


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

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

<ul style="list-style-type: none"> • Advanced Oil & Gas Law • Agricultural Law • Agricultural Contracts • Drafting Contracts and Conveyances • Energy Regulation • Environmental Regulation of Agriculture • Environmental Regulation of the Oil and Gas Industry • Estate and Business Planning for Farmers and Ranchers • Estate Planning and Taxation • Farm Bankruptcy • Farm and Ranch Taxation • Farm Income Tax Planning and Management • Federal Indian Law • Independent Readings in Natural Resources Law • Independent Study in Oil and Gas Law • International Petroleum Arbitration • International Petroleum Transactions • Kansas Legal Research 	<ul style="list-style-type: none"> • Mineral Title Examination • Mining Law • Oil and Gas Conservation Law and Practice • Oil and Gas Joint Operations • Oil and Gas Law • Oil and Gas Taxation • Property Law Issues Related to Rural Land • Public Land Law • Real Estate Transactions • Renewable Energy Law: Wind and Solar • Rural Practice Externship • Secured Transactions • Tribal Law and Government • Water, Environmental, and Regulatory Law Impacting Agriculture • Water Rights
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 Overview

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

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 Key Transfer Tax Changes Under ATRA ²
(The Changed Landscape)

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

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 Post-2012 Estate Planning Landscape

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

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 **Tax Cuts and Jobs Act**

- **Estate/Gift tax unified credit exemption**
 - Exemption set at \$11.70 million/person for 2021
 - Adjusted for inflation through 2025

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 **Some States Still Tax Transfers at Death**

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

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 **Focusing Estate Planning** 7-10

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

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 **Impact of Coupling (and Portability)**

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

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 **The Portability Election** 10

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

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 **Impact of Portability**

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

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 **Estate Planners Not Irrelevant**

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

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 **Compare Transfer Tax Cost With Basis Step-Up** 14-15

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

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 **Practical Estate Planning**

- **Under \$11.70 million (single) or \$23.40 (married)**
 - Estate tax irrelevant
 - Continual need for planning
 - Income tax basis planning
 - Identify and eliminate common errors
 - Asset protection planning
 - Succession planning
 - Family entity??
 - Insurance?

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 **Practical Estate Planning**

- **Between \$11.70 million and \$23.40 million**
 - Historic estate planning concepts
 - Consider use of portability
 - Gifting
 - No “clawback”

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 **Practical Estate Planning**

- **Over \$11.70 million (single); \$23.40 million (married)**
 - State of domicile?
 - Portability
 - Creditor protection
 - Succession planning
 - GSTT planning

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 **Common Succession Planning Objectives**

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

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 Possible Ways for Children to Become Involved in a Farming Operation

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

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 Advantages/Disadvantages of Various Entity Forms

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

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 Social Security Planning

- **No limit on Medicare portion of tax (2.9%)**
- **12.4 percent on first \$142,800 of earnings (2020)**

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 **Continuity and Transferability**

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

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 **SELECTED FARM BILL & CFAP ISSUES**



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 **Introduction**

- **Limits placed on farm programs beginning in 1970**
- **Agricultural Improvement Act of 2018 (2018 Farm Bill):**
 - Provides current payment limits
 - Provides current AGI limits
 - Many rules from previous farm bills still in place
- **Coronavirus Aid, Relief, and Economic Security Act (CARES Act)**
 - Provides additional payments and related limits

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 **FSA Payment Limitation Rules**

- **AGI Limitation New Farm Bill replaces with one overall \$900,000 limit for all programs**
 - Based on trailing three-year average (2021 based on 2017-2019 average).

