BUSINESS SUCCESSION, RETIREMENT & ESTATE PLANNING FOR THE FAMILY AGRICULTURAL BUSINESS

PRESENTED BY RICK RODD & JUSTIN BAKER

RICK RODD

- 34 years on the Western Slope
- University of Denver BSBA Marketing and Finance
- 43 years in the family financial planning business
- Working with business owners in closely-held and/or family-owned businesses with business continuation strategies, life insurance, and financial investment options
- Has worked in a team approach with prominent attorneys, accountants, and other professional advisors to help clients obtain the correct strategy for their situation
- Affiliated with J.W. Cole Financial, Inc.

JUSTIN BAKER

- Graduated Cum Laude South Texas College of Law with a Juris Doctorate
- University of Dallas with a Masters of Business Administration concentrating on accounting
- The U.S. Army War College with a Masters in Strategic Studies
- University of Central Oklahoma with a Bachelor of Science
- Currently enrolled in the LL.M. program for Wealth Management Law at Texas A&M Law School, will complete Spring 2022
- His legal practice focuses on advanced estate planning techniques to provide comprehensive and complete estate plans for families, business owners, retirees, and special need families
- Justin was recently published in the Wolter Kluwer treatise International Trust Laws and Analysis: Company Laws Wealth Management & Tax Planning Strategies
- Prior to becoming an attorney, Justin served as an active-duty infantry officer with the 101st Airborne Division to include deployments to Kosovo and Iraq. He continues to serve in the Army Reserve as Colonel
- Justin lives in Cypress, Texas with his wife Jennifer, and their two sons, Lawson and Bennett

Concerns with transferring ownership in closely-held agricultural family businesses:

- Most family assets are typically tied up in land, equipment, and crops.
- How do you transfer the business to family members who are qualified to run the business?
- How can you be fair to family members who are not involved in the business?
- How can the current generation of business owners get paid an income in retirement while transferring the operations and ownership of the business?
- How can you transfer the business upon the death of an owner without having to sell assets in order to pay estate taxes?

METHODS OF TRANSFERRING OWNERSHIP TO FUTURE GENERATIONS

Outright Gifts of Ownership Interest

- Annual gifts of ownership interest over time
- Larger gifts of ownership interest in a single gift (with or without management control)

- Gift Tax = 18% - 40%
- Annual Exclusion for Gifts: $16,000 per person 2022
- Lifetime Exclusion for Gifts: $12,060,000 per person, $24.12 million if married

Grantor Retained Annuity Trusts (GRAT's)

- Purpose:
  - Transfer income-producing or highly appreciated assets to future generations with little or no gifting.
- How It Works:
  - Individual creates GRAT and transfers property or business interest to GRAT in exchange for a stream of annuity payments for a pre-determined time period.
  - At the end of the GRAT term, the residual value transfers to designated beneficiaries.

Strategy – Transfer Assets to Grantor Retained Annuity Trust (GRAT)

Individual / Grantor

Property or Business Interest

1 Grantor transfers property to GRAT; potentially at a discounted value. Individual uses little or no lifetime gifting allowance.

GRAT

Income or appreciation from assets are used to make annuity payments back to Grantor.

2 Grantor receives annuity payments (plus a federally mandated interest rate) over a specified period of time or over his/her lifetime.

3

Children

Receive remaining assets at the end of the GRAT Term.

Grantor Retained Annuity Trusts (GRAT's)

- Advantages:
  - Allows you to transfer income-producing or highly appreciated assets to future generations with little or no gifting, reducing the Grantor's taxable estate.
  - Interest on annuity payments is currently very low.
- Considerations:
  - If the Grantor does not survive the term of the GRAT, the entire value comes back into his/her estate.
  - If the assets lose value over the term of the GRAT, there is no residual value to pass on to beneficiaries.

Family Limited Partnerships (FLP's)

- Purpose:
  - Transfer income-producing or highly appreciated assets to future generations while still maintaining control of management and cash flow.
- How It Works:
  - Individual or couple creates FLP with General Partnership (GP) and Limited Partnership (LP) interests and transfers property or business interest.
  - Individual or couple are GP's and children (or others) are LP's.
  - LP's own the majority of the assets, but GP's maintain control over management and cash flow.

