trust?"

Note: this was only one of the three reasons that the S Corp status terminated in PLR 201437009

Former Grantor Trusts – Timing of Eligibility

- Two-Year Rule applies upon DEATH of the Grantor. (See IRC §1361(c)(2)(A)(ii)).

- Since a QSST is a Grantor Trust to the beneficiary, the QSST remains eligible for two years after the death of the QSST beneficiary. (PLR's 201420005, 201516016)



Former Grantor Trusts – Two-Yr. Rule DIDN'T apply

- GRAT is a Grantor Trust, but if stock continues to be held in trust after term expires, an ESBT or QSST election is required within 2½ mos. (PLR 201425003)

- IDIT: "Intentionally Defective" trust is eligible while Grantor Trust status applies, but if Grantor waives (i.e. "toggles off") grantor trust status, an election must be made within 2 ½ months. (PLRs 201445001 and -003, 201423013, 201516001, 201516002)

Other Interesting Ways to Lose Your S Corp Status

- Decanting: Trust #1 elected ESBT, but had some undesirable provisions. Formed Trust #2 with same trustee and beneficiary, but with better provisions. Trustee transferred stock from Trust #1 to #2, but didn't make a new ESBT election. S Corporation status terminated upon transfer to Trust #2.

  (PLR 201442047)

Other Interesting Ways to Lose Your S Corp Status

- Single Trust Document created multiple trusts for grandchildren; no new QSST elections were made when new grandchildren were born. (PLR 201209005)

- Trust has U.S. Citizen as trustee, but he/she resigns and is replaced by a Non-Resident Alien. The trust becomes a "Foreign Trust", and is thus ineligible.

Other Interesting Ways to Lose Your S Corp Status

- Trust had elected QSST status with "Jane" as sole beneficiary. "Uncle Bob" later became the trustee.
- Bob asked an Attorney if it was OK to pay money to Jane's children. Attorney read Art. III, which listed beneficiaries as "Jane or her heirs." Attorney didn't notice Art. IX, which said "If trust holds S Corp stock, administer the trust to comply with all QSST rules."
- Termination occurred when Bob paid Jane's kids.

(PLR 201437009)

Other Interesting Ways to Lose Your S Corp Status

- Trust qualifies as a Grantor Trust due to either:
  - Trustee's power to use income to pay premiums on life insurance on the grantor or spouse (IRC §677(a)), or
  - Trust's power to add beneficiaries (IRC §674(c) or (d))
- Trust beneficiary ("Adverse Party") becomes trustee.
- Thus, trustee's powers are now subject to approval of an "Adverse Party", and Grantor Trust status ends.

Triggered upon Incompetency?

Agenda: Life Cycle of an S Corporation

- **Formation** of the S Corporation Entity
- **Eligibility and Elections** for S Corporation Status
  - S Corporation Status of Company
  - QSST or ESBT Status of Trust Shareholders
- **Solutions for Inadvertent Termination** of S Status
- **20% Pass-Thru Deduction (§199A)** – New in 2018
- **Transfer of Ownership** of the S Corporation
- **Liquidation** of the S Corporation

Three reasons S Corp status will terminate:

1. Voluntary Revocation (IRC 1362(d)(1), (2), and (3))
2. Failure to be a "small business corporation"
   - Over 100 shareholders,
   - Second class of stock
   - Having a non-resident alien as a shareholder
   - Having an "ineligible" shareholder
3. Investment Income over 25% of Gross Receipts (w/ E&P)

Examples of Failure to be a "Small Business Corp"

- Stock owned by C Corp (PLR 201228025, 201238007)
- Stock issued to Partnership (PLR 201232029, 201426011)
- Transferred to an IRA (PLR 200250009, 201408018)

- S Corp was owned by a Single Member LLC, which became either a Partnership, or C Corporation
  (PLR 201221006 and PLR 200218007)

Legislatively-Enacted REMEDIES

- IRC §1362(b)(5): IRS can treat late or non-existent **S Corp election** as timely, with "reasonable cause".
- IRC §1362(f): IRS can waive termination of S Corp or QSUB caused by failure to be a "**small business corporation**" (either due to late or faulty elections), provided it was "inadvertent".
- Obtain approval from IRS by requesting a PLR.

Issues related to requesting a Private Ltr Ruling

- Must be filed in accordance with Rev. Proc. 2019-1.
- Timeframe from initial letter until release of PLR is 7 to 10 months (but taxpayer is notified within 6 mos.)
- Cost of PLR depends on taxpayer's GROSS income *
  - Income under $250,000 — Fee is $ 2,800
  - Income under $1 million — Fee is $ 7,600
  - Income above $1 million — Fee is $30,000

Reduced fee is available for multiple PLR's on same issue

* =Includes income of S Corp. PLUS any >50% shareholder.

EXPEDITED REMEDIES

- Revenue Procedures allow certain situations to be approved without obtaining a Private Letter Ruling
- Rev. Proc. 97-48: Late S Corp elections (2553)
- Rev. Proc. 2003-43: S Corp, QSST, ESBT, QSUB
- Rev. Proc. 2004-48: Late Form 8832
- Rev. Proc. 2007-62: Simplified procedures

EXPEDITED RE DIES

- Revenue Procedures a certai ations to be approved without obtaining a Priva ett ling
- Rev. Proc. 97-48: Late rp elections (2553)
- Rev. Proc. 2003-43: S C , T, ESBT, QSUB
- Rev. Proc. 2004-48: L Form 2
- Rev. Proc. 2007-62: plified pr ures

All were Superseded by Rev. Proc. 2013-30

- Consolidates / standardizes prior relief procedures
- Applies to all waiver requests after Sept. 3, 2013.
- Covers all “Elections under Subchapter S”
  - Late S Corporation Elections (Form 2553)
  - Late ESBT / QSST Elections
  - QSUB Elections
  - Entity Classification Elections (Form 8832)

Rev. Proc. 2013-30   TERMINOLOGY

- “Elections Under Subchapter S”
  - S Corp, QSUB, ESBT, QSST, Entity Classification
- “Requesting Entity”
  - Includes Individuals, Corp, Trust, Trustee, or Beneficiary
- “Effective Date”
  - When the election was supposed to have been effective, NOT the date the missed election should have been filed.

Due Date for requesting relief under 2013-30

- General Rule: Request for relief must be filed within 3 years and 75 days after the Effective Date.

  Example: Stock gifted to trust July 1, 2014.

  Deadline for filing is September 14, 2017.

- SPECIAL EXCEPTION:

  3 year / 75 day deadline is waived for S Corporation elections (Form 2553), but only if all subsequent returns have been filed as if S Corporation status applied.

Unintended (aggressive?) use of R.P. 2013-30?

- Rev. Proc. 2013-30 does not stipulate that it is **only** available if an inadvertent termination has actually occurred.
- Stock transferred to a Testamentary Trust is eligible for two years.

  Example: Stock transferred to Family Trust January 1, 2016.

  ESBT or QSST election is not needed until January 1, 2018.
- ESBT or QSST election could be made "timely" during that two year period, but only effective up to 2½ months earlier.
- Presumably, Rev. Proc. 2013-30 could allow an election to be made, **effective as of 1/1/16** at ANY time during 2016 or 2017.

General requirements for all "relief" procedures:

- Requesting Entity intended to be classified as such
- Failure to qualify must be <u>solely</u> due to late election

- S Corp or QSUB: Reasonable Cause exists.
- ESBT or QSST election: Failure was "inadvertent"

- Diligent actions were taken upon discovery of error.

Rev. Proc. 2013-30: General Procedures

- Prepare the missed Election Form, and label it: "FILED PURSUANT TO REV. PROC. 2013-30"
- Prepare a Reasonable Cause / Inadvertence Stmt.
  - Explains situation, and due diligence afterward.
  - Must be declared correct under "Penalties of Perjury"
  - Signed by person as required for an original election.

Additional Statements: QSST / ESBT Elections

- <u>Statement by Trustee:</u>
  - Declare that trust complies with eligibility requirements
  - Must be signed under Penalties of Perjury
- <u>Statement by Shareholders</u>
  - Signed by ALL shareholders since the Effective Date, that they have reported all income consistent with the election.
  - Must be signed under Penalties of Perjury

Additional Statements: S Corp / QSUB Election

- Late S Corporation Election:
  - Form 2553 must be signed by all shareholders since Effective Date until date request for relief is filed.
  - Affidavit of Shareholders (under Penalties of Perjury)
- Late QSUB:
  - Statement by Officer (w/ perjury stmt) that QSUB requirements met, and all returns filed appropriately.

Rev. Proc. 2013-30: Procedures for Filing

- Three Methods to file late elections under 2013-30.
  File the late election and all statements either:
  - With the current year Form 1120-S, assuming all prior year returns were filed as if S Corp status applied.
  - With prior year Form 1120-S, provided NO tax returns have been filed since the year the election was missed.
  - Independently, with the IRS Service Center.

Rev. Proc. 2013-30: Procedures for Filing

- Under all three methods, all filings must occur within 3 years and 75 days after effective date, even if the Form 1120-S was validly extended.
- If attaching to a return, mark at top of Form 1120-S "INCLUDES LATE ELECTION(S) FILED PURSUANT TO REV. PROC. 2013-30."

Agenda: Life Cycle of an S Corporation

- **Formation** of the S Corporation Entity
- **Eligibility and Elections** for S Corporation Status
  - S Corporation Status of Company
  - QSST or ESBT Status of Trust Shareholders
- **Solutions for Inadvertent Termination** of S Corp Status
- **20% Pass-Thru Deduction (§199A)** – New in 2018
- **Transfer of Ownership** of the S Corporation
- **Liquidation** of the S Corporation

Pass-through Entity Provisions – Overview

- Section 199A deduction is allowed for 20% of income from a "Qualified Trade or Business," but could be subject to limitations based on W-2 Wages and/or Capital Investment.
- REIT dividends and qualified PTP income also eligible.
- Overall deduction limited to Taxable Income without Cap. gains

- 20% deduction allowed for Alternative Minimum Tax (AMT) purposes
- 20% deduction NOT available for Self Employment Tax purposes
- 20% deduction NOT available for 3.8% Net Investment Income Tax

Section 199A – Tax Rate Comparison

C Corporation		S Corporation	
Profits	$ 1,000	Profits	$ 1,000
Corp. Tax (21%)	(210)	Less: §199A Deduction	(200)
After-Tax Balance	790	Taxable Income	800
Dividend Paid	400		
S/H Tax (20%)	(80)	S/H Tax (37%)	(296)
Total Taxes	$ 290	Total Taxes	$ 296

Pass-through Entity Provisions – Effective Dates

- New Sec. 199A is effective for owner's tax years beginning after December 31, 2017 and before January 1, 2026 (i.e. only on 2018 to 2025 tax returns)
- However, profits allocated to the owner of a pass-through entity (Partnership, S Corp or Sole Proprietorship) with a fiscal year year ending in 2018 are eligible for Sec. 199A for the entire fiscal year, even though a portion of the profit was earned during 2017.

Pass-through Entity Rules (Sec. 199A) – Overview

- Step 1 – Calculate a tentative deduction:
  - (A) 20% of pass-through "Qualified Business Income", but
  - (B) In SOME cases, capped by a Wage or Capital Investment limit, depending on taxpayer's taxable income level.
- Step 2 – Add 20% of REIT Dividends and Qualified PTP Income
- Step 3 – Total above is limited to Modified Taxable Income
  - Defined for Step 3 as: taxable income before §199A deduction, but excluding capital gains and qualified dividends (since already eligible for favorable rates (e.g. 15% / 20% on L-T Cap Gains).

Section 199A -- Clarification of Step 1(A):

- "Qualified Business Income" is Trade or Business income of a Partnership, S Corp or Sole Proprietorship, OTHER THAN:
  - Capital gains, whether short-term or long-term, including Sec. 1231 gains treated as capital gains
  - Dividends
  - Portfolio interest (i.e. not "allocable to" Trade or Business)
  - Foreign income (i.e. the 20% deduction is limited to amounts "effectively connected" with a U.S. business).
  - Annuity income (unless connected with trade or business)

Section 199A -- Clarification of Step 1(B):

- Wage / Capital Investment Limitation is the greater of:
  - 50% of W-2 wages paid by the business, or
  - 25% of W-2 wages paid PLUS 2.5% of "U.B.I.A."

  UBIA is "**U**nadjusted **B**asis (i.e. before depreciation) **I**nitially after **A**cquisition" of qualified tangible property
- Wage/capital limitation does not apply if owner's (1040/1041) net taxable income is less than $315,000 ($157,500 single)
- Limitation "phases-in" over next $100,000 ($50,000 single)
- Fully applies if taxable income > $415,000 ($207,500 single)

Pass-through Entity Rules (Sec. 199A) – Step 1

- The Step 1 calculation is done separately for each trade or business, then added together. However, "aggregation" can be elected, if several qualifications are met. *(Reg. §1.199A-4)*
- "Aggregation" is helpful (for example) if one related business has no wages or UBIA, but another has significant wages. By aggregating, the Step 1(B) limitation will be smaller.
- To be eligible for Aggregation, each trade/business must have:
  - Common ownership (at least 50%) for majority of year, and
  - Common operations, facilities, products, management, etc.

Separate (additional) Phase-In Limit for Income from a Specified Service Trade or Business (SSTB)

- **Includes the following eleven types of businesses:**

- Health
- Law
- Accounting
- Actuarial Science
- Performing Arts
- Consulting
- Athletics
- Financial Services
- Brokerage services
- Performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities
- Any other trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees or owners

Separate (additional) Phase-In Limit for Income from a Specified Service Trade or Business (SSTB)

- Engineers, Architects, finance companies, leasing companies, and S corporation banks are excluded from SSTB status, and therefore eligible for favorable tax treatment

- SSTB income is fully eligible if the owner's (1040/1041) net taxable income is less than $315,000 ($157,500 single)
- SSTB is partially eligible over next $100,000 ($50,000 single)
- No deduction at all if income over $415,000 ($207,500 single)

(W-2 / capital investment limits still phase-in for SSTB's also).

Pass-through Entity Provisions – Trusts and Estates

- Trusts and Estates are eligible based on ownership of the Pass-Through Entity. For a Grantor Trust, the deduction is claimed (and income limitations applied) on the Grantor's personal return. A simple/complex trust can only be an eligible shareholder of an S Corporation for up to two years, unless an ESBT or QSST election is made.

- The §199A deduction of a non-grantor trust is shifted to the beneficiary's Sch K-1 in proportion to the ratio of Distributable Net Income paid to the beneficiary. The §199A amount is usually different than the taxable income shown on Sch. K-1.

Itemized Deductions – "Bunching" Example

	Old Law Year 1	TCJA Year 2	TCJA Year 3	TCJA Year 4
State Taxes	15,000	10,000	10,000	10,000
Charities	20,000	20,000	40,000	- 0 -
Total Itemized	35,000	30,000	50,000	10,000
Std Deduction	12,700	24,000	24,000	24,000
Deduction Used	35,000	30,000	50,000	24,000

Pass-Through Entity Deduction – Quick Reference Guide of Limitation

	Taxable Income Under $157,500 **	Taxable Income $157,500 to $207,500 **	Taxable Income Over $207,500 **
Qualifying Business Activity	• 20% deduction allowed. • Wage/capital investment limitation does not apply	• 20% deduction allowed subject to a proportionate phase-in of the wage or capital investment limit.	• 20% deduction allowed, but subject to the **full effect** of the Wage/capital investment limitation.
Specified Service Activity	• 20% deduction allowed. • Wage/capital limit does not apply	• 20% deduction phases out • Wage/capital investment limitation phases in as above.	• Pass through entity deduction not available

** = Double the amounts (to $315,000 and $415,000) for a Married Filing Joint return. Limit is based on net taxable income on owner's tax return (including income of spouse), not just from the trade or business itself.

Wage/capital investment limitation refers to the greater of:

- 50% of the owner's proportionate share of the W-2 wages paid by the business, or
- 25% of the owner's proportionate share of the W-2 wages paid by the business PLUS 2.5% of the initial tax basis (not reduced by depreciation) of qualified tangible property

Agenda: Life Cycle of an S Corporation

- **Formation** of the S Corporation Entity
- **Eligibility and Elections** for S Corporation Status
  - S Corporation Status of Company
  - QSST or ESBT Status of Trust Shareholders
- **Solutions for Inadvertent Termination** of S Corp Status
- **20% Pass-Thru Deduction (§199A)** – New in 2018
- **Transfer of Ownership** of the S Corporation
- **Liquidation** of the S Corporation

Three (plus one) Ways Stock is Transferred

1. During lifetime, as a **gift**
2. Upon death, as an **inheritance**
3. During lifetime, as a **sale**
4. Indirectly, via a lifetime **redemption**

Transfer of Stock as a Gift

- Carryover basis, unless both: (A) basis exceeds FMV and (B) property is ultimately sold at a loss (IRC §1015(a))
- Passive Loss Carryforward of owner at time of gift is added to basis of property (IRC §469(j)(6))
- If a Trust previously had a Net Operating Loss carryforward prior to making an ESBT election, the NOL is not available to the "S-Portion" of the trust, but rather is only available to the "Non-S Portion" of the trust (see CCA 2007-34-019).

Transfer of Stock Upon Death

- No step-up in basis for Income I.R.D. (IRC §1014(c))
  S Corporation Rules at §1367(b)(4)(B)
  Partnerships at Reg. §1.742-1 and Reg. §1.755-1(b)(4))

Example:	FMV at Death (§1014)(a))	$100,000
	Portion "attributable to" IRD	(70,000)
	Net Basis in hands of heirs	$ 30,000

- Passive Loss carry-forward of owner is NOT added to recipient's basis under §1014. (See §469(g)(2)).

Transfer of Stock via a Lifetime Sale

- Sale to an Intentionally Defective Grantor Trust (IDGT) is not a change of ownership for income tax purposes. (Rev. Rul. 85-13) Shares of stock held inside the IDGT have the same basis as shares still owned individually.

- If sale to an IDGT uses an Installment Note, and seller dies with accrued interest receivable, is interest paid post-death from the (formerly grantor) trust taxable to the estate when received, or is there a "step-up-in-basis" at death for accrued interest? Normally, no step-up for "I.R.D."

Indirect Transfer of Control via a "Redemption"

- IRC §302 provides that a "redemption" is treated as a sale (with basis offsetting proceeds in computing gain/loss).
- Payments from S Corp in exchange for stock which don't qualify as a "redemption" are treated as distributions (See §1368(a)).
- Unless S Corp has Accum. "C Corp E&P," distribution is tax free to the extent of the shareholder's basis; excess is capital gain.
- Thus, parent could do "failed §302 redemption" to indirectly shift ownership percentage and control to child(ren) without a "sale," or a gift and without creating a "Second Class of Stock."

Agenda: Life Cycle of an S Corporation

- **Formation** of the S Corporation Entity
- **Eligibility and Elections** for S Corporation Status
  - S Corporation Status of Company
  - QSST or ESBT Status of Trust Shareholders
- **Solutions for Inadvertent Termination** of S Corp Status
- **20% Pass-Thru Deduction (§199A)** – New in 2018
- **Transfer of Ownership** of the S Corporation
- **Liquidation** of the S Corporation

Lifetime Sale of Assets; Waiting for Deathtime Liquidation

- Often, after an S Corp sells the assets of an operating business, the shareholder's "outside basis" is still less than the sale proceeds held inside the corporation. Thus, liquidation of the S Corporation would cause additional gain to be recognized.

Lifetime Sale of Assets; Waiting for Deathtime Liquidation

Description	Corp's Assets	Shareholder's Outside Basis	Shareholder's Net Income
FMV of Assets	50,000		
Corp's Basis in Assets	(35,000)		
Gain (on Sch. K-1)	15,000		15,000
Shareholder's Stock Basis		5,000	
Gain from Asset Sale		15,000	
Updated Stock Basis		20,000	
Liquidation Proceeds		50,000	
Updated Stock Basis		(20,000)	
Net Gain / (Loss)		30,000	30,000

Total gain recognized: $ 45,000

Lifetime Sale of Assets; Waiting for Deathtime Liquidation

- Often, after an S Corp sells the assets of an operating business, the shareholder's "outside basis" is still less than the sale proceeds held inside the corporation. Thus, liquidation of the S Corporation would cause additional gain to be recognized.
- Instead, the shareholder would prefer to have the S Corporation continue to hold (and invest) the sale proceeds until his/her death, in anticipation of a Step-Up-In-Basis at death.
- Two concerns:
  - Passive INVESTMENT Income over 25% of Gross Receipts
  - Timing of liquidation after death.

Lifetime Sale of Assets; Waiting for Deathtime Liquidation

- IRC §1375 assesses corporate-level income tax if the S Corp has C Corporation E&P, and over 25% of Gross Receipts are "Passive Investment Income" (interest, dividends, rents, etc.)
- IRC §1362(d)(3) terminates S Corporation status if this test is failed for three consecutive years.
- Companies can increase "gross receipts" by investing in a business with high gross receipts per dollar invested (e.g. Oil & Gas or grocery stores, etc). This could be direct ownership, or participation through a Publicly-Traded-Partnership.