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 **Payment Limits**

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

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 **Payment Limitation Illustration**

Farm Entity Structure
General Partnership V. LL()

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

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 Attribution Limitation Illustration

	ABC LLC	DEF S Corp	YYX GP
Ownership %			
John	33.33%	50.00%	25.00%
Paul	33.33%	0.00%	50.00%
Jones	33.33%	50.00%	25.00%
Gross payment earned			
	\$ 225,000.00	\$ 300,000.00	\$ 150,000.00
Payment allowed to be allocated			
	\$ 125,000.00	\$ 125,000.00	\$ 150,000.00
Allocation of payment			
John	\$ 141,667	\$ 41,667	\$ 62,500
Paul	\$ 116,666	\$ 41,666	\$ -
Jones	\$ 141,667	\$ 41,667	\$ 62,500
Totals	\$ 400,000	\$ 125,000	\$ 125,000

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

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-  Major Farm Programs – ARC & PLC
- **Agricultural Risk Coverage (ARC)**
 - Income support program
 - Olympic Average Yield Times Olympic Average Price = Benchmark Revenue
 - Guarantee starts at 86% of benchmark revenue
 - Maximum payment is 10% of benchmark revenue
 - **Price Loss Coverage (PLC)**
 - Payment made if final price is less than reference price
 - PLC Yield times PLC payment rate equals payment
 - No limit on payment
 - **Both ARC and PLC paid based on 85% of base acres**
- 1/5/2021

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-  ARC Example
- 1,000 corn base acres
 - Benchmark revenue is \$814 (\$3.70 times 220 bpa)
 - Final yield is 195 and price is \$3.00
 - Guarantee is \$700
 - Final revenue is \$585
 - Gross payment per acre is \$115
 - Limited to \$81.40 per acre
 - Total payments \$69,190 (\$81.40 times 1,000 times 85%)
- 1/5/2021

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 **PLC Example**

- 1,000 wheat base acres
- PLC yield is 60 (set and does not change)
- Final MYA price of \$4.50
- Reference price of \$5.50
- Payment of \$1.00 per bushel
- Final payment of \$51,000 (1,000 times \$1.00 times 60 bpa times 85%)

1/5/2021

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 **ARC and PLC Administration**

- Elect between both for each crop
 - Locked in for 2019 and 2020 crop years
 - Annual election 2021-2023
- Administered in county where farm is located
- ARC-IC receives payment on what farmer grows but only gets paid on 65% of base acres
- Payment limit of \$125,000
- Peanut producers get extra \$125,000

1/5/2021

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 **Dairy Margin Coverage (DMC)**

- Dairy “insurance” program
- Smaller producers (5 million pounds) can cover up to \$9.50
- Larger producers maximum is \$8 per cwt
- Coverage is spread between milk price and average feed cost
- Can continue to participate in hedging programs
- No payment limit

1/5/2021

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 **Conservation Reserve Program (CRP)**

- **Designed to preserve marginal farmland**
- **Up to 27 million acres by 2023**
- **Payment of**
 - 85% of estimated county rate for regular sign-up
 - 90% for continuous enrollment
- **Payment limit of \$50,000**

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1/5/2021

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 **Marketing Assistance Loan Programs**

- **Marketing Loan Gains (MLG) and Loan Deficiency Payment (LDP)**
 - Occur if local price less than a federal adjusted loan rate
 - Producer has to elect to obtain payment
- **No payment limit under 2018 farm bill**
 - Unlike 2014 farm bill which included LDP in \$125,000 payment limit
 - MLG were not part of limit

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1/5/2021

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 **Noninsured Crop Disaster Assistance Program(NAP)**

- **“Crop Insurance” for any crop not covered by regular ins.**
- **Coverage available up to**
 - 65% of production
 - 100% of price
- **Payment limit**
 - \$125,000 for minimum coverage
 - \$300,000 for buy-up coverage

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1/5/2021

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 Environmental Quality Incentives Program (EQIP)

- **Provides incentives for farmers to make conservation efforts**
- **Efforts that qualify**
 - Cover crops
 - Forest stand improvements
 - Prescribed grazing
 - Irrigation
- **Payments limited to \$300,000 over a six-year period**
- **AGI is \$1 million instead of normal \$900k**

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 Conservation Stewardship Program (CSP)

- **Five year contracts for**
 - Annual payments for installing new conservation activities
 - Supplemental payments for adopting a resource-conserving crop rotation
- **Payment limit of \$40,000 per year or \$200,000 in five-year period**

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 Livestock Indemnity Program (LIP)

- **Reimburses livestock producers for excess death losses**
- **Payment based on 75% of FMV**
- **No payment limit, but AGI limit does apply**

