

PROPER ENTITY STRUCTURES FOR FARM FAMILIES INCLUDING RRA ISSUES

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ENTITY CHOICES

- SOLE PROPRIETORSHIP
- GENERAL PARTNERSHIP
- LIMITED PARTNERSHIP
- CORPORATION
 - TAXED AS A REGULAR "C CORPORATION"
 - TAXES AS AN "S CORPORATION"
- LIMITED LIABILITY COMPANY

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CORPORATION

- USE A CORPORATION TO HOLD THE OPERATING ASSETS
- DO NOT PUT LAND INSIDE A CORPORATION

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The Hanson Farm Family

Roger and Helen Hanson are 55

They have three children, Tim who is involved in the family farm operation, and two daughters, Gladice and Sally. Their children are all married and the Hansons are blessed with five grandchildren.

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Hanson's Financial Statement

<u>Asset</u>	<u>Value</u>
Farm Realty	\$ 2,000,000
Keough/IRA/Stocks	\$ 500,000
95% interest in R & H Hanson Farms, Inc. (operating Corp.)	\$ 500,000
Life Insurance/Roger (Cash Value) (Death Benefit - \$300,000)	\$ 45,000
Life Insurance/Helen (Cash Value) D.B - \$100,000)	\$ 10,000
Lake Property/Idaho	\$ 250,000
TOTAL	\$ 3,305,000

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Goals

- A. Minimize Federal Estate Tax and State Estate Tax Costs
- B. Provide for Succession Planning
- C. Protect Income to Roger and Helen
- D. Provide for Safeguards from Divorce, Bankruptcy and non-approved transfers (non-linear Heirs)
- E. Maintain **CONTROL** to Roger/Helen and then to their children

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Goals (continued)

- F. Purchase and/or operate additional land
- G. Maintain 960 limitation issues

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How to Accomplish Goal of Minimizing Federal / State Estate Tax

- A. Need to Gift Several Hundred Thousand Dollars of Asset Equity over the Next 15-20 years.
- B. Utilize \$12,000 Annual Gift Tax Exclusion Per Donee Per Year

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USES OF AN LLC

- TRANSITION PLANNING
- CONTROL OF ASSETS
- LAND HOLDING – RENTAL OF LAND ISSUES
- APPROPRIATE LEASES
- NEXT GENERATION FAMILY MEMBER COMING BACK TO FARM

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What is an LLC

- A separate legal entity
- Not a Corporation
- By owning the Farm Realty, Replaces Roger/Helen as the Landlord
- Opens a Bank Account
- Obtains a Federal ID #
- Collects the Landlord's share of Farm income/pays LL's share of Farm Expenses
- Does the Landlord's Business with the Elevators, FSA Offices, Treasurer, etc.
- Has a 12/31 Year End and Files a 1065 Partnership Return

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Taxation of an LLC

- Partnership Not a Taxpayer – It is a Pass Through Entity
- Partners Report Their Distributive Share of Profits/Losses as Shown on K-1
- Assume Hanson Family LLC Nets \$40,000 of Income
 - If Roger/Helen own 100% - Report all on their individual Tax Return
 - If Children own 2% - then they each would report 2% (\$800 on their Tax Return and Roger/Helen report theirs at 94% (\$37,600))

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Formation of the LLC

- Roger and Helen Transfer Farm Real Estate
 - Hanson Family LLC
 - Farm Real Estate - \$2,000,000
- 500 Units of Preferred LLC Membership Interest
- 24,500 Units of Common LLC Membership Interest
- Value - \$80/Unit based on FMV of Contributed Assets
- Roger and Helen are the LLC Managers

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The Gifting Process

Roger and Helen Gift from Their 24,500 Common Units

Year	Units	Value	Discount	Net Gift	Tim	Gladice	Sally
2007	500	\$40,000	40% (\$16,000)	\$24,000	2%	2%	2%
2008	500	\$40,000	40% (\$16,000)	\$24,000	4%	4%	4%
2009	500	\$40,000	40% (\$16,000)	\$24,000	6%	6%	6%
2010	500	\$40,000	40% (\$16,000)	\$24,000	8%	8%	8%