Lifetime Sale of Assets; Waiting for Deathtime Liquidation

- IRC §1362(d)(3) defines "passive investment income" as including dividends, interest, RENTS and royalties.
- Reg. §1.469-2(f)(6) provides that if rents are received on property rented to a business in which the owner Materially Participates, these "self-charged rents" are "re-characterized" and treated as then being "non-passive income" rather than "passive income."
- However, the §469 "recharacterization" rule should not be applied for purposes of the "investment income" rule of §1362(d)

Lifetime Sale of Assets; TIMING of Post-Death Liquidation

Description	Corp's Assets	Shareholder's Estate - Basis	Estate's Net Income
FMV of Assets	70,000		
Corp's Basis in Assets	(50,000)		
Gain (on Sch. K-1)	20,000		20,000
Estate's Stock Basis		70,000	
Gain from Asset Sale		20,000	
Updated Stock Basis		90,000	
Liquidation Proceeds		70,000	
Updated Stock Basis		(90,000)	
Net Gain / (Loss)		(20,000)	(20,000)

Net result if both occur in same tax year:
$ - 0 -

Thanks for attending!

Questions??

The information in this document is not - and is not intended to be - audit, tax, accounting, advisory, risk, performance, consulting, business, financial, investment, legal, or other professional advice. Some firm services may not be available to attest clients. The information is general in nature, based on existing authorities, and is subject to change. The information is not a substitute for professional advice or services, and you should consult a qualified professional adviser before taking any action based on the information. Crowe is not responsible for any loss incurred by any person who relies on the information discussed in this document. Visit www.crowe.com/disclosure for more information about Crowe LLP, its subsidiaries, and Crowe Global. © 2019 Crowe LLP.

Marvin D. Hills – Partner

Crowe LLP
320 E. Jefferson Blvd
P.O. Box 7
South Bend, IN 46624-0007
Tel: (574) 236-7605
Cell: (574) 360-8300
Fax: (574) 236-8692
Email: Marv.Hills@Crowe.com

SUSAN M. HUNTER

Susan M. Hunter, Esquire is an industry leader in the practice of estate planning and elder law. She received her B.A. degree from Hanover College in southern Indiana and her Juris Doctor from Northern Kentucky University, Salmon P. Chase College of Law. Susan then pursued her passion for estate planning and elder law by founding her own firm, Hunter Estate & Elder Law (f/k/a Hunter Law Office) in 2001.

She has been admitted to the Bar of the Supreme Court of Indiana and the Bar of the Supreme Court of Illinois. She is a member of the Indiana Bar Association (estate planning, real property sections), American Bar Association and Hamilton County Bar Association.

Susan is a founding member of the national organization, Lawyers with Purpose™ where she has served as the educational director, teaching attorneys across the country the legal technical aspects of Estate Planning and Elder Law, and as a mentor coach to several other law firms across the country. Susan is also a member of the National Academy of Elder Law Attorneys.

In addition to regular blogging, Susan writes a monthly column for Senior Life Newspaper. She co-authored a book with David J. Zumpano, “Protect Your IRA”, and is the author of “Breaking Through: Busting the Generational Barriers.”

Susan currently resides in Noblesville with her husband, Mark, and their dogs, Wilbur, and Wrigley.

HUNTER
ESTATE & ELDER LAW
COMPASSION-DRIVEN COUNSEL

HUNTER
ESTATE & ELDER LAW

NUMBERS UP
&
HOURS DOWN!

NUMBERS UP & HOURS DOWN!

“They don’t care how
much you know
until they know how
much you care”

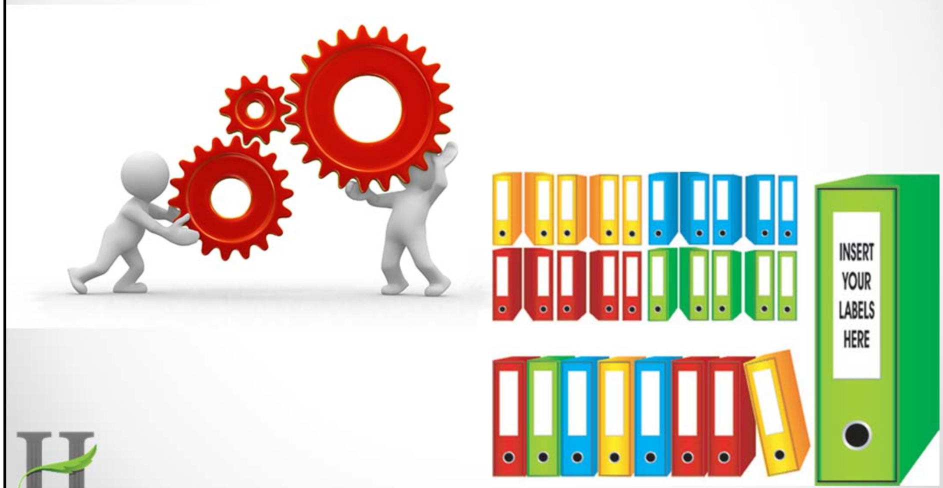
Teddy Roosevelt

NUMBERS UP & HOURS DOWN!

The EXTRAORDINARY client
experience

NUMBERS UP & HOURS DOWN!

SYSTEMATIZE for Success



NUMBERS UP & HOURS DOWN!

5 Steps to Successful Practice Managemen

- Revenue
- Production
- Sales Closing Rate
- Intake Conversion
- Marketing

NUMBERS UP & HOURS DOWN!

5 Steps to Successful Practice Management

Tracking & Measuring

NUMBERS UP & HOURS DOWN!

5 Steps to Successful Practice Management

Marketing & Sales Tracker

Team Meeting Accountability

Monthly Marketing Tracker

MONTH OF: MAY	Clients	Digital/ Social	HEEL Team	Presentations	Community	Power Partners	Facility	Hospice/ Hospital	Retail	Drive By	Other	Unknown								Totals
Current Month to Date Referral #:																				*0*
(Previous Month Total) Prev Month Referral #:																				*0*

Weekly Statistics	ICF	INI	F/U	WS	REF OUT	CLOSE	Q. Leads	Conv Rate
Week 1 (5/1)								
Week 2 (5/6)								
Week 3 (5/13)								
Week 4 (5/20)								
Week (5/27)								
MONTH TOTALS	0	0	0	0	0	0	0	

Weekly Statistics	VIS / INI	RES	CAN NO SH	HIRD	F/U	REF OUT	Close	CONV Rate
Week 1 (5/1)								
Week 2 (5/6)								
Week 3 (5/13)								
Week 4 (5/20)								
Week 5 (5/27)								
MONTH TOTALS	0	0	0	0	0	0	0	

Meetings This Week:	VM	DM	SM	Maint	PP	Bene	CAN NO SH	TOTAL EP MTG
Week 1 (5/1)								0
Week 2 (5/6)								0
Week 3 (5/13)								0
Week 4 (5/20)								0
Week 5 (5/27)								0
MONTH TOTALS	0	0	0	0	0	0	0	0

	Week Notes
Week 1 (5/1)	
Week 2 (5/6)	
Week 3 (5/13)	
Week 4 (5/20)	
Week 5 (5/27)	

IC Statistics Conv Rate	Scheduling % of people who called
IM Statistics Conv Rate	% of people who made appointments and showed
Total Hire %	Hire % of people who walked in the door
Firm MTD Hire %	Hire % of all people who made appointments

Attorney/Firm Weekly Summary

	SMH	KLA	JLR	JJS	TEAM	FIRM
Week 1 -Avg Fee						
Initial #s						0
Hire % Rate						
Fee Total						$0.00
Hire #						0
Week 2 -Avg Fee						
Initial #s						0
Hire % Rate						
Fee Total						$0.00
Hire #						0
Week 3 -Avg Fee						
Vision #s						0
Hire % Rate						
Fee Total						$0.00
Hire #						0
Week 4 -Avg Fee						
Vision #s						0
Hire % Rate						
Fee Total						$0.00
Hire #						0
Week 5 - Avg Fee						
IM's						
Hire % Rate						
Fee Total						
Hire #						
Total Fee	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Avg Fee	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Total # VM	0	0	0	0	0	0
Total # Hired	0	0	0	0	0	0
Total Hire %						

Firm MTD	Total Fee	Avg Fee	Total # Hired	Hire %
	$0.00	$0.00	0	

0

- **WIN/WIN/THANK YOU**

- **ANY FOLLOW-UP FROM PRIOR WEEK?**

- **LAST WEEK'S NUMBERS**

REPORTING PERSON		GOAL #	TOTAL #	NEW CASES	CASES CLOSED
ALLI	INITIAL CONTACTS	20		-	-
ALLI	INITIAL MEETINGS	11		-	-
ALLI	CLOSING RATE	7		-	-
LAB	BENEFITS	30			
BJC	FUNDING	50			
SAM	ADMIN	25			
SAM	GUARDIANSHIP	20			

REPORTING PERSON	IMS HIRED #	1/3 PAID @ IM #
LAB		

REPORTING PERSON		GOAL #	ACTUAL #
ALLI	# POWER PARTNER MEETINGS	2	
ALLI	# TOUCHES	20	
LAB	# MEDICAID MARKETING MEETINGS	1	

- **CALENDAR REVIEW**

- **MARKETING**

- **LEAD TEAM CHECK-IN**

- **TEAM CHECK-IN**

    - WHAT DO YOU NEED? SUPPLIES? DO YOU FEEL SUPPORTED?
    - IT ISSUES?
    - COMMUNICATION CHECK-IN (SCALE OF 1-10)
    - CHECK-IN OF LAST WEEK'S TOP 3 (HOW MANY DID YOU ACCOMPLISH?)
    - TOP 3 FOR THIS WEEK

- **PROJECT ACCOUNTABILITY**

- **TO-DO:**

Polly J. Dobbs, Esq.
polly@dobbslegal.com
52 N. Broadway
Peru, Indiana 46970
765-470-7090
www.dobbslegal.com

Hoosier Hills Estate Planning Council - Estate Planning Day May 9, 2019
How Estate Planning is Different for Farmers – What you need to know

Estate planning is important for all families and business owners, but it is crucial for farm families. Too often, farm families misunderstand the estate planning process, placing the future of their family, farm and assets in jeopardy. The laws are no different for farmers, but if their advisers aren't familiar with the nuances that surround ag families, the planning often falls short.

Tax Reform has made major changes to succession planning for farmers and ranchers. This session will also review those changes and the related planning opportunities that are available. However, many of them expire after 2025. Now is the time to act!

As a farm girl and estate planning attorney, Polly Dobbs (Dobbs Legal Group, LLC, Peru, Indiana) is passionate about helping farm families avoid these issues by focusing on the efficient transfer of their land, buildings and equipment to the next generation. During this presentation, Polly will discuss general business succession planning concepts and how they can be incorporated into a comprehensive plan that specifically addresses the unique issues facing farm families. Polly will present practical examples of farm succession plans that treat off-farm heirs equitably while passing control to those involved in day-to-day farming operations, whether that be a child, another family member, or an unrelated successor. She will also give tips to avoid common succession planning mistakes made by farm families and will discuss some of the most tax efficient ways to pass the farm to the next generation.

Bio Info: Polly Dobbs

• Attorney and Owner of the law firm of Dobbs Legal Group, LLC

• Concentrates practice in the area of estate planning and wealth transfer, including estate and gift planning, wealth preservation, probate and trust administration, federal and state tax advice, business succession planning, business organization and general business and corporate transactions

• Raised on a farm in Miami County, moved home to the family farm with her husband and two children in 2011, because Steve took over management of these farms.

• Conducts regular seminars and publishes written materials about succession of the family farm. Actively involved in Advisory Council for Farm Journal Legacy Project.

• J.D. Degree, Magna Cum Laude, Indiana University Robert H. McKinney School of Law (2004).

• M.B.A. Degree, Indiana University Kelley School of Business (2004)

• Can be contacted at polly@dobbslegal.com, 765-470-7090

Strategies to Keep the Farm in the Family

May 9, 2019
Hoosier Hills Estate Planning Council
How Estate Planning is Different
For Farmers
What Lawyers Need to Know
Polly J. Dobbs, Esq.

LinkedIn

DOBBS LEGAL GROUP, LLC

1

How Are Farmers Different? What Lawyers Need to Know

- Strong emotional ties to the land (don't want it sold)
- Different vocabulary (know what bushels are)

DOBBS LEGAL GROUP, LLC

2

How Are Farmers Different? What Lawyers Need to Know

- Operating assets (machinery, equipment, semi trucks, bins, dryers, shops, barns) are different from land. They can and probably should be thought of and planned for differently.
- They farm their own land plus have other landlords. Your plan needs to address continued access to others' land.

DOBBS LEGAL GROUP, LLC

3

How Are Farmers Different? What Lawyers Need to Know

- They're fiercely private & notoriously understate their net worth.
- Tough to get an accurate PFS.
- They can't find their deeds – just call a title company

How Are Farmers Different? What Lawyers Need to Know

- They don't hate trusts
  - If farm assets "skip" a generation, they are not included in the next generation's estate
  - Keep next gen under the estate tax exemption
  - Divorce and creditor protection. Next Gen doesn't really own it, but has all the income off it. It's still in your name, so it's out of their marital estate
  - Control ultimate disposition

How Are Farmers Different? What Lawyers Need to Know

- Team approach is crucial – CPA, CFP, insurance expert
  - Life insurance for liquidity needs – may (still) need an ILIT
  - Commercial liability and property coverage, umbrella?
  - Nuances about income tax savings available to farmers
    - Entity selection to reduce self employment taxes
    - Tax-Free Fringe Benefits
    - Commodity wages
    - Gifts of grain to children used to push income to lower tax bracket – be weary of new kiddy tax at trust & estates rates
    - Gifts of grain to charity to reduce income.

How Are Farmers Different?
What Lawyers Need to Know

- Farmers tend to outgrow their advisors
- USDA and Farm Service Agency payments are tricky
- Follow Paul Neiffer's blog: http://www.farmcpatoday.com/

DOBBS LEGAL GROUP, LLC 7

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

PLANNING FOR THE FAMILY FARM:

- Common Mistake:
  - "I want to treat all my kids exactly the same."
- "Fair" does **not** necessarily mean "equal" ownership among kids
- Equal tenants in common ownership ~~may~~ ***will*** set the stage for a family feud
  - Partition actions can allow one tenant in common to trigger a court ordered auction, no matter how small an interest he or she owns

DOBBS LEGAL GROUP, LLC 8

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

The Do Nothing Plan

- No, if you ignore this, it won't go away.
- Sweetheart Will: All to spouse… then he remarries, then what!?
- The kids will just work it out….um, no.
- Be responsible for your legacy.

DOBBS LEGAL GROUP, LLC 9

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

The Say Nothing Plan

- Planning in secrecy is a bad idea. Entitlement may be brewing at the next generation.
- Take a poll – not a vote -It's not a democracy.
- Once you decide what's fair – tell everyone – no surprises!
- "No Contest" clauses are a cop out
- "It's easier to talk to your kids about sex than about farmland transition" … said one Iowa farmer.

DOBBS LEGAL GROUP, LLC 10

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

HOW DO I START A FARM SUCCESSION PLAN?

- No "one size fits all" solution
- Start with a checklist (see handout)
- Accurate Personal Financial Statement is home base
  - Fair market value, not cost basis or book value after depreciation
  - How are things titled – individual, joint, POD/TOD
  - Face value of life insurance, not cash value
  - Current beneficiaries of retirement accounts, annuities, life insurance
- Re-evaluate as needed

DOBBS LEGAL GROUP, LLC 11

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Let's Talk Taxes

- Upon death, up to $11.4 million (as of 1/1/2019) will pass exempt from Federal Estate Tax. A married couple can pass $22.8 million.
- During lifetime, you may give away up to $11.4 million of your assets ($22.8 if married) exempt from Federal Gift Tax, which would reduce the amount of your exemption remaining at death.
- For estates or gifts in excess of this exemption, the maximum tax rate is 40%.

DOBBS LEGAL GROUP, LLC 12

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Let's Talk Taxes, tick tock

- Tax Reform under Tax Cuts and Jobs Act of 2017 ("TCJA"), made major changes to succession planning for farmers.
- Temporary doubling of the transfer tax exemption is set to expire January 1, 2026, reverting back toward the 2017 levels; $5.6 million per person, $11.2 million per married couple.
- Election in 2020 – any law can change at any time!
- Now is the time to act.

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Let's Talk Taxes, portability election

- A surviving spouse can make a portability election in order to "port" over any unused federal gift/estate tax exclusion amount from the first spouse, if he/she died on or after January 1, 2011.
  - "Deceased Spousal Unused Exclusion Amount" (DSUE) - I.R.C. § 2010(c)(5)(A)
- Election must be made by the estate of the first spouse to die, which requires filing of a Form 706 Federal Estate Tax Return, even if no tax is owed.
- Could be a $11.4M mistake is not elected-get it in writing if surviving spouse declines to elect. (well, 40% of $11.4M)

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Let's Talk Taxes
Annual Exclusions & State Taxes

- Annual gift tax exclusion is $15,000 – to as many individuals as donor wishes, without reducing donor's $11.4 million estate tax exemption or triggering Gift Tax.
- State inheritance or estate taxes deserve special attention: Connecticut, District of Columbia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oregon, Rhode Island, Vermont, Washington, Iowa, Kentucky, Nebraska, and Pennsylvania.
  - *Indiana repealed 1/1/2013*

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Common Mistake

"I'm doing nothing because I'm worth less than $11.4 million," or the similar reasoning: "Because my wife and I are worth less than $22.8 Million."

1. Taxes are probably not your biggest problem! Family farms are destroyed more often by feuding families than by taxes.

2. Who knows what will happen after 2025? The estate tax exemption reverts to half this level in 2026. Anything could happen between now and then.

3. You may have a false sense of security that your total assets are worth less than $22.8 million. What's your farm ground really worth today? What are your neighbors selling for? Maybe you have a lurking tax problem.

   -Life insurance proceeds "count"

DOBBS LEGAL GROUP, LLC 16

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Irrevocable Life Insurance Trust ("ILIT")

- ✓ Face Value of life insurance "**counts**" toward the $11.4M ($22.8M) estate tax exemption
- ✓ Transfer existing insurance to an ILIT – 3 year lookback for estate inclusion
- ✓ Apply for and own new insurance in ILIT – no risk of inclusion
- ✓ Don't be your own trustee (no control)
- ✓ Terms of ILIT should complement estate plan – facilitate loaning/buying assets from estate to inject liquidity to pay the estate tax

DOBBS LEGAL GROUP, LLC 17

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

ILIT Details

- ✓ Funding the ILIT is treated as a gift to the beneficiaries
- ✓ Contribute income producing assets, to pay premium on the insurance policy from income earned
- ✓ Contribute $ annually so the Trustee of the ILIT can pay the premium
  - ✓ *Crummey* withdrawal rights – track lapsing rights
  - ✓ Utilize annual gift tax exclusions, now $15,000 per donor per donee
  - ✓ Premium financing? Get good advice.

DOBBS LEGAL GROUP, LLC

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

ILIT – Do I still need it?

- ✓ Many had ILITs when estate tax exemption was $5M (or $3.5M, $2M, $1M, or $600k) to provide liquidity to pay tax on value of farm in excess of this exemption
- ✓ Now farm value may be under the new exemption $11.4M each ($22.8M married couple) – now what
- ✓ Unknown future after sunset 12/31/2025, or sooner after the election! Exemption could be lower
- ✓ "Family Cash Island" can be used for other things
  - ✓ Pay down debt to improve cash flow at the next generation
  - ✓ Provide cash for 2nd wife or step kids
  - ✓ Allow next generation to expand operations and land base
- ✓ This is an Investment Decision!

DOBBS LEGAL GROUP, LLC

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Common Mistake

"I'm just going to copy what my neighbor did."

- No cookie-cutter approach.
- Lifetime gifting may be great for some, and rotten for others.
- This is very fact-sensitive.
- Every family has different goals – and these are emotionally sensitive to address.

DOBBS LEGAL GROUP, LLC

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Will the Kids Sell? What's your basis?

- ✓ Lifetime gifts remove appreciating assets from donor's estate resulting in estate tax savings.
- ✓ Lifetime gifts = "Carryover Basis" → Recipient receives your low basis in your land.
- ✓ Inherited assets = "Step up in Basis" → Recipient's basis is equal to fair market value on date of death.

DOBBS LEGAL GROUP, LLC

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Will the Kids Sell? What's your basis?

- ✓Lifetime gifting may not be advisable if there may be a future sale.
- ✓Careful analysis of Estate Tax vs. Capital Gains Tax is necessary before gifting.
- ✓In light of new tax laws, higher exemptions, returning gifts previously received to original donor may be best (wait… what!?).