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1/5/2021

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 **CFAP**

- Reimburse ag producers that have suffered \geq 5% price decline from mid-Jan. 2020 to mid-Apr. 2020, or who had losses due to market supply chain disruptions as a result of governmental actions in response to coronavirus

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 **Coronavirus Food Assistance Program (CFAP)**

- Reimburse producers for losses related to COVID-19
- Must have unpriced inventory or sales (in most cases)
- Applies to:
 - Non-specialty crops
 - Dairy
 - Livestock
 - Wool
 - Specialty crops

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 **Program Eligibility**

- **Five key requirements**
 - Participant identification
 - Foreign ownership
 - Nature and extent of participation
 - Means tests (AGI)
 - Conservation requirements

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 **Limitation and Non-Deferability**

- **Limitation applicable to CFAP payments is \$250K/person and legal entity**
- **Entities with limited liability (corps, LLCs, and LPs) may receive up to \$750K of CFAP payments based on # of shareholders (or members not > 3) who contribute ≥ 400 hours of active personal management or active personal labor**
 - Expansion of payments for non-equal ownership
- **Can the payments be deferred?**
 - Related to disaster loss or tied crop price?

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 **Example**

<ul style="list-style-type: none">• CFAP #1• ABC LLC with 3 owners, 60%, 30%, 10%• Qualified for full \$750k• Limited to:<ul style="list-style-type: none">– A - \$250,000– B - \$225,000– C - \$75,000– Total \$550,000	<ul style="list-style-type: none">• CFAP #2• LLC qualifies for full \$750,000 no matter the ownership %
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 **CFAP #3**

- **Producers of 2020 price trigger crops and flat-rate crops will receive \$20 per planted acre.**
 - Price trigger crops are major commodities that suffered a 5% price decline over a specified period.
 - The crops include barley, corn, sorghum, soybeans, sunflowers, upland cotton and wheat.
 - About 240 million acres were planted to these crops so almost \$5 billion of the aid will be used for these crops.

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 **CFAP #3**

- Specialty crop producers have modifications to their payments.
 - They are now allowed to include crop insurance and disaster payments in calculating their sales, and may elect to use 2018 sales instead of 2019 sales.

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 **CFAP #3**

- Contract poultry producers were mostly left out of CFAP 1 and 2 since these growers did not own the birds.
 - CFAP 3 allocates \$1 billion of direct aid for any contract grower of livestock (primarily poultry), and will cover up to 80% of losses.
- Interruptions in livestock supply chains during the early onset of the pandemic resulted in numerous livestock being euthanized.
 - These growers will now be eligible for aid to reimburse them for 80% of the FMV of those animals.
- A livestock dealer statutory trust will be created to make sure that livestock producers get paid for their sales.

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 **CFAP #3**

- Cattle producers will receive additional payments based on a formula utilizing differences in the original CARES Act payment rate, the CCC payment rate, and the CFAP 2 payment rate.
 - The bottom line is that the following per head payments will now be made:
 - Slaughter cattle: Fed Cattle – \$63.00
 - Feeder cattle: 600 pounds or more – \$25.50
 - All other cattle – \$17.25
 - Slaughter cattle: Mature cattle – \$14.75
 - Feeder cattle: less than 600 pounds – \$7.00

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 **CFAP #3**

- Certain dairy producers are eligible for increased payments under the Dairy Margin Coverage Program.
- Smaller producers that were locked into 2011-2013 milk production can increase their coverage levels based on 75% of the increase limited to 5 million pounds.
- An additional \$400 million will be used for a dairy donation program plus an additional \$1.5 billion to allow USDA to purchase food products and donate it to food banks, etc.

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 **CFAP #3**

- Assistance for Processors
 - Domestic users of upland cotton and extra long staple cotton will receive assistance for cotton purchased between March 1, 2020 and December 31, 2020. The payment formula uses average monthly consumption between January 1, 2017 through December 31, 2019 times 60 cents.
 - Payments will be made to alternative fuel producers (such as ethanol) to reimburse them for damage caused by the drastic reduction in fuel consumption.
 - Offshore aquaculture producers will receive an additional \$300 million of aid. Timber harvesters and hauling businesses will qualify for \$200 million of aid.