Strategy – Transfer Assets to Family Limited Partnership (FLP)

Individual / Couple

Property or Business Interest

1. Individual/couple transfers property to FLP; potentially at a discounted value.

2. Value of the gift is the discounted value. No capital gain is realized upon transfer (tax cost basis remains the same).

FLP

GP's – 1% owner

LP's – 99% owner

3. **Children**

Children are gifted the 99% LP interest, but do not have control.

Family Limited Partnership (FLP)

- Advantages:
  - Large amount of assets can be removed from the taxable estate.
  - The gift is assessed at a discounted value.
  - Original owners can maintain control.
- Considerations:
  - Tax cost basis remains the same, so any future sale would still trigger a taxable gain.
  - Independent valuation of the asset / business interest must be performed.

Buy-Sell Arrangements

What if one of the owners in a business:

- Wants to retire?
- Is disabled and can no longer work?
- Dies?

- How can the other owner(s) buy them out in a manner that is fair to everyone?
- How do you keep the business in the hands of active participants?
- How do you determine a valuation that is acceptable to all parties involved?

Buy-Sell Agreements

- Cross Purchase Buy-Sell:
  - Works best for businesses with only two owners.
  - Purchasing owner receives a step-up in basis equal to the purchase price of the interest.
  - Creditors cannot makes claims on any life insurance cash value.
- Entity-Purchase Buy-Sell:
  - Works best for businesses with three or more owners.
  - Business pays life insurance premiums.
  - Business can carry the life insurance cash value as an asset on it’s books.

Non-Qualified Retirement Plans

- Purpose:
  - Provide a non-qualified retirement plan for owners and key employees to allow for tax-advantaged retirement savings above and beyond traditional qualified retirement plans.
- How It Works:
  - Business enters into agreement with owner(s) to defer some amount of current income until retirement.
  - Agreement can be funded with any investment vehicle, but life insurance provides the most tax-advantaged growth and distributions.
  - Business owns and funds life insurance policies on behalf of owners.
  - Upon retirement, funds are withdrawn and distributed by the business to the retiring owner.
  - At owner’s death, insurance proceeds can be paid to owner’s beneficiaries or retained by the business.

Non-Qualified Retirement Plans

- Advantages:
  - Allows owner to defer much higher amounts than allowed in a qualified retirement plan.
  - Owner does not pay taxes on the income until it is distributed at retirement.
  - Distributions before 59 ½ are not subject to a 10% penalty.
- Considerations:
  - Plan assets are on the company books and therefore subject to creditors.
  - Owner must decide when and how to receive distributions (lump-sum or installments) when deferrals are made.

Federal Estate Tax

- All assets are counted towards federal estate tax (business, property, residence, etc.).
- Lifetime exemption from estate tax is $12,060,000 per person.
- Spouses can make unlimited gifts to each other, therefore typically no estate tax due until second death.
- Top marginal estate tax rate is 40%.
- Estate tax is due 9 months from the date of death.

Options to Pay for Federal Estate Tax

- **Cash:**
  - Does not provide leverage; pays tax dollar for dollar.
  - May not have enough available at time of death.
- **Loans:**
  - Commercial (Bank) loan: May have higher interest rate, may not qualify.
  - IRC Sec. 6166 Loan:
    - To qualify, must have 35% of estate in a closely held business.
    - Defers estate tax for 5 years, then requires repayment over the next 10 years at a lower interest rate.
    - Government dictates terms and cannot be changed.
- **Asset Sale:**
  - Don't want to have to sell assets when it might not be the right time in the market cycle.
  - May be forced to sell at a discounted price to meet IRS deadlines.

Options to Pay for Federal Estate Tax

- **Life Insurance:**
  - Provides leverage: Pay a relatively low premium and receive a large death benefit.
  - Provides cash at time of death, when it is needed.
  - Ownership can be structured through a business or a trust – which may avoid inclusion of the death benefit as part of the taxable estate.
  - Example: Refer to legal size illustration in handout.

CONCLUSION