DOBBS LEGAL GROUP, LLC 22

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

How's your Ground Titled? Maximize the Step Up!

- ✓Step up in basis to fair market value at date of death is very powerful!
- ✓Succession planning might need to be focused on basis step up planning instead of estate tax savings
- ✓Many farms are owned ½ by husband (or his trust) and ½ by wife (or her trust). That limits the step up in basis for the whole farm at the second death. Re-examine titling! Embrace portability, and marital trusts.
- ✓Old A/B trust planning may have "trapped" an interest in ground in the first deceased spouse's credit shelter trust – may be able to get it out so that it receives a full step up at second death.

DOBBS LEGAL GROUP, LLC 23

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Threshold Issue

Is Co-Ownership at Next Generation Best?

- Should your children be in business together?
- Do you have a child in mind as a management successor?
- Can they get along well enough to split the cash rent?
- Could they get along if a professional farm manager was involved?

If not – pursue a different plan

DOBBS LEGAL GROUP, LLC 24

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Ideas & Strategies – Divide it up

- ✓ Direct ownership of different tracts of land to different children, which they wholly own *instead of* co-owning the whole as TICs.
- ✓ Can still do this if land is owned by an Limited Liability Entity ("LLE") by including instructions to dissolve LLE at death and distribute different ground to different children.
- ✓ May add a "hook" on the deeds subjecting sale of land to a right of first refusal in siblings, cousins, neighbor
- ✓ All land (or ownership in land-holding LLE) could go to farming child, identifying different assets for other beneficiaries.

DOBBS LEGAL GROUP, LLC

25

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Ideas & Strategies – Divide it up

- ✓ Are there sufficient assets to pull this off?
  - Summer lake house
  - Winter beach condo
  - Securities accounts
- ✓ Could there be with life insurance benefits to provide liquidity to balance things out? You might not want to own the insurance yourself.
  - Irrevocable Life Insurance Trust ("ILIT")
  - Direct ownership by children

DOBBS LEGAL GROUP, LLC

26

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Strategies – First Right of Refusal

- ✓ During lifetime: Landowner can "sell" first right of refusal to anyone. It is important that consideration is given (ex: $100) to make the contract valid.
- ✓ Then the first right should be recorded in the chain of title.
- ✓ At death: deeds distributing different tracts of land to different heirs can include ROFR language
- ✓ The farm cannot be sold without first being offered to the holder of the first right.
- ✓ * Operators - ask all your Landlords for this!

DOBBS LEGAL GROUP, LLC

27

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Strategies – Right to Purchase

- ✓ At death: You can leave the farm (or interests in LLE that owns the farm) equally to all children
- ✓ Require the off-farm children to offer their interests for sale to the on-farm child, and giving the on-farm the option to purchase same.
- ✓ Certain kids don't ever have a right to own land, but get cash. Are you OK with this?
- ✓ Simple strategy - avoids problems in future generations when ownership is fractionalized among cousins.

First Rights (Transfer Restrictions) Where They're Found

The document granting the first right can be any of the following:

- ✓ Last Will and Testament
- ✓ Trust Agreement
- ✓ Freestanding Contract (recorded if addressing real property)
- ✓ Articles of Organization or Operating Agreement if LLC
- ✓ Articles of Incorporation or By-laws if Corporation
- ✓ Partnership Agreement
- ✓ Separate "Buy-Sell" for any entity- careful of inconsistencies

First Rights - the details

The document granting the first right must clearly identify:

- ✓ The purchase price
  - Match offer that's on the table
  - Appraisal – who selects? average?
  - "Sweetheart deal" – ok but TELL ALL
  - What liabilities will be considered?
    - *If C Corp. will Built In Gains Tax Liability be reflected?
  - Will valuation discounts be applied?
  - CPA should walk all owners through the formula showing the current value per share, and have everyone sign off agreeing
    - in annual minutes
    - Attach a sample as an exhibit to the Buy-Sell

First Rights - the details

The document granting the first right must clearly identify:

- ✓ Payment terms
  - Cash – lump sum
  - % down with delivery of low-interest * Promissory Note for the balance due

Applicable Federal Rate, Long Term Inst., May, 2019 = 2.74%
Current WSJ Prime Rate = 5.50%

First Rights- Fund With Insurance?

- ✓ Life insurance owned by the right-holder on the life of the landowner would help provide liquidity to accomplish the purchase in a lump sum.
- ✓ May want to require amount of insurance proceeds received to be paid over as the down payment, with a promissory note for balance in excess of insurance amount.

Separate Land and Operations

- ✓ Treat assets differently during lifetime to make them easier to pass at death
- ✓ Survey and split off operations from bare land: machinery, equipment, trucks, bins, dryer, shop, barns, pasture
- ✓ Direct who gets these assets through lifetime sales or gifts or at death

Separate Land and Operations

- ✓ Include operations in share of farm successor child - either "off the top," or so farm kid gets less of other stuff
- ✓ Offer operations for sale to non-related successor
- ✓ Hold land in trust for the benefit of all children, to be *available* to a farm successor until retirement, or for lifetimes?
- ✓ Have land in entity, which all kids inherit with rules attached, keeping land available to successor

DOBBS LEGAL GROUP, LLC

34

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Landholding Entity ideas

- Entity can (should) be structured with voting and non-voting interests
- Lifetime gifting or a coordinated estate plan provides control of land to farming successor through voting interests
- Off-farm heirs can receive non-voting interests
- "Fair" does not necessarily mean "equal" ownership among kids

DOBBS LEGAL GROUP, LLC

35

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Decision Making in the Landholding Entity

- The holder of the voting interests controls the entity unless you provide otherwise
- Include specific details:
  - Must the land be offered to lease to a certain tenant? If so on what terms?
  - Can interests be owned by "non-blood" relatives? Transfer restrictions are crucial!
  - Think about a put option.
  - If a buy-back happens because of a default, do "good owners" get to pay "bad owners" a discounted price?

DOBBS LEGAL GROUP, LLC

36

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Decision Making in the Landholding Entity

- Non-voting owners need not be excluded from all management
- Define “Big” decisions that may require majority, supermajority or unanimous approval of all non-voting interests, so everyone feels involved

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Examples of “Big” Decisions In a Landholding Entity

✓ Sell land
✓ Mortgage Land
✓ Drastically change use of land
✓ Setting cash rent rates if one owner is the tenant (checks and balances) (include provision for alternative method to set rent if/when can’t agree)
✓ CAFO, Wind Farm, other “hot button” issues…

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Valuation issues

- Valuation Discounts one of the most publicized benefits of entity ownership. Perhaps less so given high estate tax exemption.
- A farm owned by an entity will need two values:
  - appraisal of the farm land, improvements, equipment and assets
  - business valuation to determine the value of an interest in the entity with appropriate discounts.
- Appraisals and business valuations satisfy the adequate disclosure rules triggering the running of the status of limitations for transfers reported on a gift tax return.
- No Guarantee the IRS will accept a valuation, best practice is rely on independent professional business valuation, no shortcuts!

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Common Mistake

"I'm just going to sell my last crop, have an equipment auction and retire."

- No! Huge tax liability.
- Careful planning can reduce tax hit.
  - Use of corporation to own operating assets, then sell stock in corporation to successor
  - Charitable remainder trust

Who's Your Successor?

If you don't have a successor, do you want to find one, or is a machinery auction your plan for retirement or after death, with spouse and kids splitting the net after taxes?

Sale to Non Related Successor

- Through estate plan, at death an option to buy machinery, or "operating" assets could be given to non related successor, for ex: long time employee, young farmer who won't be inheriting an operation.
- During lifetime, sell operating assets to identified successor, perhaps using corporation and selling stock.
- Hand picked successor gets a chance to buy operating assets, perhaps at a discounted price, or installment over time.

Sale to Non Related Successor

- Kids become landlords, with stream of income
- Take steps to insure successor to operations has access to farm land, outline formula to set lease terms, and consider giving successor operator ROFR over land.

Use of Corporate Entity to Transition Operating Assets to Next Generation

- With Successor

Forming a Farm Corporation

- Clean cut-off: End all farm income and expense activity of farm proprietorship checking account; start corporate checking account activity next day.
- Prepare bill of sale to transfer to corporation
  - Unsold inventory (grain, livestock)
  - Accounts receivable (sold, but deferred pmt.)
  - Other assets (breeding stock, M&E)
  - Never land!

Case Study: Active Operations to Successor

Facts:

- John, age 65, operates as Schedule F proprietor
  - Owns grain, machinery, and land
  - Objectives: Retire in several years, liquidate grain, and sell machinery to Sam (might be his son, but could be unrelated)
  - Est. grain value: $800,000; machinery $500,000
- Sam, age 34, ***who may or may not be related***, farms with John, but also files as proprietor
  - Owns his share of grain, some machinery (total value $200K)
  - Buying 160 acres on contract from neighbor

Case Study: Active Operations to Successor

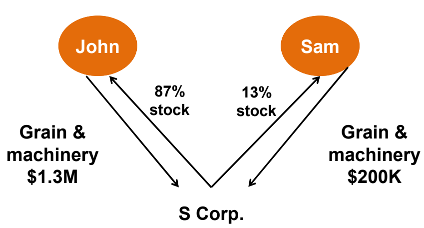
Plan A: Liquidate grain/lease & sell machinery to Sam

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

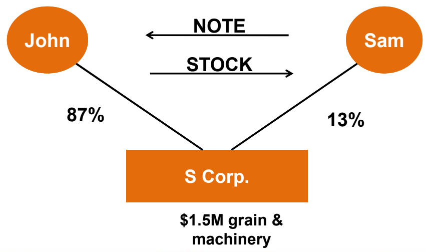
41% Combined Tax

Case Study: Active Operations to Successor

Plan B: Use an Entity to Transition Operating Assets



Case Study:
Active Operations to Successor

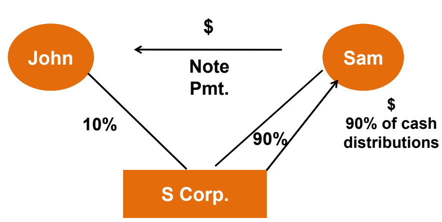


Case Study:
Active Operations to Successor

Strategies with corporate entity:

- Capital gain & no self employment tax to John on stock sale
  - Cuts effective tax rate from 41% to 20% (or 15% or 0%)
  - Spread gain over term of note (e.g., 10 yrs.)
- Sell stock in minority increments with discounts
- Consider reorganizing into voting & non-voting shares
  - John can dispose of most stock, but retain control if desired.

Case Study:
Active Operations to Successor



Case Study: Summary

- Entity sells John's grain, but offsets income with ongoing farm input expenses & prepaids
- Sam does not get fresh depreciation on machinery
  - Bought nondeductible stock, but at a discount
  - Sam gets favorable long-term financing from John
- Helps with "Fair" – if Sam is related, siblings can see that he bought in. Transition of Operations is complete during lifetime.

DOBBS LEGAL GROUP, LLC 52

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

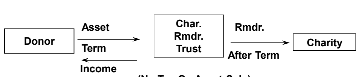
USE A CHARITABLE REMAINDER TRUST TO DISPOSE OF GRAIN AND EQUIPMENT

-WITH NO SUCCESSOR

DOBBS LEGAL GROUP, LLC 39

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Charitable Remainder Trusts



DOBBS LEGAL GROUP, LLC 54

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Charitable Remainder Trusts

Advantages

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

DOBBS LEGAL GROUP, LLC

55

CRT Examples

- 10 year term, annual payout
- $500,000 funding
- Annual payout @ year-end

	IRS Interest Rate 2.0%	4.0%
Payout amount	$50,095	$55,400
Charitable remainder	10.01%	10.13%

[Current IRS rate: About 3.4%!]

DOBBS LEGAL GROUP, LLC

56

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

Dust it off every 5 years

- Plan for now, based on today's circumstances.
- Original plan should allow as much flexibility as possible.
- Review when there's a change in the laws, or a change in circumstances. Adjust if necessary
- No "one size fits all" solution

DOBBS LEGAL GROUP, LLC

57

52 N. Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091 | www.dobbslegal.com

By Polly Dobbs
Attorney, Dobbs Legal Group, LLC
(Updated January, 2019)

DOBBS LEGAL GROUP, LLC
52 N. Broadway
Peru, IN 46947
polly@dobbslegal.com
(P) 765-470-7090
(F) 765-470-7091
www.dobbslegal.com

4 Legal Estate Planning Strategies

A comprehensive succession plan gives your farm the best chance of surviving for future generations, notes Polly Dobbs, an attorney at Dobbs Legal Group, LLC, in Peru, Indiana. There isn't a cookie-cutter approach to estate planning, so you must factor in your goals, family dynamics and financial situation. She shares the following strategies in her own words:

1. First Right of Refusal: This may be given during a producer's lifetime, or it can become effective at death. A landowner can "sell" a first right of refusal to a family member, trusted neighbor or long-time tenant. Going forward, that farm cannot be sold without first being offered to the holder of the first right on the outlined terms. A right to purchase can also be effective at death. For example, your will or trust could leave the farm equally to all your children and require your off-farm children to offer their interest in the ground for sale to your on-farm children using the appraised value on the date of your death.

2. Dynasty Trusts: Protect your farm during your children's lifetime for ultimate distribution to your grandchildren or great-grandchildren via a dynasty trust. If your children never truly own the farm, then their creditors cannot reach it nor can they lose it in a divorce. You control who inherits the farm because your children's last will and testament doesn't govern the disposition of your dynasty trust's property. A dynasty trust can ensure all farm income goes to your children for their lifetime and can help keep the farm intact for distribution to your grandchildren without being included in your children's taxable estates.

3. Limited Liability Company (LLC): The formation of a limited liability company (LLC) can provide an orderly arrangement to keep farm property within the family by establishing an order of succession and control over the transfers of the interests. Frequently, children and parents contribute land to an LLC. In return, each receives proportionate ownership percentages. An LLC may restrict the right of non-family members to acquire interests in the farm ground. Other benefits of an LLC include the promotion of knowledge and communication about the family farm and other assets. An LLC may avoid probate administration upon death if used in conjunction with a revocable trust agreement.

4. Buy-Sell Agreements: A buy-sell agreement is a no-brainer when unrelated parties are in business together or when brothers or cousins farm together and want to set forth exactly how the business will transfer upon the death of one. Upon certain triggers, an owner may be contractually obligated to sell his interests to the company or other owners. The company or other owners may have the option to buy those interests or be required to do so. You might want to agree on what the purchase price should be and then reevaluate and update the price every year according to the current fair market value. The price set in a buy-sell agreement is not binding on the IRS for valuation purposes unless it meets specific arms-length characteristics. Most commonly, the purchase price for an interest in a business that owns a farm is going to be based on an appraisal of the farmland and improvements thereon, and also a business valuation, which may include discounts for lack of control and lack of marketability.

Down on the Family Farm: How to avoid five common estate planning mistakes

By Polly J. Dobbs, Attorney, Dobbs Legal Group, LLC (Updated January 2019)

I'm a farm girl and an estate planning attorney. So naturally, I'm passionate about helping farm families efficiently transfer ownership of their land, buildings and equipment to the next generation.

Too often I sit down with farming clients who misunderstand the estate planning process. Their misunderstanding is usually the result of overhearing inaccurate information. Perhaps they've heard a couple neighbors discussing death taxes and loopholes at the grain elevator and pick up some more chatter at the local diner. This secondhand advice, while perhaps well-meaning, will inevitably become their estate planning downfall.

Here, we explore five common examples of estate-planning-gone-wrong for farmers.

1. **"I'm going to give away the remainder interest, but hold on to the life estate to retain control and income stream."**

The only goal this plan accomplishes is avoiding probate administration. Retained interests such as this cause 100 percent of the value to be taxable upon the death of the life estate holder under the Federal Estate Tax. This is not a good plan for someone trying to minimize death taxes.

2. **"I plan to title my property jointly with my children and their spouses so that it automatically passes to them at death."**

Yes, this avoids probate; however, it also puts the farm squarely within the marital estate of your child's potential future divorce. Leaving your child outright ownership could make the family farm susceptible to claims by the child's creditors and subject to division by a divorce court in the event of that child's failed marriage. Consider leaving your child's inheritance in a trust or creating an LLC to achieve goals of keeping the farm within the family.

3. **"I'm doing nothing because I'm worth less than $11.4 million," or the similar reasoning: "Because the wife and I are worth less than $22.8 million."**

Most farmers are land rich and cash poor with little to no estate planning in place. This situation is a ticking time bomb that will explode into a liquidity problem after death when it's time to pay potential state and Federal death taxes. Many farmers keep a "dirt savings account" and do not have any other savings or investment accounts. As the value per acre of our tillable land continues to increase, the bottom line on the farmers' balance sheets skyrockets, and most aren't aware of the tax problems lurking at their death.

Farmers are generally familiar with the Federal Estate Tax; there are numerous articles addressing this topic in farm journals. Our current federal laws allow each decedent to pass $11.4 million of assets free from Estate Tax; a married couple can pass $22.8 million. However, state death taxes deserve careful consideration. Not every state taxes property transferred by a decedent. For example, Indiana repealed its inheritance tax for every decedent who dies on or after January 1, 2013. However, some states impose significant taxes at death, so it is a wise idea for each farmer to find out how his own state's laws affect his estate plan.

Also, many farmers have a false sense of security and think they don't have a tax issue because their farm is worth less than $11.4 million. However, if his neighbors are selling farm ground for over $11,000 an acre, that farmer may be worth several million dollars more than he thinks, and his heirs will owe significant taxes at his death. It's crucial to take a look at a farmer's accurate balance sheet given today's value of farm land when discussing taxes.

DOBBS LEGAL GROUP, LLC

Polly J. Dobbs, Esq. | polly@dobbslegal.com
52 North Broadway | Peru, IN 46970 | P: (765) 470-7090 | F: (765) 470-7091
www.dobbslegal.com

4. "I want to treat all my kids exactly the same."

Many times, estate planning isn't about tax planning – it's about family dynamics. A farmer is lucky if there is one child who wants to return home (or stay home), but it's more likely that a farmer has at least three children. Treating the children fairly does not necessarily mean treating them equally.

A typical will would leave all assets equally to the children which, without planning, would yield "tenants in common" ownership. A series of complex questions might arise from this situation, though. Does the child who actively farms have to pay cash rent to the non-farming siblings? Would the majority of the non-farming siblings out-vote or second guess each decision made and question the yields acquired by the on-farm sibling? The one farming child may also wish to buy out the other siblings' share of the farm, but that could easily become a huge burden on the farming child. In no time, these scenarios would lead to a family feud.

If one child is going to be managing the family farm, there are methods of planning that allow that child to have control and be provided with a reasonable salary for services rendered. After paying the child a manager's salary, net profits can be divided equally among all children. A farmer's estate plan should be drafted so that non-farm children cannot second guess the on-farm child's daily decisions. Large decisions can require supermajority or even unanimous agreement, but daily decisions can be left to the one who's in the tractor cab.

5. "I'm just going to copy what my neighbor did."

There is no cookie cutter approach to estate planning, especially not for farmers. For some farmers, it might make sense to do some gifting during their lifetime in order to reduce the size of the taxable estate at death. This is an especially attractive option given the current Federal Estate Tax laws that provide each individual with an $11.4 million unified exemption, which can be used during lifetime or at death.

For other farmers, lifetime gifting might not be advisable. If the next generation will likely sell the farm, then their "basis" in the property becomes very important. Careful analysis is necessary to determine whether the Federal Estate and/or state death taxes saved by lifetime gifting are greater than the capital gains tax triggered by an after-death sale. It's best if the estate planning attorney, accountant and financial planner are all involved in such analysis.

It may also make sense to transfer the farm ground to a business entity first, such as an LLC, so that certain transfer restrictions can be put in place to accomplish the farmer's goals. Some goals may include restricting property ownership to blood descendants; preventing or restricting future development of tillable acreage or historic green spaces; and providing protections in the event of a child's divorce.

Estate planning is important for all families and business owners, but it is crucial for farmers.

Raised on a farm herself, Dobbs Legal Group, LLC owner and attorney, Polly J. Dobbs, helps farmers create holistic succession plans that are tax efficient and provide the desired succession of control to the next generation while treating all family members fairly. If you have questions about the role estate planning plays in your family farm, please contact her at 765-470-7090, polly@dobbslegal.com.

Are You Ready for a Farm Succession?

Preparation is the key to a successful farm succession. Waiting for a life-changing event may leave your farm – and your family – vulnerable

Documents

Have you prepared your succession documents? Use this checklist to identify the documents you have which are up-to-date and reflect your current goals and concerns for your family and your company:

- ☐ Will
- ☐ Revocable Trust
- ☐ Durable Power of Attorney
- ☐ Written Operating Agreement (if my farm is an LLC)
- ☐ Written Partnership Agreement (if my farm is a partnership)
- ☐ Bylaws (if my farm is a corporation)
- ☐ Shareholders Agreement or Buy/Sell Agreement

Essential Questions

Do your succession documents address the essential questions of a farm succession? Use this list to identify whether you have **written, legally binding** documents which answer the following questions to your satisfaction.