Over a 4 Year Period – 24% of LLC (\$480,000) Transferred vs. \$288,000 (difference of \$192,000 in Value)

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Cash Flow

- A. Manager's Complete Discretion
- B. Normally distribute cash to pay Partner's Income Tax
- C. May make Disproportionate Distributions
- D. Example – Assume 2009 – Net of \$40,000
 1. Roger and Helen (82%) **\$32,800**
 2. Tim, Gladice, Sally (6% each) **\$ 2,400 Each**

Roger and Helen could distribute \$1,000 of their distributive share to each child – and that leaves \$1,400 allocated to each child's capital account, but Roger/Helen could distribute the \$4,200 cash to themselves

Net effect is a reduction to Roger/Helen's capital account by \$4,200, but Remember they still own 82% of the LLC or a capital account of \$1,640,000

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Control – Control - Control

- A. Hansons are the designated managers/may designate successor manager
- B. Complete control over all farm decisions relating to the land – rent/sell/exchange, etc.
- C. Complete control over cash flow/distribution decisions
- D. As Complete Prohibition on transfer of ownership of units as possible – typically want transferability only to Hanson Family Lineal descendants without prior approval

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OTHER BENEFITS

- PROPER STRUCTURING OF OUR FAMILY FARM IS ESSENTIAL TO A TRANSITION PLAN THAT WORKS FOR THE FAMILY.
- USE OF PROPER ENTITIES IS THE ESSENTIAL COMPONENT OF YOUR FAMILY TRANSITION PLAN.

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ASSET PROTECTION STRATEGIES

1. HOLDING REAL PROPERTY
 - ADVANTAGE OVER CORPORATIONS
 - REDUCED FORMALITIES
 - DISPROPORTIONATE DISTRIBUTIONS
2. HOLDING TANGIBLE OR INTANGIBLE PERSONAL PROPERTY
 - MORE FLEXIBLE THAN A TRUST
3. HOLDING LIFE INSURANCE POLICIES
 - AN ILIT IS IRREVOCABLE

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ESTATE PLANNING STRATEGIES

1. ANNUAL GIFT EXCLUSIONS
2. VALUATION DISCOUNT
3. REDUCTION IN ESTATE VALUATION
4. FLEXIBILITY OF OWNERSHIP INTERESTS
5. PROBATE AVOIDANCE
6. MEDICAID PLANNING / GIFTING

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RECLAMATION REFORM ACT ("RRA")

- TWO TYPES OF ENTITLEMENTS
 1. OWNERSHIP
 2. NONFULL-COST ENTITLEMENT

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RRA OWNERSHIP

- Maximum amount of owned land an individual or entity may irrigate with water from a Reclamation Project
- Any nonexempt land directly or indirectly owned in excess of an individual's ownership entitlement is referred to as EXCESS LAND
- Such EXCESS LAND is not eligible to receive Reclamation irrigation water while in ownership of that landholder

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NONFULL-COST ENTITLEMENT

- Maximum amount of directly or indirectly owned or leased land an individual / entity may hold and irrigate at less than the full-cost rate
- Unlike ownership entitlement, only land actually receiving Reclamation water counts against the nonfull-cost entitlement
- Select at the beginning of year

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Attribution Rules

- You, your spouse and your dependent(s) are considered one qualified recipient with one 960 acre ownership entitlement
- Any land you and/or your spouse own indirectly through an entity must be taken into account

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Trusts Attribution Rules for All Trusts

- Attribution Rules for Irrevocable Trusts
 - Irrevocable trust means a trust that holds irrigable or irrigation land and does not allow any individual, including the grantor or beneficiaries, the discretion to decide when or under what conditions the trust terminates, and that upon termination the title to the land held in trust transfers either directly or indirectly to a person or entity other than the grantor
 - If all of the preceding criteria are met, the land held in trust will be attributed to the beneficiaries of the trust identified within the trust document
 - If one or more of the criteria are not met, the land will be attributed to the trustee

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Use of LLC to Buy Land

- Set up LLC
- Set up Irrevocable Trust with children as Beneficiaries
- Transfer LLC interest to the Trust
- LLC buys new land
- Maintain Control

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