Farm Management

Custom-design your estate plan based on goals

Farm & Family

By STACEY LEE

Key Points

- Estate planning encompasses farm succession and future business goals.
- A limited liability company aids in transfer of business to farming heir.
- Parents decide when to gift or sell LLC membership interests.

ESTATE planning often occurs in steps, each one building off of the previous step.

We, as estate planners, begin the first step by assessing the client's current situation and identifying their particular hopes, dreams, goals and aspirations. At this point, the design phase begins.

The previous month's article set forth the scenario of Joel and Kim, dairy farmers in their mid-50s who wish to continue farming an additional 10 years. They have three children in their 20s, one of which farms with them in the dairy operation.

They would like to set up both a farming succession and an estate plan that would meet their current and future goals. Client goals included planning for both incapacity and death, succession planning for their farming son, and asset protection for their heirs.

We began by breaking Joel and Kim's estate into separate parts: the farming operation (grain, machinery, livestock), the farm real estate (land and buildings) and their remaining estate (house, cash, life insurance and investments). When considering these separate parts, it's essential to keep the client's goals in mind, one of which was to plan for their farming child to ultimately take over the farming operation. In this article, I will focus on the farming operation, which was addressed by establishing a limited liability company.

LLC set up

Joel and Kim transferred the operating assets of their farming operation into the LLC (cash, grain, machinery and livestock) in exchange for 100% ownership of the LLC. A separate checking account was set up, and a separate partnership tax return is required. The income from the LLC flows through to Joel and Kim on a Form K-1, issued by the partnership.

The LLC not only provided limited liability protection, but also created a vehicle to transition the LLC membership interests to their farming son over the next 10 years, which could be accomplished by either sale or gift to their farming son.

Joel and Kim decided to gift 30% of the LLC membership interests (valued at $1 million) to their farming son, using a portion of the $5.34 million federal gift tax exclusion in 2014. They will need to file a 2014 federal gift tax return showing the gift, but no gift taxes will be owed. This gift will be supported by an Assignment and Consent of the Gift of membership interest and will also be documented in the LLC's annual minutes.

After the initial gift of LLC interests, Joel now owns 35%, Kim owns 35% and their farming son owns 30%. Three Form K-1s will be issued by the partnership, allocating the income according to these ownership percentages at year-end for tax return purposes. In addition, any distributions made by the partnership will be made according to the ownership percentages. Guaranteed payments to the farming son could be used to compensate for extra labor spent on the farming operation.

Note that Joel and Kim retained management control of the LLC, owning a combined 70% of the LLC membership interests after the gift, and are able to decide when and how to transfer the remaining LLC membership interests to their farming son. If they so choose, they are able to use their annual gift exclusions in future years as well.

We continue to meet with the clients on an annual basis to discuss whether to gift or sell LLC membership interests in order to further their goal of transferring the farming operation to their farming son over the next 10 years.

In addition, Joel and Kim have also included an LLC buy-sell agreement to protect the farming son's interests, as well as language in their LLC operating agreement that addresses the possible scenario involving disability or incapacity.

As I mentioned earlier, this is just one step in the design phase, completed while keeping the client's goals in the forefront. Please note that the nonfarming children have not been forgotten and will be addressed in a future column. Next month's article will address the farm real estate.

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