Who receives my ownership in the farm if I, or one of my partners, die while owning and/or operating the farm?
Yes ☐ No ☐

Is there sufficient 'key person' life insurance in place to help the farm through a transition if I or a partner were to die?
Yes ☐ No ☐

Is there sufficient life insurance in place for the specific purpose of purchasing the shares of a deceased partner (and providing for the family of the deceased partner) if I or a partner were to die?
Yes ☐ No ☐

If I, or one of my partners, becomes <u>disabled or incapacitated</u> for a long period while owning and/or operating part or all of the farm, who will gain control of the farm and the stock/ownership interest?
Yes ☐ No ☐

If I, or one of my partners, becomes <u>insolvent, bankrupt or divorced</u> and stands to lose an ownership interest/stock in my farm to a creditor or divorcing spouse, do the remaining partners have the right to reacquire that ownership interest/stock?
Yes ☐ No ☐

Who will take my place at the farm if I die or become disabled?
Yes ☐ No ☐

If you answered "No" to any of these questions, you may need to start or review your farm succession plan. For more information on farm succession planning or estate planning, contact Polly Dobbs by email at polly@dobbslegal.com or by phone at 765-470-7090.

How to head off family heartache

BY DARRELL BOONE

POLLY DOBBS FOCUSES her Peru law practice on farm estate and succession planning. Earlier in her career, she saw the heartbreak and long-term negative effects that can result from a failure to communicate with family members and get a good plan down in writing. In this interview with Indiana Prairie Farmer, Dobbs offers thoughts on developing a plan, which she says can make things much easier for everyone involved.

How common is the problem of farm families fighting over money?

Unfortunately, it's the rule, not the exception. It's basically human nature to fight about money. For most people, it springs from greed, which lies just below the surface. Then when one little event shifts that surface of that family, it comes out.

How can good succession plans help farm families?

Earlier estate and succession planning was about saving death taxes that could sink a family farm operation in transition between generations. That landscape has changed, and now it's much more about the "soft issues"— saving family relationships and keeping the farm operation intact. I've seen more farm operations destroyed by families fighting over money than taxes ever did. A good plan means that the family's still having Thanksgiving and Christmas dinner together. That's a success.

Are there other ways the process can help families?

Succession and estate planning is like a giant jigsaw puzzle with many parts that need to be coordinated. Besides helping to simplify the process, we frequently see potential problem areas that our clients might miss. Plus, we catch a lot of "little" things that people don't think about, like a giant life insurance policy still payable to an ex-spouse, or a young farmer who put his mother as his beneficiary on his assets before he got married.

Why are families reluctant to plan?

No one wants to think about their own mortality or disability. Most of my clients are still very focused on building, growing and running their businesses now, rather than thinking about life's unpleasant things. Next is what I call the "ostrich syndrome." Planning seems so overwhelming that clients just stick their heads in the sand rather than deal with it. Finally, if a client suspects there will be conflict, they don't even want to start.

PREVENT DISASTER: The worst thing you can do to your children and grandchildren is refuse to make a succession plan, says attorney Polly Dobbs.

What if a family gets along great? Is a plan necessary?

Yes! Because you want to keep it that way. Writing down your intentions in a succession and estate plan is a great way to help ensure that your kids keep getting along.

What if a family already has difficulties?

If it's bad now, you can count on it getting worse later. These are family disputes that wind up in tens or hundreds of thousands of dollars in legal fees. I'm not saying it's an easy process to work through, but in these cases, having a good plan is crucial. There are counselors and consultants who can help with intrafamily communication and what I call the "softer" issues of family difficulties.

Is it expensive to set up a plan?

In today's world with high land and machinery values, a simple "sweetheart will" — where everything is left to the spouse and equally to all children upon the spouse's death — is probably not good enough. I tell my clients that my services are an investment now in a good plan that will prevent potential huge fees and taxes later, and the litigation fees that accompany nasty probate disputes and contesting of wills. Good legal services should more than pay for themselves.

How does one get started?

The first step is an accurate, up-to-date personal financial statement, with fair market value of assets, how assets are titled, along with current beneficiary designations. Also, ask yourself, "If I died tomorrow, what would I want?" When someone wants to make an initial appointment, I send out forms to help them get the wheels turning and start getting organized.

Where can I find an ag law attorney in my area?

You may not always be able to find an attorney in your immediate area who's knowledgeable in ag succession planning, and you may have to travel outside your county. You can find attorneys or get recommendations from members of the Purdue Extension Succession Planning Team.

Any closing thoughts?

Don't keep secrets from your attorney, even the "dirty laundry." It's so much easier for everyone if you take care of these things while you're "still breathing and still have all your marbles." Review your plan every five years, and change it if necessary. Finally, know that a good plan will help you sleep better.

Boone writes from Wabash.

Developing a succession plan can help

Polly Dobbs grew up on a rolling, picturesque, multigenerational Miami County farm overlooking the Mississinewa River. She now lives on the farm, once owned by relative and famed composer Cole Porter. He may have been the ultimate absentee landlord, alternately living in Paris, Vienna and New York City.

Despite her farm's and family's colorful histories, Dobbs, a 10-year 4-H member and former Indiana Angus Princess, grew up doing chores like most other farm kids. She credits the work ethic she learned as a farm kid with helping her become a successful attorney.

"While my friends were lying around their pools in bikinis, I was clipping cattle and doing other chores," she recalls. "Those experiences really set you apart from every other city slicker, and the work ethic can't be overestimated. Now when I talk with farm families, it's like, 'Oh, you know what we're talking about.'"

By the time she went to college, Dobbs was ready to leave the farm in her rear-view mirror. Later, fresh out of law school, she landed a job with a big Indianapolis law firm, where she wound up doing estate and succession plans for business owners and executives. In doing so, she quickly learned how contentious money can be for families.

Practicing what she preaches

Years later, with her parents in declining health, Dobbs and her husband, Steve, had an opportunity to return to the farm, but not before applying what she'd learned in her Indy law practice.

"I'd seen plenty of families fight about the family business, and I was determined that wasn't going to be us," says Dobbs, the youngest of five siblings.

Before she agreed to return to the farm, where her husband is now the manager, she insisted on having good succession and estate plans in place.

Using another attorney to avoid any conflicts of interest, Dobbs' parents set up a plan that split the farm equally among the five siblings, but allows Dobbs to have the voting shares and day-to-day operational control of the farm. Her four out-of-state siblings have nonvoting shares, except for major decisions.

Of her journey that led her away from the farm, then back to it, plus a thriving ag law practice that helps farm families stay intact, Dobbs says: "That's how I found my niche. This is exactly what I'm supposed to be doing."

More Planning Now, Less Fighting Later

POLLY DOBBS
Attorney Polly Dobbs specializes in estate and succession planning. As part of a seven-generation farm family, she knows the unique issues facing farmers.

@ *polly@dobbslegal.com*

Many farmers want to avoid the topic of succession planning because they don't want to hurt anyone's feelings. Those who actually do make a plan sometimes proceed in secret with the attitude of letting the chips fall where they may. This is a sure way to initiate a legal battle over the value and control of the family farm. It's better to have clear, open and honest communication about your goals for the farm's ownership and operation with the next generation.

The following hot-button issues frequently send farm heirs to court:

■ Does anyone have the right to purchase your land or machinery upon your death? If so, at what price? Fair market value, as determined by an agreed-upon appraiser, is a reasonable starting point. A public auction is rarely the best outcome for the farm.

If you want one of your family members to have a right to buy land or machinery after your death, you need to say so. If you want them to have a chance to buy it at a discounted price, you certainly need to say so.

Unintended consequences, regarding your trust, might occur if you name one child as the trustee of your land. If you intend for that trustee child to be able to purchase some or all of the trust's property, you should say so. Absent specific language in the trust, state laws generally prohibit a trustee from participating in the purchase of trust property because of a conflict of interest.

■ Is there a non-family successor to your operation? Many farmers are creating succession plans that allow a non-relative, such as a long-time tenant or trusted employee, to buy interests in the operation during retirement and upon death. Open communication is key, so the children don't feel their parents were unduly influenced while they were off living in the city.

If city heirs are going to be absentee landlords, special attention to details is crucial to allow the non-related operation's successor continued access to farm your family's land, while your children earn fair value rent on the land, based on the formula you define.

■ What about your house? What about your barns, pastures, shop and grain bins? Does one of your children get to live in your house? Do they have to pay rent, or is it part of their compensation for running the operations? Be specific.

If it's your intent for one of your heirs or another non-relative successor to use the barn, pastures and shop, for little to no rent, that's fine. Just say so. Often the bins, shop, etc., have been built on land that's going to end up co-owned by multiple children.

Take steps now to obtain a survey and split off that land as a separate parcel to make it easy to transition control and ownership of the operation to one child while all of the children own the farmland.

■ Outdated buy-sell agreements and estate plans can cause more trouble than if no documents existed at all. Review the governing documents of your farm business entities to make sure they are still a good fit and meet current goals. Farmland values change, family relationships change.

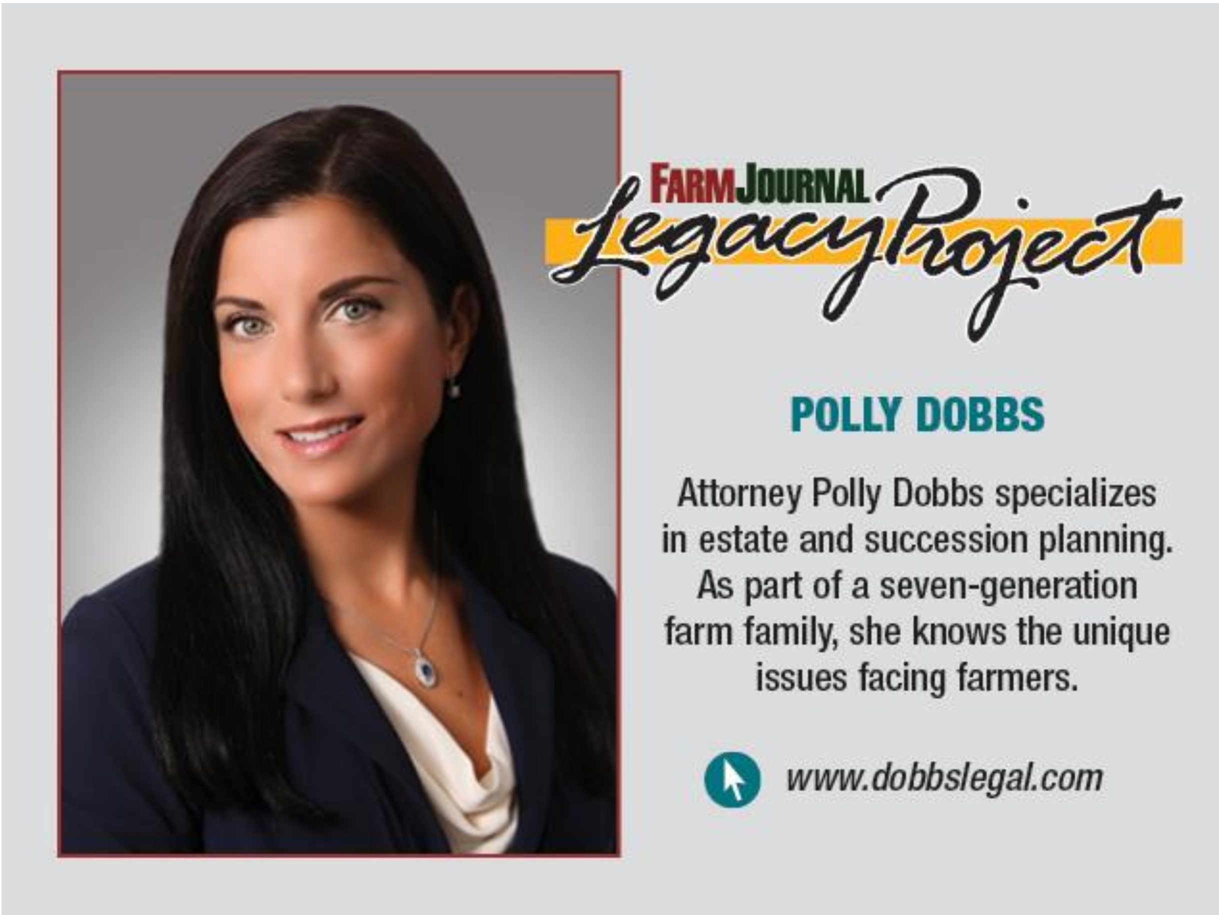
■ If some of your children will be landlords and another (or non-related successor) will be a tenant, be specific about who sets cash rent rates and what to do if (or when) they cannot agree.

You might be tempted to include a no-contest clause in your will or trust that says, "he who sues gets nothing." Courts in about half our states will not enforce no-contest clauses. Other tactics have a similar effect. Include language waiving attorney-client confidentiality with respect to your intent regarding a different, lesser or lack of inheritance left to one child. Consider a clause that all legal fees to defend a lawsuit brought by a child be charged against that child's share.

Plan early, before your mental capacity becomes questionable. We can't stop an heir from suing, but we can help you take steps to build a wall and make it easy to defend that future lawsuit so it quickly fails. **FJ**

Polly Dobbs: Why Estate Planning is Different for Farmers

JANUARY 11, 2019



By **Polly Dobbs**
Legacy Project
Attorney, Dobbs Legal Group, LLC

The laws for estate planning aren't any different for farmers versus non-ag business owners; however, there are important variances, such as the following, that require special planning when a farmer meets with an attorney:

- Vocabulary. One client told me his previous lawyer charged $600 per hour and at one point during a meeting asked him: "What are bushels?" Farmers have a different vocabulary, and if the lawyer can't understand a farmer's balance sheet, then the communication barrier might prevent the right assets from being directed to the right beneficiaries.
- Emotional ties to land. A non-ag business owner might use words such as "exit plan" and put together a plan that includes a sale at retirement or after death, but most farmers have strong emotional ties to the land and don't want it sold. Farmers use words such as "transition" instead of sale. Many farmers are still reeling from buying out siblings when the last generation passed away and want a plan that avoids another sale. I often hear, "How many times do we have to buy this same farm?" The next generation is relieved to learn they don't have to own all the family land but can have access to it.
- Operations versus land. There's an important distinction between an operation and its land, but a reference to "the farm" might mean both of those lumped together. Farming is unique because an operation and its land can, and many times should, be separated into two distinct businesses, then passed along differently to different beneficiaries after retirement or death. "The farm" won't look the same for the next generation. One child, or unrelated successor, might take over the operation, while all the children become landlords who enjoy an income stream, with restrictions in place to give the operation's successor access to the land base at a fair rental rate. The difficult task of creating a fair succession plan becomes a lot easier if "the farm" isn't pushed into one heir's bucket and all of the children can share in land ownership.
- Own versus rent. Most farmers farm a lot more land than they own. A good farm succession plan involves attention to assets the client doesn't own but needs to maintain access to. Working with landlords to secure first rights of refusal and drafting leases are important pieces to an estate plan. If you're good to your landlord, they might want to know you'll be the one buying the farm when they're gone, at a fair price, instead of having to bid on it at auction when the kids sell it.
- Personal financial statement. Farmers are fiercely private and notoriously understate their net worth, while most non-ag business owners have big egos and inflate their bottom line. The personal financial statements I see often don't have the information I need. Equipment might be listed as fully depreciated and land valued at the original price or $2,500 per acre because the farmer wants to be conservative. Life insurance is usually listed at current cash value. Your estate planning attorney needs to know what you're worth dead, and that means knowing the face value of life insurance and the fair market value of everything else. All the pieces of the estate planning puzzle, such as the way assets are titled, any payable on death designations and the current beneficiaries of contract assets, must properly fit together.
- Deeds. It's ironic that a farmer usually can't produce the documents that prove ownership of the most important and valuable asset on the balance sheet. I'm so tired of seeing outdated abstracts of title on yellowed bound stacks of paper that don't tell me an acre was sold off or the state took a chunk when expanding the highway. Often we need to retitle land as part of the succession plan, and the lawyer needs the last deed of record and any exceptions. It's important to work with a local title company, which will cost a few hundred dollars, to get accurate land records.

PIECING TOGETHER THE PUZZLE

Indiana farmer finds a way to transfer his land and business separately

Brad and Patti Starr, left, are in the process of transferring their Indiana farm operation to non-related heirs, Jennifer and Doug Behl, right.

BY ANNA-LISA LACA
alaca@farmjournal.com

When Brad Starr graduated from Purdue in 1976, he decided that if he was successful in building a viable business, he wanted it to grow into the future. He did not want the farm to end with an auction like many other operations he had seen. So he's spent the last several years searching for a viable successor for his Indiana corn and soybean farm.

Like many farmers, Starr was faced with an on-farm child and an off-farm child. His daughter became a pediatrician and his son, Daryl, decided to join the family farm. Unlike many families, the Starrs realized after much trial and tribulation that it would be best for the farm and the family if father and son were not in business together.

Coming to that conclusion wasn't easy, for anybody involved.

"Due to personality conflicts, we decided it was better to go our own ways in business," Starr says. "It was a very tough decision, as there were lots of emotions. We finally got to a crossroads where we knew we needed some outside help."

Starr and his son worked for a long time to resolve the issue between them. Then they decided it was best to work with a mediator. That mediator is who helped them realize being in business together might not ever work for them.

Daryl has since gone on and created several successful businesses.

Successor Solution. Aside from the difficult conflict management that had to happen as a result of that decision, Starr was faced with another major hurdle: he no longer had a successor to take over his thriving farm business.

So he looked for a solution. Starr attended seminars and did a lot of research on estate planning. He decided to split his farm business into pieces and find a non-relative heir to take over the business when he and his wife, Patti, pass away. >

PLANNING TIP: BE SPECIFIC

Estate planning is important for all families and business owners, but it is crucial for farm families, says Polly Dobbs, Indiana attorney and an advisor with the Farm Journal Legacy Project. If your business will have your children and non-relative heirs working together in the future, you have to lay out specific plans.

"If it's your intent for one of your heirs or another non-relative successor to use the barn, pastures and shop, for little to no rent, that's fine, just say so," she says. "Often the bins, shop, etc., have been built on land that's going to end up co-owned by multiple children."

What about your house? Does one of your children or the non-family heir get to live in the home place? Do they have to pay rent, or is it part of their compensation for running the operations?

"Be specific," she says. "If some of your children will be landlords and another (or non-related successor) will be a tenant, be specific about who sets cash rent rates and what to do if (or when) they cannot agree."

Photo: Brad Starr

"What we felt like we had to offer was an opportunity for a young person to not have to re-create the wheel to get into the business of farming," he says.

A plan was formed. Starr wanted the land he and his wife owned to be passed to their children. Then the farm business could be transferred to a non-relative. To achieve this goal, the Starrs created a limited liability corporation to house the land. Another corporation would own the operations side, which includes rolling stock, inventories and the fixed assets pertinent to producing corn and soybeans.

Meandering Path. Once those pieces were in place, Starr set out to find his business' heir.

"We spent seven years trying to find a partner," he says. Through university programs and other networking opportunities, Starr found a young person to partner with him. Except that partnership wasn't a fit, so they split ways.

"As we were about to abandon this idea and start our secondary plan of winding down and eventually having an auction, we found our partner," Starr recalls.

The answer came through working with Lori Culler and her firm Ag Hires, a matchmaking service for agribusinesses and those looking for jobs in agriculture.

"We spent about three hours explaining what we were looking for to Lori and she was to find the individual and do all the pre-screening," Starr says. "She called me one day and said 'Brad, I found somebody that you need to meet.'"

That candidate was Doug Behl, a young man who did not grow up on a farm but fell in love with the profession through volunteering on farms and working in the industry. Behl and Starr have been business partners for almost five years. The two are excited about the future. In fact, Starr recently started his glide path to retirement, moving from CEO of the company to CFO. This move allows Behl to take the helm.

Transition Plans. When Starr and his wife pass, the LLCs holding their farmland will be owned by their children. Behl will own the operations side of the business and will rent the land from Starr's children. Biehl is purchasing the farming operation as an ongoing business. The farm is set up as a sub-chapter S corporation, meaning it has its own set of books. Ensuring the finances are done correctly is one of Starr's main functions in his new role.

"We are working to ensure the connections and communications are there with all our landlords, so that our partner can continue to lease the ground we currently operate in the future," Starr says.

That type of communication is key in making these arranagments work, says Polly Dobbs, an Indiana attorney and an advisor with the Farm Journal Legacy Project.

"Farmers can create succession plans that allow a non-relative to buy interests in the operation during retirement and upon death," she says. "If non-farming heirs are going to be absentee landlords, special attention to details is crucial to allow the non-related operation's successor continued access to farm your family's land, while your children earn fair value rent on the land, based on the formula you define."