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 **Principal Business Categories**

- **Sole proprietorship or family farm**
- **Joint operation (general partnership)**
- **Corporation which includes**
 - LLC
 - LP
 - LLP
 - LLLP

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 **Actively Engaged in Farming**

- **Must have significant contribution to farm operation of**
 - Capital, equipment, or land (“left-hand” requirements)
 - Active personal labor or active personal management (“right-hand” requirements)
- **Share of profits and losses**
- **At risk of loss**

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 **Partnership Issue**

- **“Right-hand” contributions require**
 - Allocation of profits and losses to partners
 - Guaranteed payment may disallow
 - If for both active personal labor and active personal management

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 **Reduction for Lack of Left and Right-Hand**

- **If any owner does not meet either left or right-hand**
 - Reduction in payments
 - Based on their ownership
 - May be adjusted for other ownership

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 **Spouses**

- **Spouse with left-hand contributions**
 - Not required to provide personal active labor or management
 - Active spouse is attributed to non-active spouse
- **Creates two payment limits**
- **Does not require two Schedule Fs**
- **Does not necessarily require SE income**
 - Not active in operation
 - Form 4835

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 **Capital Requirements**

- **Cash contributions**
- **Loan proceeds can't be guaranteed, co-signed or secured by**
 - Any person with interest in farming operation

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 **Changes in Farming Operations**

- **To increase a payment limit, the change must be**
 - Bona Fide, and
 - Substantive
- **Typically changes must be reported to Farm Service Agency (FSA) by June 1**
- **If not, change is effective for next crop year**

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 **Land Rental**

- **Cash Rent Landlords**
 - Do not receive any payments
- **Crop Share Landlords**
 - Receive their share of the payment
 - Can convert cash rent to crop share to expand payments

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 **Base Acres**

- **Adding more than 20% of base acres to a farming operation**
 - Allows for an increase in payment limits
- **May want to create additional JV to farm the land if less than 20%**
- **Whole farm insurance may require separate entities**
 - For permanent crop operations

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 **Program Payment Limitation**

- **Applied at legal entity first**
- **Then applied to each individual owner**
- **Up to four levels of ownership**

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 **Managers and Family**

- **Large operations can have up to 3 non-family managers**
- **2014 removed cousins, nephews and nieces from “family”**
- **2018 added these back**
- **Allows for unlimited family in farm operation to qualify for payments**
 - Assuming they meet left-hand and right-hand

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 **Partnership payment limits**

- **GP and JV unlimited payment limits, but**
 - Reduced by any member that has met limit at personal level

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 **CRP and Conservation Limits**

- **Title I farm programs normally have annual \$125,000 limit**
- **CRP has \$50,000 annual payment limit**
- **EQIP, CSP and other conservation usually have a contract limit**

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 **AGI Limits**

- **Established in 2002 farm bill**
- **Started at \$2.5 million**
- **2008 Farm Bill had farm AGI, non-farm limit and conservation limits**
- **2014 Farm Bill – one \$900k overall limit**
- **3 year average – excluding first year before crop year**
 - 2020 crop year is average of 2016-2018 AGI
- **No adjustment for “extraordinary items”**

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 **Married Filing Joint Returns**

- **MFJ returns can have a \$1.8 million AGI Limit**
 - In Community Property state
 - Or equal ownership of income by each spouse
- **Separate property planning**

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 **MFJ Exceeds AGI Limit**

- **If MFJ AGI exceeds current payment limit**
 - CPA or attorney can write letter to FSA determining “separate” AGI is less than limit
- **Sample letter in FSA Handbook 5-PL**

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 **CRP AGI Limit**

- **CRP AGI limit is determined at the time of contract**
- **Also determined if contract is transferred to another person**

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 **AGI Defined**

- **Individuals – Form 1040 line 8b**
- **C corporations – Form 1120 Line 30 plus line 8 contributions**
- **Estates or trusts – Form 1041 line 23**
- **LLC, LP, LLP, LLLPs taxes as partnership – Form 1065 line 22 plus line 10 guaranteed payments to partners**
- **S corporations – Line 21 ordinary income**
- **General partnership and joint venture - ignored**