This process will also ensure the land isn't sold out from underneath the operator. "You need to draw the road map," Dobbs says. "Don't make them figure it out on their own."

To that end, Starr is visiting with his landlords to ensure Behl can continue renting that land.

"A major part of my role is to make sure our other landlords are on board," Starr says. TP

> "We are working to ensure the connections and communications are there with all our landlords, so that our partner can continue to lease the ground we currently operate in the future."

7 Steps to Resolve a Business Conflict

Indiana farmer Brad Starr and his son ultimately decided it was in their relationship's best interest to not be in business together. But that might not be the case for your operation. If members of your farm team are in conflict, gather everyone involved in the dispute in the same room, says Carolyn Rodenberg, founder of the consulting firm Alternatives to Conflict and an advisor with the Farm Journal Legacy Project. Once everyone is seated around the table, follow these steps:

1. Name the problem together. Start by asking, "Why aren't we communicating better?"
2. Discover the underlying cause of the conflict. What does each person need, and why?
3. Brainstorm possible solutions to the conflict issues.
4. Analyze the options.
5. Select the best solution.
6. Implement the solution.
7. Evaluate the solution's effectiveness in one month.

By Polly Dobbs
Attorney, Dobbs Legal Group, LLC
(Updated January, 2019)

DOBBS LEGAL GROUP, LLC
52 N. Broadway
Peru, IN 46947
polly@dobbslegal.com
(P) 765-470-7090
(F) 765-470-7091
www.dobbslegal.com

Tax Acts of 2012 and 2017 - Game Changers

Make sure your estate plan doesn't cause a tax headache.

The American Tax Payer Relief Act of 2012, and the Tax Cuts and Jobs Act of 2017 ("TCJA") were game changers for many farmers. As a result, your existing estate plan may now be obsolete.

In a nutshell, upon death, you may pass up to $11.4 million worth of assets free from federal estate tax. A married couple can pass $22.8 million.

You might think you don't have a tax problem because your farm is worth less than $22.8 million, but due to the run up in land values since the 90's (although pulling back recently), be sure to look at what your neighbors are selling for, so that you understand the "real" value of your farm ground if you died tomorrow, not the value you think it should be. Also, be aware the proceeds from life insurance policies are included in the value of your estate, and when added to the value of your farm and other assets, your family may face an estate tax bill you never saw coming. State death taxes also deserve careful consideration since some states impose significant taxes at death.

Also, the TCJA's "doubling" of the estate tax exemption is scheduled to expire on January 1, 2026, at which time the estate tax exemption would revert back toward the previous levels of $5.6 million per person, and $11.2 million for a married couple (plus inflation). Therefore, while you may not have a tax problem now, you could have one in 2026.

For federal tax purposes, you may give away up to $11.4 million of your assets without having to pay federal gift tax during your lifetime.

That would reduce the amount of your exemption remaining at death. The annual gift tax exclusion is currently $15,000, which won't reduce your $11.4 million gift tax exclusion or be required to pay gift taxes. Like the federal estate tax exemption, the federal gift tax exemption is also scheduled to revert back to $5.6 million per person in 2026.

For estates or gifts in excess of this exemption, the maximum tax rate is 40%. As always, there is an unlimited marital deduction.

Also, portability of unused exemption to the surviving spouse is available. That means if your spouse dies first, leaving all assets to you, the unlimited marital deduction requires no tax at the first death and your spouse's $11.4 million may be "ported" to you. That shelters $22.8 million of your assets from tax when they pass to your children at your death.

These exemptions are indexed for inflation. The deceased spouse's unused exemption that is "ported" to the survivor will not receive future inflation adjustments, but the survivor's exemption will continue to increase with inflation.

Before portability, estate planners took great pains to help clients divide ownership of their assets, so that each spouse owned enough property to fully utilize their estate tax exemption. That is no longer necessary. In fact, it may be more beneficial to make sure all assets are owned by the surviving spouse, in order to get the highest step-up in basis at the second death.

If your farm is worth more than $22.8 million, you and your spouse need to think about how your heirs will pay the 40% federal estate tax. The special use valuation under Internal Revenue Code § 2032A may allow the value of your farm to be reduced for estate tax purposes.

You should review the special use valuation metrics on a frequent basis and make adjustments to bring your estate into compliance. Also, your succession plan should be structured to make sure your heirs meet the strict compliance of the special use valuation rules after your death.

Life insurance can provide liquidity to pay the estate tax.

However, it is important for the policy to be properly owned so the death benefit is not included in your gross estate, which would only exacerbate your tax problem.

You could create an irrevocable life insurance trust (ILIT) to be the beneficiary of the life insurance policy, which would keep the insurance proceeds from being included in your estate. The ILIT can purchase assets from your estate for cash or loan money to your estate to pay the tax.

The beneficiaries of your ILIT and estate are typically identical, so shifting assets between the two doesn't change their ultimate disposition.

Proper use of withdrawal rights can allow your annual contributions to the ILIT for premium payment purposes to qualify for annual tax exclusions.

If you can't fathom one more trust as a part of your estate plan, then direct ownership of the life insurance policy by your adult children can accomplish the same estate tax exclusion. But think carefully about the associated risks it brings, such as your child's divorce, failure to pay the premium and refusing to use the proceeds to pay the tax after your death.

A member of the Farm Journal Legacy Project Advisory Team, attorney Polly Dobbs is part of a seven-generation farm family. She understands the unique issues facing farmers and succession planning.

2019

Succession Planning for the Family Farm

Entity Structure- The Options for Farm Operations, Land Ownership and Estate Planning

Prepared by:

Polly J. Dobbs &

Paul Neiffer

Dobbs Legal Group, LLC | Clifton Larson Allen, LLP

Entity planning has four main components:

- The reduction in liability exposure to the owners,
- The income tax consequences of entity selection,
- The Estate and Succession planning objectives, and
- The Farm Service Agency (FSA) issues.

We will review each of these features and try to determine which entity choice is best for your farm or ranch. Although we are focusing on the best entities for estate planning purposes, the other considerations are equally important so we will review each of these to see what might be best for your farm operation.

Liability Exposure

Sole Proprietor

Almost all new farmers and ranchers start as a sole proprietor. This form of ownership is extremely easy to set up. All the farmer has to do is simply start business. In most states, there is no required business license and the farmer can simply start operations.

However, there are two primary weaknesses to a sole proprietorship. First, all of the income of the operation is subject to full income taxation including self-employment taxes. For many farmers starting out, the self-employment taxes can be two or three times higher than income taxes.

Second, a sole proprietor is subject to unlimited exposure to all liability issues associated with the farm. These include the debts of the operation, but more importantly, the sole proprietor exposes all of their other investments and assets to any tort liability that may arise from a lawsuit. For example, suppose your hired man is driving a semi loaded with corn to town and has an accident and kills someone. The farmer has good insurance, however, the liability limit is only $5 million and the final judgment is for $10 million. The farmer is now exposed to losing all of his/her other non-farm assets (home, personal vehicles, bank accounts, investments, retirement accounts), because the liability insurance didn't cover the extra $5 million.

Partnership

Many farm operations naturally evolve from a sole proprietor to a partnership when a son or daughter is added to the operation. Also, many brothers, sisters or cousins naturally form a partnership to farm. Again, like a sole proprietorship, a partnership is very easy to create and manage and in many states, a formal written partnership agreement is not required. However, the major disadvantages of the sole proprietorship also apply to partnerships. All of the ordinary income of the partnership is subject to full self-employment tax and each partner is subject to unlimited liabilities of the partnership. And in the case of a partnership, this exposure may be worse than a sole proprietor, because a partner can be liable for the actions of other partners, not just their own actions.

For example, assume you join a partnership with your brother. Things are going smoothly until we have the accident with the semi-truck that is driven by your brother. The $5 million excess judgment is now owed by the partnership, your brother, and now yourself, since you are a partner in the partnership. If you had been operating as a sole proprietor, you would not owe anything, but once you become a partner, all of your assets are subject to the claims of the partnership creditors, and in some situations, the creditors of the other partners.

Due to the liability concerns of the partnership structure, a limited partnership was created to solve a lot of these issues. Under this entity form, a limited partnership allows for limited partners to only have exposure to their initial investment. Any liabilities of the partnership could not attach to their personal assets. However, there was a requirement for there to be a general partner that would still have unlimited liability exposure.

Corporation

Corporations have been around for several generations and the primary reason for the creation of the corporation is to eliminate the exposure to unlimited liabilities for the owners. If you invest money into Google and it has a large liability settlement, the most that you can lose is your original investment for your Google stock. The creditors of Google are not allowed to come after your other personal assets and the same concept applies to a farmer forming their own corporation to run their farming operation.

If the corporation's employee has the semi accident as in our other example, the $5 million excess judgment (after the insurance payment) can only be satisfied with the corporation's assets. Suppose the corporation has a net worth of $1 million. Once this $1 million is used to reduce the judgment down to $4 million, the creditor of the corporation cannot go outside to attack the owner's other assets.

Now, there can be some exposure to what is called "piercing the corporate veil" if, and only if, the owners do not run the operations of the corporation properly. Formalities such as separate bank accounts, annual meetings/minutes are important to maintain liability protection. However, for most farm corporations, assuming they properly dot there i's and cross their t's; this should not be a concern.

Limited Liability Company

The origin of this new entity form is generally attributed to a German law passed in 1892, although Pennsylvania had actually passed a form of limited liability partnership associations back in 1874. Beginning in 1977 with Wyoming creating the first limited liability company statute, we now have the ability to form this type of entity in all 50 states. A limited liability company (LLC) provides for the formal liability protection of a corporation while allowing for the flexibility of the partnership. And if structured properly, a farmer may get the same amount of income tax savings as with a corporation (discussed in the income tax section later).

Since the creation of the LLC, several new forms of entities similar to the LLC have been created. These include a limited liability partnership (LLP) and a limited limited liability partnership (LLLP). For purposes of the remainder of this discussion on entity structure, we will generically refer to these entities as limited liability entities (LLE).

Income and Estate Tax Entity Planning

There are considerable income tax ramifications when selecting which type of entity should own or operate the farm, which are discussed in more detail in the following sections, but here is a refresher on the Federal Estate Tax landscape, which should also be a consideration when doing any planning:

- Upon death, up to $11.4 million (as of 1/1/2019) will pass exempt from Federal Estate Tax. A married couple can pass $22.8 million free from Estate Tax. This more than double the exemption that was available in 2017. These exemptions are part of the Tax Cuts and Jobs Act of 2017 ("TCJA"), and this temporary doubling of the transfer tax exemption is set to expire January 1, 2026, reverting back towards the $5.6 million per person, $11.2 million per married couple level (as indexed for inflation). For those with sufficient wealth, provided an 8 year window to pursue planning opportunities that may be off the table in 2026. Who knows what will happen after 2025? There are 7 years left to get something done (maybe less if the laws change)!
- Under the TCJA, during lifetime, you may give away up to $11.4 million of your assets without triggering Federal Gift Tax, which would reduce the amount of your exemption remaining at death. This helps remove appreciating assets from your estate.
- For estates or gifts in excess of this exemption, the maximum tax rate is 40%.
- Lifetime gifts have a "carryover basis" with the recipient receiving your (perhaps low) basis in the gifted asset. Inherited assets receive a "step up in basis" and the recipient's basis is equal to fair market value on the date of death. This step up in basis is very powerful!
- A surviving spouse can make a portability election in order to "port" over any unused Federal Gift/Estate Tax Exclusion Amount from the first deceased spouse. The portability election must be made by the estate of the first spouse to die, which requires filing of a Form 706 Federal Estate Tax Return, even if no tax is owed. Portability is not automatic! It can be a multimillion dollar mistake if not timely elected!
- The Annual Gift Tax Exclusion as of 1/1/2019 is $15,000 - to as many individuals as the donor wishes, without reducing the donor's $11.4 million Estate Tax Exemption or triggering Gift Tax.
- Potential state inheritance or estate taxes deserve special attention. These states still tax its decedents, or the transfer of real property located therein, even if owned by a nonresident: Connecticut, District of Columbia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New Jersey, New York, Oregon, Rhode Island, Vermont, Washington, Iowa, Kentucky, Nebraska, and Pennsylvania. Even for farmers and ranchers with a gross estate under $22 million, lifetime gifts may be advisable to save state death taxes.
- Farmers and ranchers in excess of the Estate Tax Exemption need to address liquidity needs to make sure cash is available to pay the Estate Tax due at death.

Best choices for the ownership of the farmland.

Most farmers and ranchers start out as sole proprietors who file a schedule F. All of the income reported on a schedule F is subject to both income tax and self-employment taxes. Self-employment income is subject to a 15.3% tax rate on the first $128,400 of income (2018 rate) and a 2.9% tax rate on income in excess of that until the farmer reaches the high-income level of about $200,000 for single farmers and

$250,000 for married farmers, at which point there is an extra .9% Medicare tax assessed. In many cases, farmers with about $130,000 of net farm income will incur substantially more self-employment taxes than income taxes.

By creating an entity to hold the farmland or farm operation, or both, the farmer can substantially reduce their self-employment tax burden. By removing the "rental" component of the farm operation from SE tax, the farm family will save substantial amounts of tax during his or her career.

Example: Farmer Millet owns 500 acres of farm ground in Kansas. She normally earns about $125,000 each year from the farming operation which is subject to about $18,000 of SE tax. She elects to place her farmland into an LLC and rent the land back to her schedule F operation for cash rent of $200 per acre (which is fair market value for her area). She now removes $100,000 of income from SE tax, reducing her SE tax from $18,000 to about $3,000. This is a permanent $15,000 savings per year.

A common Estate Tax savings technique is to make lifetime gifts to reduce the size of one's estate at death by removing appreciating assets from the gross estate. This was more common when the Federal Estate Tax Exemption was lower ($600,000, $1 million, $2 million, $3.5 million) than it is at today's level; but for farmers and ranchers who live in states with death taxes, or with estates in excess of $11.4 million ($22.8 million if married) lifetime gifting is still good planning. Some assets are very easy to gift. For example, cash is as simple as writing a check, whereas gifting land requires a deed to be prepared then recorded at the county courthouse. This results in additional costs to be incurred each time a transfer of land occurs. Additionally, a person who receives a direct gift of land now has certain rights that the person making the gift may not desire. One example is the persons owning land as a tenant in common has the right to demand a partition of the land under most state laws. This partition requires the land to be split up into separate parcels which then allows the person to sell the property or lease the farm ground to non-family heirs. A partition action is open to any tenant in common, no matter how small of an interest is owned. It's not majority rules. Judges don't have time to draw lines on plat maps, and will often order a sheriff's sale if the tenants cannot agree on how to divide the land.

A solution to these problems is to create an entity, and transfer the land thereto. This requires one deed to be prepared and recorded for the transfer of the land into the entity. We normally use a LLE. As discussed previously, these come in many flavors depending on state law. It can be a limited partnership (LP), limited liability company (LLC), limited liability partnership (LLP), or some combination of a LP and LLP (LLLP in some states). We select these types of entities to allow for the following:

- Limited liability – Owners of a LLE are not subject to the claims of a creditor of the entity. Only the assets of the entity are subject to a claim, and all outside assets are exempt from these claims. This does require the entity to be operated properly under state law and the entity should always make sure to have the proper amount of liability insurance.

- Ease of transfer into and out of entity – Corporations have limited liability, however, under current law, the transfer of assets out of a corporation (whether C or S) triggers a gain as if the property was sold for fair market value. This results in a tax at the corporate level. If the corporation is a regular C Corporation, this gain is subject to regular corporate tax of 21%. Then, on top of this tax, the shareholders will now have a qualified dividend from receiving the asset. This will result in additional state and Federal Capital Gains Tax of close to 30% or more.

If the corporation is an S Corporation, we eliminate the dividend tax, but the gain will be subject to regular Capital Gains Tax, and if sold during the built-in gains tax period, it will be subject to the same C Corporation tax (normally a C Corporation converting to an S Corporation, will pay this tax during the first 5 years after conversion). A transfer of assets out of a limited liability entity other than a corporation will usually result in no income or Capital Gains Tax. Care must be taken if there are liabilities involved with this transfer, but normally no tax will be owed due to a transfer in or out of the entity.

- Ease of transfer of units – As previously discussed, the transfer of land to numerous people requires the preparation and recording of a deed resulting in additional county recording costs and possible legal costs. However, the transfer of LLE "units" (ownership) to family members is as simple as recording the new units on the entity's organizational documents.

- Valuation discounts – Once assets are transferred into a limited entity, the person no longer owns individual farm land or other assets. Rather, the owner now has legal ownership of units in a limited entity. This is very similar to someone owning 100 shares of stock in Google. The farmer no longer owns the land. The Google investor is only entitled to their share of the income flowing through from Google and not much more. This concept results in a valuation discount for limited entity units that are transferred. These discounts usually range from about 25% on the low side to more than 50% in some cases. A general rule is a discount of about 30-35% is normal.

- Consolidated management – The governing documents of the LLE will dictate control of its assets; no longer can one minority tenant in common petition a court for a partition action and trigger an auction. Transferring farmland to an LLE during lifetime means heirs will inherit business interests following death (not have their names on a deed), and be subject to the rules put in place by the previous generation during lifetime. Specifics should be included in the LLE documents if anyone should have the first right to lease or buy land owned by the LLE, especially addressing the determination of rent. The LLE can, and perhaps should, be structured with voting and nonvoting interests, which should be carefully passed to the appropriate heirs to achieve desired transition of control. Safeguards can be included to allow the nonvoting owners to have a say in "big" decisions, such as a sale, mortgaging land, drastic change of use of LLE property, CAFOs, wind turbines, or any other hot button issues that the family wishes to involve a consensus of most or all owners, while leaving day to day control in the hands of the voting owners.

- Transfer restrictions – Ownership in the LLE can only be transferred in accordance with the governing documents, which should be carefully drafted to achieve family-specific goals. These provisions are sometimes referred to as a "buy sell" agreement. Permitted transferees may include spouses (or a trust for a spouse's benefit), descendants (or a trust fbo a descendant), or not, and then any transfer to a non-permitted transferee will trigger a first right of refusal in the

LLE or other owners. Events of defaults, such as bankruptcy or divorce, may trigger the right of owners to buy out the defaulting owner's interest, perhaps at a discounted price, with a promissory note over a long period of time at a low interest rate. It may be an event of default to leave ownership in the LLE to a spouse or step child at death, giving the surviving owners the option to buy back interests (at discounted price with a low interest long term promissory note) rather than letting them pass outside the family "blood." First rights of refusal can be included to require owners to offer to sell to co-owners before interests can be sold to a third party. The valuation of the LLE interest being bought and sold at these trigger points is very important. Discounts are appropriate when a minority interest is being transferred, and should be specifically referenced in the buy sell if the current generation intends them to be used. It's best if a sample value is attached as an exhibit to the buy sell, as a model for how the per interest value should be calculated, which liabilities should be included (ex: BIG tax for a corporation), and how valuation discounts should be applied.

- Put options – Usually, owners of an LLE are "stuck" and can only cash out if they can reach an agreement with the other owners to buy them out. Many farmers and ranchers like this; an heir is receiving an income stream, not an opportunity for one big payday. However, some worry about ownership interests becoming fractionalized among second and third cousins who have no interest in the farm or ranch, and some want heirs to be able to easily cash out of ownership. If a put option is included in the LLE governing documents, then any owner can force the LLE or other owners to buy them out. This keeps ownership consolidated in those who want to own the LLE. The put option can be drafted to protect the LLE with only a certain amount of interests being purchased each year, and allowing payment over time at a low interest rate. The LLE may own life insurance on owners in anticipation that heirs may exercise such a put option.

All states have adopted the Limited Liability Partnership (LLP) and Limited Liability Company (LLC) forms of entity. All states allow family farms or small farming entities to utilize these forms of business structure (but beware of the specific definitions within various state statutes that may restrict the use of limited liability entities to certain family farm and other non-investor farming arrangements).

The new tax law has implemented a 20% Section 199A deduction for all non-C Corporation taxpayers which also tilts the entity selection toward using an LLC or LLP for your farm operation. However, this deduction is scheduled to expire after 2025, so for long-term planning, we are likely to not plan on this being permanent.

Choices Regarding the Operating Entity Structure

Partnership as Operating Entity

Because of self-employment tax considerations, a general partnership does not provide the same tax advantages as operating in the corporate environment. The arrangement may be appropriate, however, for the parent-child operating entity, with the land being leased from the parent. This allows for rent income earned by the parent to not be subject to SE tax, however, all other earned income will be subject to SE tax for both the parent and child.

S Corporation Farms

Some farms choose to operate as S Corporations. Sometimes the land is inside the S Corporation; the land may also be owned outside the corporation. Either way, the primary tax benefit of the S Corporation farm is the reduction of self-employment tax. Ensure, however, that compensation paid is not unreasonably low for the services performed. The IRS has been successful in assessing payroll taxes when employee-shareholders are paid too little for the services performed.

A primary disadvantage of operating as an S corporation (and this disadvantage applies to all corporate operations) relates to the Estate Tax. Upon the death of the owner of a sole proprietorship, the inventory, land, and depreciable assets of the farm are adjusted to the Estate Tax value. (The determination of "value" and "special use value" is beyond the scope of this discussion.) The heirs of the sole proprietor or LLE may sell such assets with little or no taxable gain due to the adjustment. The shareholder of a corporation, however, owns stock in the corporation, not the individual assets inside the corporation. Therefore, the assets inside a corporation do not receive a basis adjustment to estate value; rather, the stock of the corporation is adjusted. Unless very carefully planned, the sale of commodities by the corporation will not provide a similar tax benefit. No matter what, the benefit provided will be substantially less than the benefit provided to the heirs of a sole proprietor or partnership.

Unlike the C Corporation form (discussed below), the S corporation may not provide fringe benefits in a tax-free form.

Regular C Corporation Farmers with Calendar-Year Corporations

The C Corporation farmer will have the same tax-planning issues as a sole proprietor, with some adjustments. Under laws before 2018 we usually targeted federal taxable income of $50,000. However, the tax rate for C Corporations is now a flat 21%.

Operating as a C Corporation creates a "double tax." The income is first taxed in the corporation. Later, upon payment of a dividend or upon liquidation, a second tax occurs at the shareholder level. (An S Corporation has a single tax, in that whatever income the corporation realizes is taxed directly to the shareholder, even if the shareholder receives no distributions from the corporation.) Let's assume that the corporation has $50,000 of taxable income and pays a federal tax of $10,500. This leaves $39,500 of remaining income in the corporation. If the shareholder wants that cash currently, a dividend is paid. At current dividend tax rates, the shareholder pays another $5,925 of tax at 15% (a higher rate is owed by high income taxpayers plus state income taxes). The total tax paid on the $50,000 is $16,425, an effective rate of 32.85%. If the shareholder is otherwise in the 35% or higher tax bracket, a C Corporation will save tax dollars. (State taxation must also be considered.)

Maintaining low levels of taxable income each year likely makes the most sense for any farm C Corporation. We want to make sure to prevent the extra layer of double tax at the owner level, yet maintain the tax free fringe benefits as discussed in the next paragraph.

C Corporations are provided with tax-free fringe benefit rules that do not apply to sole proprietors or S Corporations. A C Corporation may provide tax-free meals and lodging on the corporate premises, which includes housing the corporation owns or leases. In addition, the C Corporation may provide medical insurance on a tax-free basis to a reasonable class of employees. Such a class may include management employees (who happen to be family members of the shareholders and their dependents). Medical expenses not covered by insurance may be reimbursed by the corporation, but if this plan is implemented, it must be done on a nondiscriminatory basis (certain part-time and underage employees may be excluded), and special care must be made to comply with Patient Protection and Affordable Care Act market reforms

The C Corporation with excess income may push out income to the individual shareholder-landlords through the payment of reasonable rent. Reasonable wage payments for services rendered may also be paid to shareholder-employees. Again, C Corporation taxable income should be maintained at low levels each year.

Wage payments to employees (including shareholder-employees) are subject to payroll taxes. Wages may be paid in the form of commodities, however, to avoid payroll taxes. Appropriate caution is necessary to meet IRS rules in this regard. The year-end payment of a commodity wage will not reduce the corporate taxable income. This should be viewed only as a means of moving income out of the corporation. Year-end transfers of commodities in payment of wages are viewed as a sale of the commodity by the corporation with a related payment at fair market value as an expense. The employee receives the commodity with a tax basis equal to that fair market value. Form W-2 must be completed. Thus, the receipt of commodity wages does not provide the corporation with a net tax deduction, but the individual employee receives taxable income.

Consider the Social Security implications of commodity wages. Since commodity wages are not subject to payroll taxes (if properly paid), no Social Security benefits will accrue to the employee's account. For this reason, caution is warranted for paying wages to nonfamily members in the form of commodities.

The corporation should not accumulate earnings beyond what is needed for operations. After several years of accumulating taxable income, the corporation may find itself with excess investment assets. The accumulated earnings tax may be assessed by the IRS for an unreasonable accumulation. In addition, the corporation may be tempted to purchase land with these excess funds. This is strongly discouraged, in that you (nearly always) don't want to own real estate within a corporation. Flexibility is limited and you lose the benefit of capital gains when appreciated property is owned by a C Corporation. Since C Corporations do not have special tax rates for capital gains, farming operations that generate substantial capital gain income—such as dairies, through the sale of cull cows—need to be structured in such a manner that the cows are not owned by the corporation.

If the individual shareholder finds himself in the 15% or lower tax bracket, it may be appropriate to declare a dividend from the corporation's accumulated earnings. Dividends paid to a person in the 15% or lower bracket are subject to a zero percent rate. Only that portion of the dividend that would have been taxed at 15% or lower, if the special rate didn't exist, would be subject to the zero percent tax rate.

Regular C Corporation Farmers with Fiscal Year-End

A C Corporation with a fiscal year-end has the same tax benefits as discussed immediately above, with one more benefit thrown in: The payments from the corporation to the individual are not immediately taxed at the individual level. An element of deferral exists, which allows the individual more flexibility and time to tax-plan further.

Corporate Row-Crop Farms with Livestock Farms Outside of Corporation

Livestock farmers who also raise row crops may find themselves with a C Corporation for the row crops and another entity (perhaps a sole proprietorship or S Corporation) for the livestock. Now there are two farms to work with in tax planning. The C Corporation can plan its taxable income by paying rent and compensation to the shareholder-landlord-employee before its year-end. The livestock operation can reduce its taxable income by purchasing feed, which has been raised by the row crop C Corporation, before its year-end.

Limited Liability Entity Farms

A single member domestic entity, owned by an individual, that does not elect to be taxed as a corporation is treated as a proprietorship, and its separate existence is disregarded for income tax purposes. This structure eliminates the potential exposure to creditor claims of the LLC; however, it still subjects the owner to unlimited self-employment tax.

Use of a manager-managed LLC with two classes of membership provides SE tax savings to the non-managing members. A manager-managed LLC may provide separate classes of membership for managers (who have the authority to bind the LLC under contract) and non-managers (who have no such authority). Both classes would default to provide limited liability protection to the members in their capacity as members. Personal guarantees, making certain debts recourse to the member, do not violate the provision stated above with regard to personal liability, because such exposure is not due to the status of being a member.

Non-managers who do not meet the 500 hour involvement test are not subject to SE tax, except to the extent of guaranteed payments received as long as non-managers own a "substantial continuing interest" in the class of interest and the individual's rights and obligations with respect to that class are identical to the rights and obligations of that specific class held by persons who satisfy the general definition of "limited partner" (i.e., non-manager, less than 500 hours).

Managers are subject to SE tax on income from that interest. If there are non-managers who spend less than 500 hours with the LLC and such members own at least 20% of the interests in the LLC, those non-managers who spend more than 500 hours are not subject to SE tax on the pass-through income, but are subject to SE tax on the guaranteed payments.

Use of the manager-managed LLC form, with the taxpayer holding both manager and non-manager interests that may be bifurcated. Individuals with non-manager interests who spend less than 500 hours with the LLC must own at least 20% of the LLC interests. The farmer owns a class of non-manager interests identical to those held by the other non-managers and also owns a manager interest. This exception allows the individual who holds both manager and non-manager interests to be exempt from SE tax on the non-manager interest. The taxpayer is subject to SE tax on the pass-through income and guaranteed payment of the manager interest only.

The manager's interest may represent a very small ownership in the LLC. In addition, an appropriate guaranteed payment is made to the manager for their services to the LLC.

Example:

Bear LLC is an operating farm owned by Papa and Mama, who are married to each other. Mama is not active in the farming operation but is an equal owner. Because Mama does not work more than 500 hours in the farm and she holds at least 20% of the ownership, Papa's membership interest could be structured as manager and non-manager units. Papa is provided a 2% manager interest for which he will also receive an appropriate guaranteed payment for labor and management provided to Bear LLC. This 2% interest will be subject to SE tax, as will the guaranteed payments received by Papa. The 49% non-manager's interest owned by Papa and Mama will not be subject to any SE tax.

The manager can also be provided a larger interest in the LLC. This larger interest provides the reward to the manager for the services rendered to the LLC, without requiring a guaranteed payment.

Example

Peter and Mary own PPM LLC, a corn and bean farm. Although they own everything 50-50, Mary operates the farm; Peter is a full-time house builder. He devotes minimal time to the farming operation. In structuring the LLC ownership, they determine that Mary should receive a 20% profits interest for her management and labor provided to the farm. Remaining profits will be split 50-50 between the owners; Mary and Peter each received 40% non-managers interest in the LLC for the contribution of the equipment and other tangible assets to the LLC. No guaranteed payments will be paid, as the members determined that the profits interest represents reasonable compensation for the labor and management provided.

The Estate Tax benefits of step-up in basis for equipment and inventories will apply to assets held by the LLC. A C Corporation will remain the only entity, however, that will have the advantage of certain tax free fringe benefits.

In summary, the LLC has potential for limiting SE pass-through income, as an LLC can generally be drafted in a manner where some members have management/SE status and others do not. There are at least three ways (and many permutations) in which SE tax savings may be structured. All require manager-managed LLC status under state law. This separation of management authority is not available in most states with respect to the LLP.

Farm Service Agency Considerations

The final consideration regarding entity planning is to make sure that our great income and Estate Tax planning does not reduce payments that may be received under the appropriate farm bill program. Each individual farmer will have a payment limitation ($125,000 under the current 2014 farm bill as of the time of this writing). In addition, if the farmer is married and the spouse qualifies as an "active" spouse with the local FSA office, an automatic additional payment limit is allowed.

However, if the farmer operates the farm operation as a "limited liability entity" (corporation, LP, LLP, LLLP, LLC, etc.), then that farming operation has only one payment limit even if it is owned by more than one individual.

Partnerships and joint-ventures do not have a payment limitation, but rather, income flows through to the individual owners and then the payment limitation is applied at that level. Therefore, for farmers with larger operations, it is critical to make sure that the operating structure allows for maximum payment limitations. This will usually involve some type of partnership or joint-venture structure with multiple owners. If a concern exists regarding liability exposure, then setting up each owner as a single-member LLC will eliminate the liability exposure and not require the preparation of additional tax returns.

Finally, creating a bunch of additional entities will not usually create additional payment limitations since the Farm Bill has attribution requirements built-in to reduce payments to only one payment limitation per individual. Attempts to get around these limitations can be costly to farmers since penalties may be due if done incorrectly.

As of the time of this writing, there is consideration by Congress in eliminating the one payment limit for limited liability entities and make the rules similar to partnership limitations. However, this has not been fully placed in law yet (it may be the law by the time you read this).

Succession Planning for the Operating Entity

Income taxes and other issues guide which entity is selected for operations, but once operations is separated from land and other assets, that eases the transition of operating assets to different beneficiaries.

At retirement, a farmer or rancher may sell ownership in the operating entity to the on-farm child, or to an unrelated successor, in a way that minimizes income taxes, and allows the operating successor to buy in over time, into an industry that has overwhelming barriers to entry. Many farm families are the last generation of active operators, with all children and grandchildren living off the farm with no plans to return. In such case, a sale to a non-related successor may make sense. Many young farmers are eager to break into the industry, but there isn't room for them on their home farms. Properly mentored by a farmer or rancher approaching retirement, such young farmers have an opportunity to learn, to be introduced to other landlords to earn their trust, and can provide an income stream to a retiring farmer by purchasing ownership in the operating entity over time.

If a farmer sells their equipment on an installment note, all of the depreciation recapture is due in the year of sale, even if they receive very little cash. Plus, this income is subject to ordinary income tax rates. This can make it difficult to sell equipment to the next generation. One option is to transfer the equipment into a new S Corporation and then sell the stock to the next generation. This allows for capital gains treatment on the gain and allows for installment sale treatment (i.e. you are only taxed as you receive cash).

If a child or grandchild will be the successor to operations, entity ownership facilitates a transition of ownership over time, through profit interests, gifts of capital ownership, sales, or part gifts-part sales, perhaps leveraging valuation discounts. One child can be the successor to operations while all children become the successors to land ownership.

The overall succession plan must fit together such that the successor to operations, whether related or not, has continued access to the land. The operating successor doesn't need to own all the land, just have continued access to it. Similarly, care should be taken to protect continued access to rented land. Landlords will appreciate knowing details about a tenant's succession plans, and having a chance to meet the successor who is being mentored to care for the land in a manner consistent with past performance. Don't overlook first rights of refusal to protect the operation's land base. A good farm succession plan pays attention to assets that aren't even on the farmer's balance sheet. If a landlord is pleased with a tenant, he may grant a first right of refusal, allowing the tenant an opportunity to purchase the land at appraised value before it could be sold on the open market. If a farmer suspects the landlord's heirs will be auctioning the farm, a first right can allow that farmer a chance to buy the farm at appraised value, without having to be the highest bidder at an auction.

Buy sell provisions are important in an operating entity just as in a landholding entity. If two brothers farm together, a contract should be in place addressing how one will buy out the other's interest at death. If Dad and son are farming together, a contract should be in place giving Dad the right to buy back son's interest in the event of divorce.

Retirement, without a Successor

Another option for the farmer who is ready to retire and has built-up grain inventory with no related expenses, is to transfer the grain into a Charitable Remainder Trust. This allows the farmer to sell the grain for cash and only pay income tax as the trust makes an annual annuity payment to the farmer. This also eliminates the self-employment tax.

Finally, a farmer nearing retirement may want to consider using a cash balance pension plan. This allows the farmer to set aside perhaps $200-300,000 each year for five years to help offset the grain inventory build-up. However, one drawback to this option is the extra self-employment tax that is owed. But many farmers would like to pay more into social security before retirement, so for many this is actually a plus, not a minus.

Conclusion

The bottom line is that all entity planning must incorporate all aspects of the proper entity structure. This includes liability protection, proper income and Estate Tax planning and making sure to achieve proper FSA payment limitations. These all need to be closely examined by appropriate professionals to determine the right structure for your farm or ranch.

In succession planning, fair does not mean equal. Every farm is different. Not all farm families should be in business together. In those cases, identifying different assets for different children is a better plan, and life insurance proceeds may help even things up with some children receiving cash instead of farm assets. Once entities are selected for land and operations, a coordinated Last Will and Testament and perhaps Trust(s) are crucial to control who gets which assets, when, and how. Minor children and blended families require special attention! Also, ancillary documents such as powers of attorney for finances and health care are important, to allow trusted individuals to make decisions following incapacity. Prenuptial agreements for children, or for widows or widowers remarrying later in life, should be considered an important part of a farm succession plan.

An accurate personal financial statement is home base. Advisors need to know fair market value, not cost basis or book value after depreciation, and not what a farmer thinks his land is worth, even though a neighbor's land just sold for much more. Include face value of life insurance, not just cash value, which is included in a gross estate at death. Information about how are things titled – individual, joint, life estate, payable on death/ transfer on death, and current beneficiaries of retirement accounts, annuities, and life insurance is crucial to determine how assets pass at death, and whether any adjustments are necessary as a part of the planning process.

The TCJA window of double Gift/Estate Tax exemption should prompt large farmers and ranchers to act. However, those with assets under the current Federal Exemption should not rest on their laurels with a false sense of security that no planning needs to be done. Taxes often are not the biggest problem when farms pass from one generation to the next! Family issues and lack of a successor in management cause the most problems and heartaches.

The final decision may seem daunting, however, most tax professionals are equipped to help you with deciding the appropriate entity for your operation, and estate planning attorneys can help you put together a comprehensive succession plan. There is no reason to delay making the decision. An estate and farm succession plan should be structured to fit today's circumstances, and reevaluated as time goes by, family circumstances and assets evolve, and laws change. The attached checklist may be a helpful starting point.

Are You Ready for a Farm Succession?

Preparation is the key to a successful farm succession. Waiting for a life-changing event may leave your farm – and your family – vulnerable

Documents

Have you prepared your succession documents? Use this checklist to identify the documents you have which are up-to-date and reflect your current goals and concerns for your family and your company:

- ☐ Will
- ☐ Revocable Trust
- ☐ Durable Power of Attorney
- ☐ Written Operating Agreement (if my farm is an LLC)
- ☐ Written Partnership Agreement (if my farm is a partnership)
- ☐ Bylaws (if my farm is a corporation)
- ☐ Shareholders Agreement or Buy/Sell Agreement

Essential Questions

Do your succession documents address the essential questions of a farm succession? Use this list to identify whether you have **written, legally binding** documents which answer the following questions to your satisfaction.

Who receives my ownership in the farm if I, or one of my partners, die while owning and/or operating the farm?
Yes ☐ No ☐

Is there sufficient 'key person' life insurance in place to help the farm through a transition if I or a partner were to die?
Yes ☐ No ☐

Is there sufficient life insurance in place for the specific purpose of purchasing the shares of a deceased partner (and providing for the family of the deceased partner) if I or a partner were to die?
Yes ☐ No ☐

If I, or one of my partners, becomes <u>disabled or incapacitated</u> for a long period while owning and/or operating part or all of the farm, who will gain control of the farm and the stock/ownership interest?
Yes ☐ No ☐

If I, or one of my partners, becomes <u>insolvent, bankrupt or divorced</u> and stands to lose an ownership interest/stock in my farm to a creditor or divorcing spouse, do the remaining partners have the right to reacquire that ownership interest/stock?
Yes ☐ No ☐

Who will take my place at the farm if I die or become disabled?
Yes ☐ No ☐

If you answered "No" to any of these questions, you may need to start or review your farm succession plan.

By: Paul Neiffer, CPA, Principal, Agribusiness,
Clifton Larson Allen, LLC
Phone: 509-823-2920
Email: paul.neiffer@CLAconnect.com
Website: www.CLAconnect.com

Polly Dobbs, Attorney
Dobbs Legal Group, LLC
Phone: 765-470-7090
Email: polly@dobbslegal.com
Website: www.dobbslegal.com

Brian Melvin, RICP

SENIOR WEALTH MANAGER
brian.melvin@unitedcp.com

317-636-1000

Brian Melvin serves as a Wealth Manager for the United Capital Indianapolis office, formerly CS Capital Management, Inc.

He works with a team of financial professionals who are dedicated to providing the comprehensive, holistic services retirees and preretirees need to pursue their retirement dreams. A financial professional since 1997, Brian possesses in-depth knowledge that comes from over 16 years of experience. His credentials include a Bachelor's of Science in Finance from Indiana State University, a Life and Health Insurance License, a Series 65 securities license and a Retirement Income Certified Professional (RICP) designation from the American College. His experience and training enable him to assist clients with a broad range of services, from financial, retirement income and investment planning to Social Security planning. Away from work, Brian serves the community through Traders Point Christian Church of Zionsville, where he is a volunteer in the Children’s Ministry and Kairos Prison Ministry. In his spare time, he enjoys exercising, including bike riding, and spending time with his wife, Christine, and their two daughters, Lia and Lilly

Savvy Social Security Planning:

What Baby Boomers Need to Know to Help Maximize Retirement Income

Baby boomers want to know:

- **Will Social Security be there for me?**
- **How much can I expect to receive?**
- **When should I apply for Social Security?**
- **How can I potentially maximize my benefits?**
- **Will Social Security be enough to live on in retirement?**

Understanding the value of Social Security

Social Security offers income you can't outlive

If your monthly benefit is $2,000 today and you live:

10 more years	**you'll receive a total of**	**$304,256**	**in lifetime benefits**
20 more years		**$673,622**	
30 more years		**$1,160,479**	

Assumes 2.8% annual cost-of-living adjustments

Social Security offers annual inflation adjustments

If your monthly benefit is $2,000 today and annual cost-of-living adjustments are 2.0% :

In 10 years		$2,438
In 20 years	Your monthly benefit will be	$2,972
In 30 years		$3,623

Assumes 2.0% annual cost-of-living adjustments

Social Security offers survivor benefits

Both spouses living **After husband dies**

$2,000 **$1,200** **$2,000**

Baby Boomer Social Security Question #1

Will Social Security be there for me?

OASDI Trust Fund has been in trouble before

Deficit was almost 10 years long before changes were made!