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 **Section 179**

- **Section 179 originally not allowed as deduction**
- **Due to administrative hearings with FSA in 2016**
 - FSA decided to allow Section 179
 - Updated FSA Handbook 5PL on January 11, 2017 with Exhibit 21

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 **Schedule K**

- **For 1065 and 1120-S filers**
 - Other Schedule K items are still ignored
 - Do not include Section 1231 gains in AGI
 - Do not include interest, dividends, etc. in AGI
- **Can be very favorable to dairies and other livestock operations**

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 **75% of AGI From Farming**

- **Some FSA offices may request CPAs sign CCC-942**
 - To attest farm AGI exceeds 75%
 - AICPA standards prohibit this signature
- **Instead, FSA has provided sample letter that CPAs can use**
- **Note wages from farm corporation is not considered to be farm income**

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 **New Entities**

- **Larger farm operations**
 - Use general partnership or joint venture
 - Each partner
 - Structured as S or C corporation
 - SMLLC
 - Manager managed LLC
 - Determine crop insurance requirements
 - Whole farm has \$10 million cap on coverage
 - High variability farms in separate entity

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 **C Corporations**

- **A C Corporation can be 1% owner in GP**
 - Makes the corporation a “farm” corporation
 - Employer provided housing
- **General partnership taxed as C corporation**
 - GP for FSA purposes
 - C Corporation for income tax purposes
 - Can convert corporation to partnership and check-the-box as corporation
 - If state law allows

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 **Crop-Share**

- **If self-rental is cash rental**
 - Consider switching to crop share
 - Splits the payment
 - Tenant share
 - Landowner share

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 **Profits Interest**

- **Adding next generation can create large tax liabilities**
 - Negative capital
 - Ordinary income
- **Adding as profits interest**
 - Great for income tax purposes
 - Likely does not create full payment limit

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 **LLC to GP**

- **LLC to GP**
 - No income tax effect (still a partnership)
 - Should be substantive since all partners now “at risk”
 - Can have all members be SMLLC
 - One return
 - Limited liability
- **Merger of C corporation into GP**

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 **Carving Off Operations**

- **Substantive increase in acres**
 - Create new entities for each large increase
 - Have one GP for all farm entities

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 **AGI Opportunities**

- **Community Property States**
 - Automatic \$1.8 million AGI Limit
- **Separate Property States**
 - Split ownership 50/50
 - Have farm substantially owned by lower AGI spouse
 - Active spouse attributed to non-active spouse

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 Other Key Issues When Deciding Entity Form

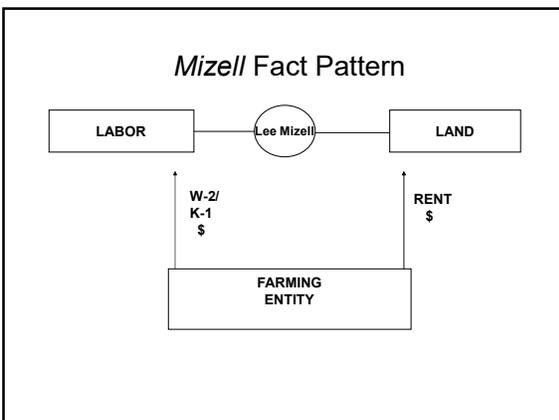
- Management structure
- Liability of owners
- Fringe Benefits
- Liquidation costs
- Ability to finance
- NIIT

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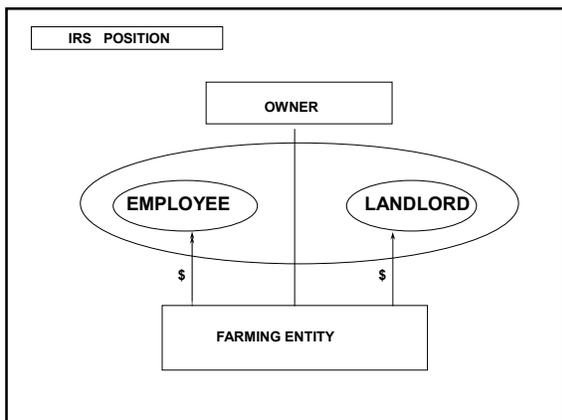
 Multiple Entities?