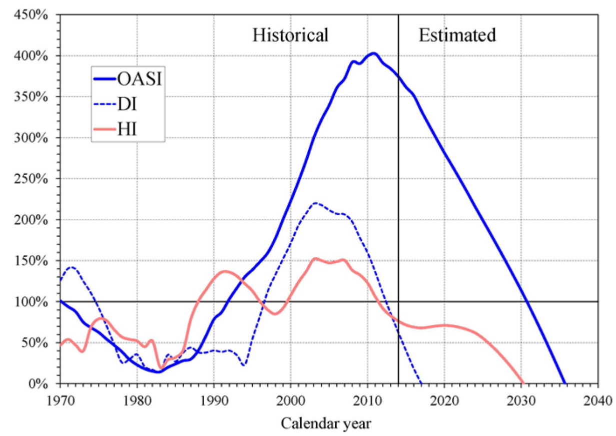
Major 1980's Changes…

- ***Raised Full Retirement Age for everyone born after 1954.***
- ***Started taxing Social Security benefits.***
- ***Federal workers started paying into system.***

Source: Social Security Administration, Office of the Chief Actuary

Long-term projections:

without reform, benefits fall to 79% in 2034 & 73% in 2089



Savvy Social Security Planning

What would it take to restore solvency to the system?

Reform proposals being studied

- **Increase maximum earnings subject to Social Security tax** (currently $132,900 in 2019)
- **Raise the normal retirement age** (currently 66 for individuals born between 1943 and 1954; 67 for those born in 1960 or later)
- **Lower benefits for future retirees** (escalate benefits based on increases in consumer prices rather than wages)
- **Reduce cost-of-living adjustments (COLAs) for all retirees**
- **CHANGE STRATEGIES AVAILABLE!!!**

Savvy Social Security Planning

Baby Boomer Social Security question #2

How much can I expect to receive?

Your benefit will depend on:

- How much you earned over your working career
- The age at which you apply for benefits

Savvy Social Security Planning

How Social Security benefits are calculated

- At age 62, each year's earnings are tallied up and indexed for inflation
- Highest 35 years of earnings are averaged (AIME)
- AIME is divided by three "bend points" to determine your primary insurance amount (PIA). This is the amount you'll receive at full retirement age.
- Benefit is increased each year by cost-of-living adjustments (COLAs)

Example of benefit formula

- Baby Boomer born in 1950
- Maximum Social Security earnings every year since age 22
- AIME = $8,915
- PIA formula:
  - $926 x .90 = $833.40
  - $4,657 x .32 = $1490.24 ($5,583 - $926 = $4,657)
  - $3,582 x .15 = <u>$537.30</u> ($9165 - $5,583 = $3,582)
  - Total = $2,860.94

PIA = $2,861

Amount worker will receive at full retirement age

Savvy Social Security Planning

Full Retirement Age (FRA)

Year of Birth	Full Retirement Age
1943-54	66
1955	66 and 2 months
1956	66 and 4 months
1957	66 and 6 months
1958	66 and 8 months
1959	66 and 10 months
1960 and later	67

Savvy Social Security Planning

SOCIAL SECURITY

What if you apply for early benefits?

You will receive a percentage of your PIA

Apply at age	If FRA = 66	If FRA = 67
62	75.0%	70%
63	80.0%	75%
64	86.7%	80%
65	93.3%	86.7%
66	100%	93.3%
67		100%

Savvy Social Security Planning

SOCIAL SECURITY

What if you apply after FRA?

You will earn 8% annual a delayed credits

Apply at age	Benefit will be % of PIA if FRA = 66	Benefit will be % of PIA if FRA = 67
66	100%	93.3%
67	108%	100%
68	116%	108%
69	124%	116%
70	132%	124%

How to estimate your Social Security benefits

- Obtain your annual Social Security statement at www.socialsecurity.gov/mystatement
  OR
- Go to www.socialsecurity.gov, click on "Estimate Your Retirement Benefits“
  OR
- Use one of the calculators on the SSA website: www.ssa.gov/planners/benefitcalculators.htm

Savvy Social Security Planning

Spousal benefits

Spousal benefit = 1/2 the primary worker's PIA if started at full retirement age (35% if started at 62)

Example:

- John's PIA is $2,000
- Jane's PIA is $800
- If Jane applies at FRA, her benefit will be $1,000 (50% of John's PIA)

Rules for spousal benefits

- Primary worker must have filed for benefits
- Spouse must be at least 62 for reduced benefit or 66 for full benefit
- No delayed credits on spousal benefits after 66
- Must be married at least 1 year.

Divorced-spouse benefits

Same as spousal benefits if:

- Marriage lasted 10 years or more
- Person receiving divorced-spouse benefit is currently unmarried
- The ex-spouse is entitled to Social Security retirement or disability benefits and is at least age 62

Rules for divorced-spouse benefits

- More than one ex-spouse can receive benefits on the same worker's record
- Benefits paid to one ex-spouse do not affect those paid to the worker, the current spouse, or other ex-spouses
- The worker will not be notified that the ex-spouse has applied for benefits
- Divorced-spouse benefits stop upon remarriage of spouse collecting benefits (not upon remarriage of primary worker spouse)

Survivor benefits

- Survivor benefit will depend on:
  - The age at which the deceased spouse originally claimed his benefit (the "original benefit")
    - If he claimed before FRA, survivor benefit will be limited to the higher of the deceased spouse's benefit or 82.5% of his PIA
    - If he claimed after FRA, the survivor benefit will include delayed credits
  - The age at which the widow claims the survivor benefit (the "actual benefit")
    - If she claims before her FRA, her survivor benefit will be a fraction of the original benefit (e.g., 71.5% if claimed at 60)
    - If she claims at her FRA or later, her survivor benefit will equal 100% of the original benefit

Savvy Social Security Planning

Survivor benefits

- If spouse dies while both are receiving benefits, widow(er) may switch to the higher benefit

Example:

- Joe and Julie are married. Both are over full retirement age.
- Joe's benefit is $2,000, Julie's benefit is $1,200.
- Joe dies.
- Julie notifies Social Security and her $1,200 benefit is replaced by her $2,000 survivor benefit.

Savvy Social Security Planning

Survivor benefits
Example of early claiming

- Joe and Julie are married.
- Joe's PIA is $2,000.
- Joe files for Social Security at 62; his benefit is 75% of $2,000, or $1,500.
- Joe dies.
- Julie's survivor benefit will depend on when she claims it.
  - If Julie claims her survivor benefit at 66 or later, her benefit will be 82.5% of Joe's $2,000 PIA, or $1,650 (special floor for survivor benefits).
  - If Julie claims her survivor benefit at age 60, her benefit will be 71.5% of $2,000, or $1,430.

Survivor benefits
Example of delayed claiming

- Joe and Julie are married.
- Joe's PIA is $2,000.
- Joe files for Social Security at 70; his benefit is 132% of $2,000, or $2,640.
- Joe dies.
- Julie's survivor benefit will be equal to Joe's benefit of $2,640.
  - If Julie claims her survivor benefit at age 60, her benefit will be 71.5% of $2,640, or $1,887.
  - If Julie claims her survivor benefit at 66 or later, her benefit will be 100% of $2,640, or $2,640.

Rules for survivor benefits

- Couple must have been married at least 9 months at date of death (except in case of accident).
- Survivor must be at least 60 for reduced benefit (50 if disabled), or FRA for full benefit.
- Survivor benefit not available if widow(er) remarries before age 60 (or 50 for disabled survivor), unless that marriage ends.
- Divorced-spouse survivor benefit available if the marriage lasted at least 10 years.

Baby Boomer Social Security Question #3

When should I apply for benefits?

Factors to consider when deciding when to apply

- Health status
- Life expectancy
- Need for income
- Whether or not you plan to work
- Survivor needs

Why delay benefits?

Bigger checks to start

Age at which benefits are claimed	% of PIA if FRA = 66	Benefit without COLAs ($)	Benefit with COLAs ($)
62	75	1,500	1,500
63	80	1,600	1,632
64	87	1,733	1,803
65	93	1,867	1,981
66	100	2,000	2,165
67	108	2,160	2,385
68	116	2,320	2,613
69	124	2,480	2,849
70	132	2,640	3,093

Assumes **PIA = $2,000 and** 2.0% annual COLAs

Why delay benefits?
More income later on

Benefit at age	If claim at 62	If claim at 70
70	$1,758	$3,094
75	$1,940	$3,415
80	$2,142	$3,771
85	$2,365	$4,163
90	$2,611	$4,596
95	$2,883	$5,075

Assumes **PIA at 66 = $2,000 and** 2.0% annual COLAs

Savvy Social Security Planning

31

When to apply for Social Security
Key points to remember

- **If you apply early, your benefit starts lower and stays lower for life.**
- **COLAs magnify the impact of early or delayed claiming. The longer you live, the more beneficial it is to delay benefits.**
- **Decision impacts survivor benefits as well: delaying benefits may give surviving spouse more income.**

Savvy Social Security Planning

Baby Boomer Social Security Question #4

How can I potentially maximize my benefits?

Strategy #1 for potentially maximizing your benefits

Improve your earnings record

Examine your earnings record from your latest Social Security statement, available online at www.socialsecurity.gov/mystatement

- Is it accurate?
- Any missing years?
- Can you improve it by working longer?

Savvy Social Security Planning

Strategy #2 for potentially maximizing your benefits

Apply for Social Security at the optimal time

Consider:

- Your income needs, both now and in the future
- Your life expectancy
- Your spouse's life expectancy

Annual earnings test

- If you apply for Social Security before full retirement age and you work:
- $1 in benefits will be withheld for every $2 you earn over $17,640 ($1,470/mo) in 2019
- Benefit will be adjusted at full retirement age
- Don't let annual earnings test discourage you from working
- To avoid the earnings test, wait until full retirement age or later to apply for benefits

Savvy Social Security Planning

Strategy #3 for potentially maximizing your benefits

Coordinate spousal benefits

"File and suspend"

Cannot be done after April 29th 2016!!!!

At FRA, higher-earning spouse applies for his benefit and asks that it be suspended

Lower-earning spouse files for spousal benefit

Higher-earning spouse claims benefit at 70

Example:

- **Bob and Barbara are 66**
- **Bob's PIA is $2,000; Barbara's PIA is $800**
- **Bob wants to delay his benefit to age 70. Barbara wants to file for her spousal benefit now**
- **Bob "files and suspends" at 66. This entitles Barbara to her spousal benefit while Bob's benefit continues to earn delayed credits**

Caution: "File and suspend" may not be done before FRA

“Claim now, claim more later”

You must have born in 1953 or earlier!!!

At FRA, higher-earning spouse restricts his application to his spousal benefit (lower-earning spouse must have filed for benefits on her record)

At 70, higher-earning spouse switches to his own maximum benefit

Example:

- **Mike and Mary are 66**
- **Mike’s PIA is $2,000; Mary’s PIA is $800**
- **Mary files for her benefit at 66**
- **Mike files for his spousal benefit at the same time and begins collecting $400 (half of Mary’s PIA)**
- **When Mike turns 70, he switches to his maximum benefit of $2,640. Mary adds on her $200 spousal benefit (total $1,000)**

Caution: Higher-earning spouse may not do this before FRA

- **Only one spouse may do this (both spouses can’t receive spousal benefits on each other’s record at the same time)**
- **Spousal planning analysis can determine which of the various spousal strategies will work best for your situation**

Strategy #4 for potentially maximizing your benefits

Minimize taxation of benefits

Filing status	Provisional income*	Amount of SS subject to tax
Married filing jointly	Under $32,000 $32,000 - $44,000 Over $44,000	0 Up to 50% Up to 85%
Single, head of household, qualifying widow(er), married filing separately & living apart from spouse	Under $25,000 $25,000 - $34,000 Over $34,000	0 Up to 50% Up to 85%
Married filing separately and living with spouse	Over 0	85%

***Provisional income = AGI + one-half of SS benefit + tax-exempt interest**

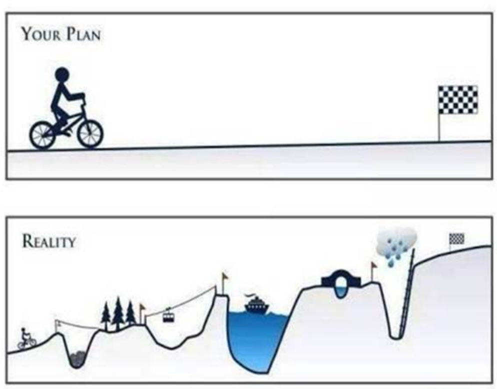
Ways to help minimize taxes on Social Security benefits

- Reduce other income with tax-advantaged investments (but not municipal bonds!)
- Anticipate IRA RMDs, which may put you in a higher tax bracket; consider drawing down IRAs before 70-1/2
- Convert traditional IRA to Roth
- Delay Social Security: reduces number of years benefits are subject to tax
- Reduce expenses: pay down debt, adopt simpler lifestyle
- Continue to manage taxes throughout retirement

Savvy Social Security Planning

Strategy #5 for potentially maximizing your benefits

Coordinate Social Security with your overall retirement income plan



Savvy Social Security Planning

Baby Boomer Social Security Question #5

Will Social Security be enough to live on in retirement?

Answer: Probably not.

Savvy Social Security Planning

Consider Social Security in the context of:

- Pensions
- IRAs and 401(k)s
- Required minimum distributions at age 70-1/2
- Investment portfolio
- Work

Savvy Social Security Planning

Social Security is too important for guesswork.

Let us help you protect your nest egg and potentially maximize your income in retirement.

Savvy Social Security Planning

SOCIAL SECURITY

IMPORTANT DISCLOSURES

United Capital Financial Advisers, LLC (“United Capital”) provides financial life management and makes recommendations based on the specific needs and circumstances of each client. For clients with managed accounts, United Capital has discretionary authority over investment decisions. Investing involves risk and clients should carefully consider their own investment objectives and never rely on any single chart, graph or marketing piece to make decisions. The information contained herein is intended for information only, is not a recommendation to buy or sell any securities, and should not be considered investment advice. Please contact your financial adviser with questions about your specific needs and circumstances.

There are no investment strategies that guarantee a profit or protect against a loss.

The information and opinions expressed herein are obtained from sources believed to be reliable, however their accuracy and completeness cannot be guaranteed. All data are driven from publicly available information and has not been independently verified by United Capital. Certain statements contained within are forward-looking statements including, but not limited to, predictions or indications of future events, trends, plans or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties. Opinions expressed are current as of the date of this publication and are subject to change.

Unless otherwise stated, all data are as of March 2, 2019 or most recently available.

Savvy Social Security Planning

SOCIAL SECURITY

CHANGES TO SOCIAL SECURITY THAT MAY AFFECT YOU

By Jarrod Upton, CFP, Mark Ciucci and Gene Balas, CFA

The Bipartisan Budget Act of 2015, passed last year, may change the timing of when you and your spouse start to receive Social Security. One of the purposes of this new legislation is to improve the fiscal health of the Social Security system. Of course, there are always two sides in an accounting ledger: and in this case, modest savings for the Social Security system necessarily mean a little less in benefits for some future Social Security recipients. We'll discuss these changes, as well as offer some questions you might ask your United Capital financial adviser.

The recent changes to Social Security benefits reduces the flexibility that some Americans had in structuring when they and their spouse would begin to receive benefits. These changes affect those persons reaching age 62 ***after*** 2015. What is ***not*** changing is the basic principle that, as one delays receipt of benefits from Social Security, the amount of monthly benefits increases (though one must eventually begin to receive benefits at age 70).

File and Suspend becomes "All or None"

Prior to this legislation married couples could elect different benefit start dates for the primary wage earner and his or her spouse, using the option of *file and suspend*. In the past, the primary wage earner could file for benefits, thus providing spousal benefits to their spouse, and then suspend receipt of their own benefits. That would allow at least one spouse to allow benefits to grow while still receiving the other spouse's benefits in the meantime. This version of *file and suspend* was primarily of interest to couples with one wage earner. This hybrid technique of delaying some, but not all, of one's benefits is no longer permissible. Either all benefits are suspended (i.e., delayed) or none of them are.

Restricted Application is Eliminated

Another major change is the end of the *restricted application* option, which allowed a spouse who had attained full retirement age, and who was also eligible for his or her own retirement benefit, to collect only a spousal benefit. At a later date, usually age 70, the spouse would switch to his or her own retirement benefit, which would have grown to its maximum with delayed retirement credits. This tended to be of interest to dual-income couples.

How should I Plan?

Of course, there is much more to this law than we can discuss here, so please be sure to have a discussion with your United Capital financial adviser. The summary message is that these changes can affect how you plan for your retirement needs, as they remove a level of

flexibility. As we mentioned, though, you may still be able to suspend benefits for both you and your spouse to a later date to maximize your monthly benefit amount. But if you do need cash flow earlier, and your intent is to delay receiving your Social Security benefits until later, you may need to rely on other sources, such as your United Capital portfolio, to do so.

And that perhaps may mean planning your investment strategy so that it might provide more income than you had originally planned in the years immediately following retirement, up until the date you elect to receive Social Security benefits for both you and your spouse. That could mean realigning a portion of your investment portfolio more conservatively: towards more income-producing instruments, and/or towards instruments that would allow greater withdrawal of principal.

The upside to this strategy is that, even though you may rely on some portion of your portfolio earlier than you had planned (assuming, of course, that you elect to suspend Social Security benefits), your benefits may grow to a larger amount when you do begin receiving them.

That may offset a more conservatively-positioned segment of your portfolio that is less oriented towards growth.

The other alternative is to receive all benefits now, which means that, conversely, you may need *less* income from your portfolio than you had originally intended. This will mean that your portfolio can be invested in a way that could potentially provide for growth of principal over time to hopefully offset the fact that your monthly Social Security benefits might be less than what you had intended, should you have been planning on using either *file and suspend or restricted application.*

United Capital's broad investment platform can help you choose strategies that seek to match the intended timeframe and purpose of the account with the risk level. Your United Capital financial adviser is here to help you with your decisions regarding not just Social Security or retirement planning – we're here to help you in all of your financial life management decisions. And as lengthy, arcane legal documents indicate, that is of no small matter indeed!

Disclosures

United Capital Financial Advisers, LLC ("United Capital") provides financial life management and makes recommendations based on the specific needs and circumstances of each client. For clients with managed accounts, United Capital has discretionary authority over investment decisions. Investing involves risk and clients should carefully consider their own investment objectives and never rely on any single chart, graph or marketing piece to make decisions. The information contained in this piece is intended for information only, is not a recommendation to buy or sell any securities, and should not be considered investment advice. Please contact your financial adviser with questions about your specific needs and circumstances.

There are no investment strategies that guarantee a profit or protect against a loss.

This material does not constitute tax, legal or accounting advice and neither United Capital nor any of its employees or registered representatives is in the business of offering such advice. It was not intended or written for use and cannot be used by any taxpayer for the purpose of avoiding any IRS penalty. It was written to support the marketing of the transactions or topics it addresses. Comments on taxation and estate planning are based on United Capital's understanding of current tax law, which is subject to change. Anyone interested in these transactions or topics should seek advice based on his or her particular circumstances from independent professional tax advisers and estate planning attorneys.

Patrick J. Olmstead, Jr.
Patrick Olmstead Attorney at Law

In addition to a complex civil litigation practice, Patrick defends attorneys in malpractice suits and grievances filed with the Indiana Disciplinary Commission. He serves as outside general counsel for other law firms and provides private ethics consultations and ethics opinions. He has been designated as an Indiana Super Lawyer in the field of Professional Liability Defense since 2014.

Patrick is a member of the ISBA Legal Ethics Committee where he chairs the Ethics Hotline Subcommittee. Patrick is President of the Notre Dame Class of 1990 and president of the St. Thomas More Society of the Archdiocese of Indianapolis.

Patrick received his B.A. in Government from the University of Notre Dame in 1990, and his J.D., *summa cum laude*, from the Indiana University School of Law-Indianapolis in 2001, where he was salutatorian.

Patrick is lucky to be married to his college sweetheart, Julia. They have two children – Deborah, M.D./Ph.D., who is entering her residency at the Mayo Clinic, and Jessica, B.S.P.A., Management, IUPUI.

Phone: (317) 884-8524
Email: polmstead@patrickolmsteadlaw.com

Ethics Issues in Estate Planning and Administration

By Patrick J. Olmstead, Jr.

May 9, 2019

Why am I here?

- Defend lawyers in lawsuits, grievances.
- Outside counsel to firms.
- Panel counsel to insurers.
- Risk management for underwriter.
- Chair Ethics Hotline for Indiana State Bar Association.

2

Topics covered

- Unauthorized practice of law
- Referrals
- Who is my client?
- POA's and Guardianships
- Trust Account Management
- Cyber Fraud

3

Unauthorized Practice of Law

- A company and its non-attorney employees cannot offer advice regarding what estate planning you need – this is the Unauthorized Practice of Law. *State ex rel. State Bar Ass'n v. United Fin. Sys. Corp.*, 926 N.E.2d 8 (Ind. 2010), cert. denied 131 S. Ct. 288.