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

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Court Opinions:

Self-rental SE Issue

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

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 **Equitably Treating Heirs?**

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

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 **Strategies for Transferring Assets**

- **Gifting**
- **Rental**
- **Sale**
- **Inheritance**

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 **Social Security Planning**

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

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 **Last Year of Farming?**

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

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 **Importance of a Buy-Sell Agreement**

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

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 **Succession Planning and Divorce**

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

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 **Planning for Long-Term Health Care**

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

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 **The Role of Life Insurance in Succession Planning**

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

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 **Other Basic Succession Planning Issues**

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

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 **LIKE-KIND EXCHANGE ISSUES**



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 **TCJA - Like-Kind Exchanges**

- Limited to real property exchanges where the property is not held primarily for sale
 - Permanent provision
- New rules (barring non-real estate trades) apply to exchanges completed after 2017
- Old rules apply to exchanges of personal property if the taxpayer has either disposed of the relinquished property or acquired the replacement property on or before 12/31/17

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 **Like-Kind Exchanges**

- Definition of “real estate” is critical
 - Improved for unimproved
 - Urban for rural
 - Commercial for residential rental or investment real estate
 - Leasehold with at least 30 years remaining for fee simple
 - *VIP Industries case*

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 **New Prop. Regs.**

- On June 11, 2020, the Treasury Department issued proposed regulations defining “real property” for like-kind exchanges completed after 2017.
 - Prop. Reg. §1.1031-3 defines real property as one of the following:

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 Prop. Regs. On Definition of Real Estate

- Land,
- Improvements to land,
- Unsevered natural products of land, and
- Water and airspace adjacent to land
- Fee ownership,
- Co-ownership,
- A leasehold,
- An option to acquire real property,
- An easement, or
- A similar interest

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 What is a "Distinct" Asset?

- **Analyze separately from any other assets to which the asset relates to determine if the asset is real property**
 - Could be land
 - Could be an inherently permanent structure
 - Could be a structural component of an inherently permanent structure
- **Buildings and other inherently permanent structures are distinct assets**

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 Test For Determining if Item is Distinct Asset

- **Facts and circumstances test:**
 - Is the item customarily sold or acquired as a single unit rather than as a component part of a larger asset?
 - Can the item be separated from a larger asset? If so, at what cost?
 - Is the item commonly viewed as serving a useful function independent of a larger asset of which it is a part?
 - Would separating the asset from a larger asset impair the functionality of the larger asset?

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 **Buildings**

- **Include certain distinct assets if permanently affixed:**
 - Houses
 - Apartments
 - Hotels/motels
 - Factories
 - Warehouses
 - Barns
 - Enclosed garages
 - Stores

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 **Like-Kind Exchanges**

- **More real estate issues**
 - Exchange of a remainder interest in a tract of real estate for a life estate (where the life expectancy of the life tenant exceeds 30 years) for another tract of real estate
 - *Rev. Rul. 72-601, 1977-2 C.B. 467.*
 - Remainder interest in real estate can qualify for like-kind exchange treatment when it is exchanged for a remainder interest (or, probably, a reversionary interest) in a different tract of farmland.
 - *Rev. Rul. 78-4, 1978-1 C.B. 256.*
 - Real estate owned in fee simple can qualify for like-kind exchange treatment when traded for real estate subject to 99-year leases.
 - *See, e.g. Koch v. Comr., 71 T.C. 54 (1978).*

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 **Like-Kind Exchanges**

- **More real estate issues**
 - Sale followed by leaseback
 - Installment sale
 - Water rights
 - Impact of state law
 - What about property that doesn't produce income?
 - Mixed use real estate
 - Vacation homes
 - Tenancy in common property

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 Machinery

- **Generally, not considered part of real property**
 - Exception if it is a structural component of building that serves the inherently permanent structure and does not contribute to the production of income other than for the use or occupancy of space

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 Other Items of "Real Property"

- **Unsevered natural products of land**
 - Growing crops, plants and timber
 - Mines
 - Wells
 - Other natural deposits

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 Safe Harbor

- **Personal property is deemed to be incidental to real property acquired in an exchange if in standard commercial transactions, the personal property is typically transferred together with the real property and the aggregate FMV of the incidental personal property does not exceed 15% of the aggregate FMV of the replacement real property**

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 Final Regulations

- **Approved on Nov. 18, 2020**
 - Published in the Dec. 2, 2020 Federal Register
 - Effective for exchanges beginning after 12/2/20
- Property is classified as real property for purposes of section 1031 if the property is:
 - Specifically listed as real property in the final regulations;
 - Classified as real property under the state and local law test included in the final regulations; or
 - Considered real property based on all the facts and circumstances under the various factors provided in the final regulations.

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 Final Regulations

- **State and local law test**
 - Under the proposed regulations, the classification of property under state or local law was not taken into account in classifying a property for purposes of section 1031, with one limited exception for mutual ditch, reservoir, or irrigation companies.

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 Final Regulations

- **Under the final regulations, property is real property for purposes of I.R.C. §1031, if, on the date it is transferred in an exchange, the property is classified as real property under the law of the state or local jurisdiction in which the property is located.**
 - Thus, property that might otherwise have failed to be real property under the proposed regulations may be classified as real property under the final regulations

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 **Final Regulations**

- Treasury was clear that the final regulations do not allow property that was ineligible for I.R.C. §1031 under pre-TCJA law to now become eligible simply because the property is classified as real property under state or local law.
 - Property that was ineligible for LKE treatment under pre-TCJA law remains ineligible for LKE treatment after the enactment of the TCJA, even if the property is classified as real property under the relevant state or local law.

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 **Final Regulations**

- **Still not real property (regardless of state law):**
 - Stock (other than stock in a cooperative housing corporation or shares in certain mutual ditch, reservoir, or irrigation companies),
 - Bonds, and notes;
 - Other securities or evidences of indebtedness or interest;
 - Partnership interests (other than an interest in a partnership that has in effect a valid election under section 761(a));
 - Certificates of trust or beneficial interests; and choses in action.

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 **Final Regulations**

- Items of machinery or equipment may be real property for purposes of I.R.C. §1031 if they comprise an inherently permanent structure, a structural component or are real property under the state or local law test regardless of their purpose or use or whether they contribute to the production of income.
 - In making this determination, the focus is on the degree to which the property should be considered permanently affixed, not on whether the property contributes to the production of income.

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 **Final Regulations**

- In determining whether the agreement between the taxpayer and the qualified intermediary, qualified trustee, or qualified escrow agent expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property as required by Treas. Reg. §1.1031(k)-1(g)(6), the taxpayer's receipt of, or right to receive, personal property that is incidental to real property acquired in the exchange is disregarded.

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 **Final Regulations**

- For purposes of this exception, personal property is incidental to real property acquired in an exchange if:
 - In standard commercial transactions, the personal property is typically transferred together with the real property; and
 - The aggregate fair market value of the incidental personal property transferred with the real property does not exceed 15% of the aggregate fair market value of the replacement real property or properties received in the exchange.

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 **The I.R.C. §1245 Tax "Trap"**

- **If property with an I.R.C. §1245 depreciation recapture attribute is disposed of in an LKE, depreciation recapture is recognized to extent that replacement property has insufficient I.R.C. §1245 property**

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 **LKEs – Special Situations**

- **Property that doesn't produce income**
 - Is it held for investment purposes or resale?
- **Mixed-use real estate**
- **Vacation homes**
- **Tenancy-in-common**
 - Rev. Proc. 2002-22

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 **Deferral for Non-Deferred Aspects of IRC 1031 Exchange**

- **Basic requirements of Sec. 1031**
- **Example in Treas. Reg.**
- **Safe Harbor**
- **Example**
 - Structured sale aspect
 - Assignment agreement
- **Alternative approach**
 - IRC Sec. 453

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 **Thank You!**

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