4

United Financial Systems

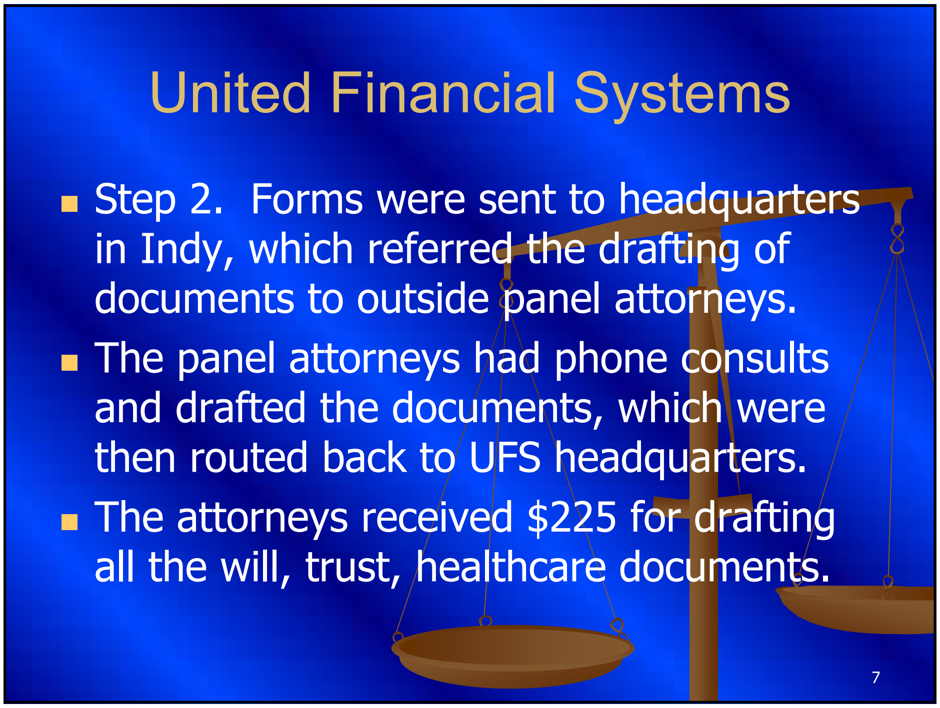
- Step 1. UFS mailed scare brochures to nursing homes warning of "probate." Sales person 1 would meet the retiree, get their financial information, tout the UFS "experts" such as "tax strategists" (they had none), sell a package (e.g., will and trust package for ~ \$2,500), fill in forms, and collect the money. Her commission = \$750-\$900.

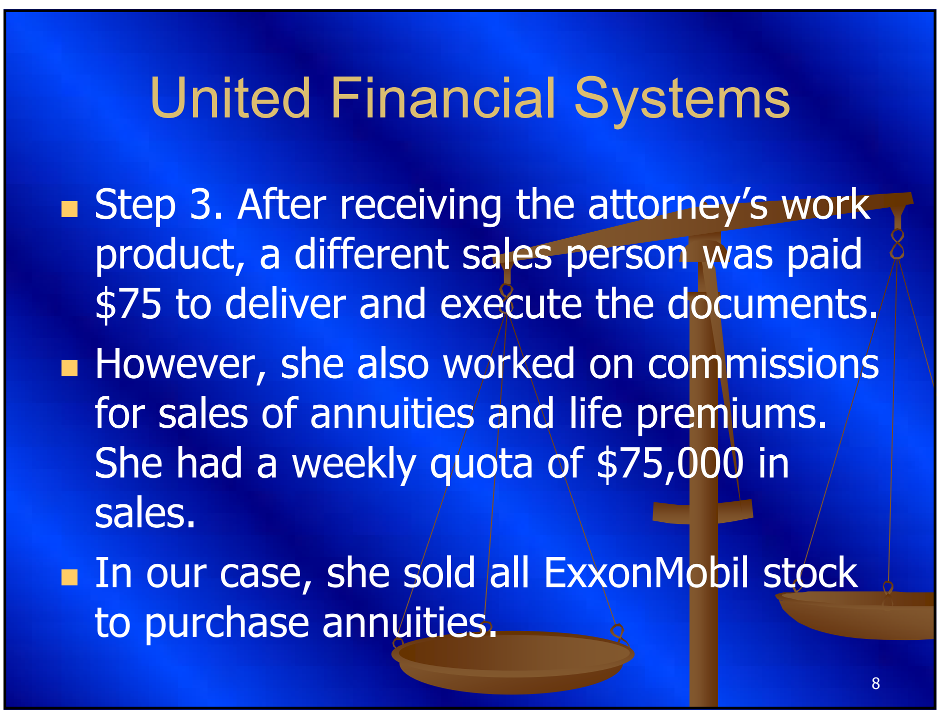
5

United Financial Systems

- Training manual included how to dissuade clients from calling their children or their attorneys.
- Why do you want to burden your children with these issues?
- Why do you want to pay a high priced attorney?

6


United Financial Systems
Step 2. Forms were sent to headquarters in Indy, which referred the drafting of documents to outside panel attorneys.
The panel attorneys had phone consults and drafted the documents, which were then routed back to UFS headquarters.
The attorneys received $225 for drafting all the will, trust, healthcare documents.
7


United Financial Systems
Step 3. After receiving the attorney's work product, a different sales person was paid $75 to deliver and execute the documents.
However, she also worked on commissions for sales of annuities and life premiums. She had a weekly quota of $75,000 in sales.
In our case, she sold all ExxonMobil stock to purchase annuities.
8

United Financial Systems

- UFS's sales of the estate planning packages were "loss leaders."
- UFS's profits were generated by the sale of the annuities and other insurance products, which were often used to fund the trusts.

9

United Financial Systems

- UFS was issued an injunction.
- Ordered to pay some of the State Bar Association's attorney fees, and all costs and expenses, including expert fees.
- Required to send copy of the opinion to all clients since 1995, advising all to consult an attorney, and to offer refunds to recent clients.

10

United Financial Systems

- A lawyer cannot accept referrals from a company that is offering estate planning services. *In re Joyce*, 9 N.E.3d 142 (Ind. 2014) (180 days suspension without reinstatement for UFS panel lawyer).
- See also Ind. Disc. Comm'n Opinion #2-18 *Lawyer Affiliation with Legal Services Companies and Out-of-State Law Firms.*

11

Referrals

- Referrals between accountants, lawyers, financial planners, insurance agents can be reasonable and beneficial to the clients.
- The client's best interest is to have a comprehensive, integrated plan where the professional advice is aligned and complementary.

12

Referrals

- Lawyers are prohibited from paying non-lawyers for soliciting attorney-client relationships. Rule 7.3(e).
- Lawyers cannot share legal fees with a non-lawyer. Rule 5.4(a). *Trotter v.* Nelson, 684 N.E.2d 1150 (Ind. 1997) (invalidating agreement to give secretary 5% of fees from cases she brought in).

13

Referrals

- Undisclosed exclusive reciprocal referral relationships are generally prohibited. Ind. Ethics Op. No. 3 of 2008.
- Concerns include lack of independent judgment; making referrals to someone who might not be competent; sharing fees with non-lawyer.

14

Referrals

- On some level (hopefully a high one), you have to be content with sending your client to a competent professional whom you trust.
- Better practice is referral to 3 different professionals.
- You hope to develop a reputation that garners repeat referrals.

15

Referrals

- How do you say thanks?
- Cannot agree to a percentage of the fee.
- You can give anyone a bonus from your firm. (If less than $500, no 1099 req'd.)
- May be easier to invite them with you to a firm retreat, take them to golf, or buy gifts (and not worry about writing them off, in light of Tax Cut and Jobs Act).

16

Who is my client?

- Not always obvious.
- When grandma is wheeled in to your office to change the estate plan, who is your client? Grandma? Daughter? Grandsons?
- Do THEY know who your (sole) client(s) are? Are you SURE?

17

Who is my client?

- Husband and Wife come in.
- Are you making joint and mutual reciprocal wills? Do they each understand (separately) that they cannot change their wills after the death of the spouse?
- Remember to tell them (both) – if you want to change your will, you need to go see another attorney, because I might have a duty to tell your spouse.

18

Who is my client?

- Put your engagement in writing.
  - Who are you representing?
  - What are you doing?
  - What are you <u>not</u> doing? [Your will only directs distribution of probate property; it will not control distribution of your pension, retirement account, life insurance, etc.]

19

Teaching by allegory

- Every estate planning client.
- Pension case we had. Son was married for about 6 months. Named then-spouse and her child as beneficiaries.
- Tried to change his beneficiary designation in favor of his mom, who cared for him through cancer.

20

Beneficiaries up to date

- But, he could not walk the stairs to the pension office at his (former) employer.
- Girlfriend hid the form and lied to him. Bragged at the bar that she would get the money.

21

Beneficiaries up to date

- Mom and Dad tried to challenge proposed distribution to the child of ex-spouse. Ex-spouse and her kid objected. So, TPA of pension plan filed declaratory judgment in court in Illinois. Complete mess.
- Illinois court would not cede jurisdiction to our Indiana estate matter.
- So, lesson is to keep the beneficiaries up to date.

22

Who is my client?

- Beneficiaries can sue you. *Walker v. Lawson*, 526 N.E.2d 968 (Ind. 1988) (known beneficiary can sue for a breach of duty in drafting a will).
- I provide a checklist of goals before initial meeting. Is minimizing tax liability one of your goals? I'm not your guy. I will get you another lawyer.

23

Who is my client?

- Omitted beneficiaries are suing the lawyers in their will and trust contests. Often argue some sort of conspiracy.
- And, it's because the lawyer often has insurance, so it makes you a target.
- No good deed goes unpunished.

24

Who is my client?

- Second wife calls – Husband is in hospital. About to have surgery. Need to change estate plan.
- Lawyer goes to hospital. Changes estate plan to cut out his kids.
- Kids file will/estate contest and sue second wife and lawyer. Argue not competent, duress, undue influence.
- Nurse said he was not always competent.

25

Who holds the privilege?

- Hypo: Mom prepared a will, radically changing the disposition. After mom's death, daughter gets appointed as personal representative of the estate. Will contest is filed by son, and asks for attorney's file.
- Do you turn over the file?
- Who pays for the discovery dispute?

26

Who holds the privilege?

- Attorney-client privilege generally excludes testimony of communications regarding the preparation of a will. *Brown v. Edwards*, 640 N.E.2d 401, 404 (Ind. Ct. App. 1994), *trans. denied*.
- Privilege survives client's death. *Buuck v. Kruckeberg*, 95 N.E.2d 304, 308 (Ind. Ct. App. 1950).

27

Who holds the privilege?

- Testamentary exception – communications regarding the will and related transactions are not, after death, protected in a suit between the heirs, devisees, and claimants. *Gast v. Hall*, 858 N.E.2d 154, 163 (ind. Ct. App. 2006), *trans. denied*.
- Limited to preparation of will and documents. *Estate of Meyer*, 747 N.E.2d 159, 1166 n. 4 (Ind. Ct. App. 2001).

28

Who holds the privilege?

- "…but where the client's interest has been assigned and the client or his estate cannot . . . have any interest in the matter assigned . . . the privilege is transferred to the assignee for the purpose of waiver[.]." *Buuck v. Kruckeberg*, 95 N.E.2d 304 (Ind. Ct. App. 1950).
- Um, when exactly does this apply? ☺

29

Who holds the privilege?

- Hypo: Mom was under a guardianship. Son was guardian. After mom's death, daughter gets appointed as personal representative of the estate. Now, daughter "waives privilege" and asks for attorney's file for advising Guardian. Son instructs attorney to object.
- Do you turn over the file?
- Who pays for the discovery dispute?

30

POAs and Guardians

- Increasing number of suits concerning self-dealing by powers of attorneys and guardians.
- The advisors, especially attorneys, get named in the breach of fiduciary duty lawsuits.

31

POAs and Guardians

- Early key question – who was your client?
- Are you representing the ward? The agent? Both?
- Do you have an engagement letter?
- How were you getting paid? A check out of the ward's account? Why are you allowing the ward's check to pay you?
- Ward is a known beneficiary of your work.

32

POAs and Guardians

- First, ask WHY this person is the POA/Guardian.
- Are they the beneficiary of the estate?
- If not, why in the world are you doing this?
- Why are you going to spend your time (and spend the ward's money) trying to preserve the estate for someone else?

POAs and Guardians

- Are you getting paid?
- Anyone telling you it's OK to get paid?
- Do you have the beneficiary's blessing to get paid? Why not?
- Do you really want to defend a breach of fiduciary duty / objections to your accounting, on your own dime?

Personal Representatives

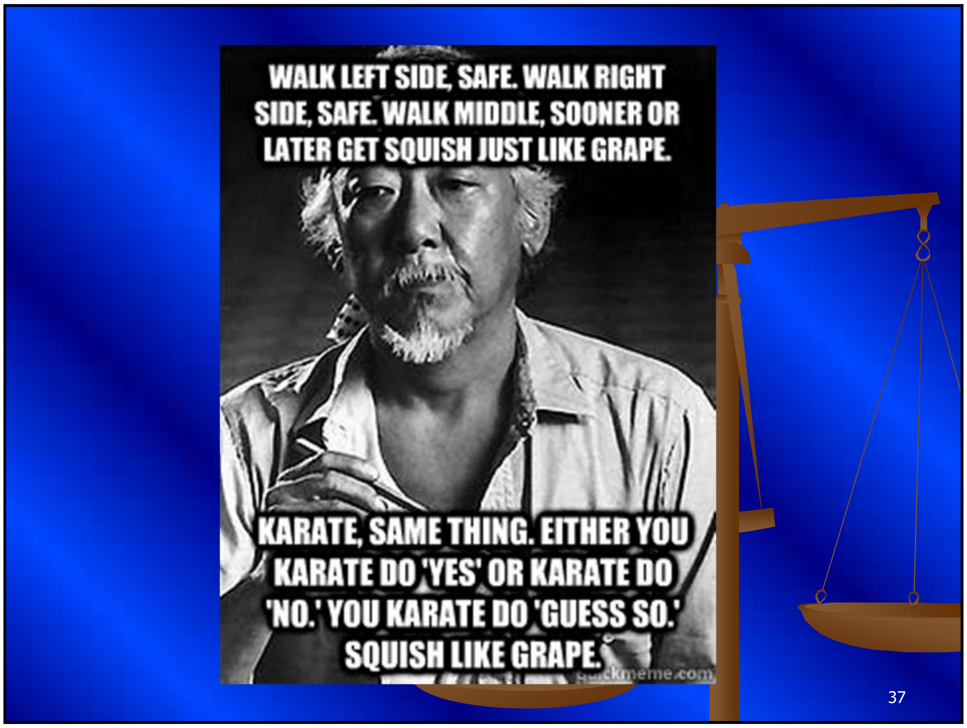
- Finnerty v. Colussi (Estate of Lee), 954 N.E.2d 1042 (Ind. Ct. App. 2011), *reh'g denied, trans. denied*.
- Named personal representatives paid lawyer by the hour, ignored his advice to get "and" checks, instead got "or" checks, PR 2 spent all the money, PR 1 and PR 2 got replaced, successor PR sued the lawyer for not supervising PR 1 and PR 2.

35

Personal Representatives

- IC § 29-1-10-20(b)(2).
  - "an estate lawyer: (2) does not have a duty to collect, possess, manage, maintain, monitor or account for the estate assets, unless otherwise required by a specific order of the court."
- Has not been tested in court.

36



Get in or Get out

- Make a choice! Make your choice clear.
- Termination of representation letter. Cut off continuous representation. (Representation is complete. I owe you no further duties. I will not be monitoring the spending of your POA. If you want me to do so, we will have a separate engagement letter.)

38

Get in or get out

- My preference – for lawyers and agents (POAs) - get appointed by a court, if possible, with approval of your <u>rate of pay and what you get paid for</u>.
- Keep your time. Keep your mileage. Pay yourself regularly. Have someone else look at the bank records, and someone else sign off on payments to the POA or guardian. (Great use of a lawyer – especially if the lawyer reps the ward.)

39

Get in or get out

- Lawyer should tell principal and the beneficiaries – I will be monitoring the spending. I will be receiving the bank statements / have online access. I will be making bi-monthly / quarterly / semi-annual reports. (I am charging $xxx/hr. for my services – or offer a flat rate.)
- This is a GREAT use of a lawyer's time – protecting out-of-state beneficiaries and ward.
- If they won't approve payment, why are you doing it? And, find out now!

40

Get in or get out

- Make reports to the Court.
- Seek court approval for payment to: lawyer, agent (POA / guardian), others.
- That said – if beneficiaries don't get notice, they can (and do) file belated objections to accountings – and courts let them! (So, give notice to beneficiaries to be safe[r].)

41

Beneficiaries up to date

- Real life example. Lawyer is appointed as guardian. Learns from financial advisor that she does not have any beneficiaries listed on her accounts.
- Now what?

42

Beneficiaries up to date

- I.C. 29-3-9-4.5. Allows a court to authorize someone (e.g., guardian) to make beneficiary designations for insurance policies, retirement plans, and annuities in line with her wishes.

- You might have to have a hearing regarding the wishes, though.

43

Trust Account Management

- Why is this here? Because Firms get stolen from. Trusted long-time admin; daughter; son; wife; brother. Bipolar disorder – they are literally insane.

- The inside jobs are the biggest losses.

- 2 sets of books, forged bank statements.

44

Trust Account Management

- Ind. Adm. & Disc. Rule 23, Sec. 29(a). *Required trust account records.* **An attorney who is licensed in Indiana** shall maintain current financial records as provided for in this Rule and required by Rule 1.15 of the Indiana Rules of Professional Conduct.
- This is non-delegable. It's your duty!

45

Trust Account Management

- "All bank statements or periodic account activity statements from the financial institution **shall be delivered unopened to and reviewed by an attorney having supervisory authority** over the non-attorney signatory, or the supervising attorney shall review the bank statements electronically directly from the financial institution;" Ind. A&DR 23, Sec. 29(c)(3)(i).

46

Trust Account Management

- "Responsibility for conducting periodic reconciliations between internal trust account records and periodic trust account activity statements from the financial institution shall be vested in a person who has no authority to disburse funds from the trust account." Ind. A&DR 23, Sec. 29(c)(3)(ii).

47

Trust Account Management

- Tips:
  - Be the sole signatory on your Trust Account checks, if you can.
  - Always get unopened copies of your Trust statements.
  - Reconcile your Trust Account monthly (banks wrote UCC 4 and required only 60 days of clawbacks).
  - Be aware that you are solely and personally responsible for these funds and must pay them back if stolen. (So, act like it.)

48

Cyber Fraud

- Comment 8 to ABA Model Rule 1.1: "To maintain the requisite knowledge and skill, a lawyer should keep abreast of changes in the law and its practice, including the benefits and risks associated with relevant technology[.]"

49

5.3 Duty to Supervise

- You have a duty to supervise and train your staff. Rule 5.3.
- You have a duty to supervise and train all nonlawyer "assistants" (e.g., your outside support people).

50

5.3 (cont'd)

- Comment 2: "Paragraph (a) requires lawyers with managerial authority within a law firm to make reasonable efforts to **establish internal policies and procedures** designed to [comply with the Rules]."

51

Social Engineering Fraud

- Try to learn about you through your website, Facebook page, social media accounts.
- Trying to get access to your operating account and trust account.

52

Train, Train, Train

- We must be leaders in our firms.
- This is a fantastic topic for a firm lunch. Teach them about some of these scams. Have your IT vendor come in to talk. Show YouTube videos. https://www.youtube.com/results?search_query=training+to+avoid+phishing

53

Train, Train, Train

- Phishing scams. 12% click on the link.
- "See attached receipt." Shipping confirmation with tracking link. Document for you in OneDrive (link). Fake e-mail from inside the Company.
- One antivirus company claims it blocks 20 million per month.
- Spearphishing – social media component.

54

Real Estate Closing scam

- Real Life Example 1: E-mail with fraudulent wire transfer information is sent to the law firm just after closing for a real estate deal. The law firm transfers money to the wrong account.
- Law firm is liable to the client who provided the money and to intended recipient and banks.

55

Real Estate Closing scams

- Real Example 2: The law firm had represented client numerous times. A paralegal’s account was hacked. The hackers sent multiple e-mails purporting to be from the client (changed 1 letter in the e-mail address), asking for the $100,000 to go to a different account.
- Tip: Call the client to confirm changes.

56

Real Estate Closing scams

- Law Firm provided a $250,000 check to Seller's counsel. E-mail from "seller's counsel" said he ripped up check and wanted $$ wired. Paralegal wired the $$. Then, law firm discovered the check had been cashed, too.
- [This happened to one of PJO's clients. But, we called to confirm and learned of fraud. Whew.]

57

Fraudulent check scams

- Call your bank and find out the magic words to be sure the check cannot be stopped/reversed.
- "~~Has the check cleared~~?" IS THE WRONG QUESTION!!!!
- "Has the cash been received?" or "Is the cash in my account?" may be better q's.

58


If any questions, contact:
Patrick J. Olmstead, Jr.
Patrick Olmstead Law LLC
633 Library Park Dr., Ste. K
P.O. Box 1067
Greenwood, IN 46142
(317) 884-8524
polmstead@patrickolmsteadlaw.com
©2019
59