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## ESTATE PLANNING AND FARM TRANSITION

### I. What is Farm/Land Transition

- a. Start with a framework for a smooth transition of ownership and management
- b. Provide for the needs of all family members, even those not involved
- c. Reduction of estate taxes
- d. Address problems in transferring non-liquid asset
- e. Involves a complete approach that encompasses:
  - i. Personal Goals and Concerns
  - ii. Financial and Legal Issues

### II. The Challenge of Transition

- a. The Generation Paradox – Each generation has differing business and personal goals, which can lead to significant “goal clashes” during the transition phase.
- b. Concerns of each Generation
  - i. Older Generation concerns
    1. entrusting “their” land to someone else: “Would the next generation able to manage the land/farm as the older generation thought it should be run?”
    2. Whether the business assets would be able to generate sufficient income to support the older generation through their retirement years
    3. How to develop a plan that treats all children fairly and equitably
  - ii. Younger Generation concerns
    1. Economic viability of the land/farm

2. Are significant changes to the existing management/operation necessary for continued economic viability
  3. Stress of high debt necessary to maintain or expand
  4. Communication of transition plans by senior members
- c. When is the Right Time to Start Transition Planning
- i. Excuses: "I don't have time" or "It's too expensive"
  - ii. Really the question you should be asking is: When is time better spent than when protecting your family's future?
  - iii. As for the expense, the modest sum you invest now in professional assistance will seem insignificant next to the expense your estate could incur in litigation, taxation and red tape.
  - iv. Worse than the expense is the family quarreling and confusion which could occur because you died without an estate plan.

### III. Estate Planning

- a. A will is essential, but just the beginning of an estate plan
  - i. Names executor
  - ii. Appoints guardians for dependents
- b. A good estate plan should accomplish at least four goals:
  - i. Transfer ownership and management of the agricultural operation, land and other assets
  - ii. Avoid unnecessary transfer taxes (income, gift and estate)
  - iii. Ensure financial security and peace of mind for all generations
  - iv. Develop the next generation's management capacity.
- c. Laws, especially tax laws, change.
  - i. Two important elements of estate planning are to
    1. set goals
    2. revisit them over time as families, finances, priorities and laws change.
  - ii. As part of this goal-setting process, landowners must take inventory of their assets and be sure they fully understand who owns what

d. The Process

- i. Estate planning is the process of developing a program for effective management, enjoyment, and disposition of your property at the least possible tax cost.
- ii. Planning your estate means reviewing how you own your property, considering insurance needs and examining your family business structure. This task can be less overwhelming if you separate it into basic steps:
  1. Initiate the discussion
  2. Develop your objectives
  3. Compile information
  4. Seek professional advice
  5. Keep things updated

b. Importance of Powers of Attorney and Advance Medical Directives

IV. The Business Structure for Your Farm Land

a. What is a Business Structure?

- i. When family farm business owners see the term “business structure,” quite often the first thing that comes to mind is what type of legal entity the business is operating under.
- ii. The legal form of the business can have significant implications for tax management, estate planning, business transition planning, and other important business objectives.
- iii. A significant amount of attention should be given to this management choice, especially when making significant changes in the farm business such as bringing in a new generation

b. Why is a Business Structure important for Your Land?

- i. Management Flexibility and Control
- ii. Limiting Liability
- iii. Continuity/Succession
- iv. Taxation

- v. Access to Capital
- c. Overview of Business Structure Entities
  - i. Sole Proprietorship (SP)
    1. The sole proprietorship is the most common form of business organization for farms and ranches.
    2. The business is limited to the life of the owner, and the individual is responsible for all debts and obligations.
    3. Income is reported and taxed at individual rate.
    4. Primary advantages of the SP
      - a. ease of startup- few formalities to get business going
      - b. low maintenance costs as there are few legal filing
      - c. Decision making and management control are centralized with the owner/ manager.
      - d. Profits are taxed at the owner's personal rate, and business losses can typically be used to offset other income for taxation purposes
    5. Primary disadvantages of the SP
      - a. Disadvantages include the fact that the sole proprietorship terminates with the death of the owner
      - b. investment capital is limited to that available to the sole owner, making it difficult to obtain long-term financing and limiting growth potential, particularly as the operator ages.
      - c. Business growth is limited to the abilities, skills, and interests of the sole owner.
      - d. This "life cycle" disadvantage results in the sole proprietorship being the least effective structure for maintaining a farm/land management operation at peak efficiency when transferring the business across generations.
      - e. The owner's personal assets are subject to any business liabilities.

- f. Loss of estate tax planning
- ii. Limited Liability Company (LLC)
  - 1. A limited liability company is a business entity that combines the limited liability of a corporation, with the flexible management options of a general partnership.
  - 2. Advantages
    - a. limited liability of the members
    - b. flexible management options
    - c. partnership tax status
    - d. Ownership and voting rights can be divided in “unconventional” ways relative to corporations.
    - e. Continuity after founding members death
    - f. Relatively ease of organization and maintenance
    - g. Discount planning
    - h. Ease in adding additional members to company
  - 3. Disadvantages
    - a. Periodic reporting (annual tax returns)
    - b. Annual meeting and following of corporate form required
    - c. Issues with IRS attacks on LLCs/FLPs
    - d. Must separate from “personal” assets
- iii. Trust
  - 1. A trust separates the control of assets (Trustee) from those entitled to benefits of the trust (Beneficiaries)
  - 2. Advantages
    - a. Allows senior generation to establish succession plan for family at death
    - b. Estate tax deferral in certain circumstances (e.g. Marital Trust planning)
    - c. Retention of control by senior generation (if desired)
  - 3. Disadvantages
    - a. Lack of liability limit

- b. Limited flexibility for future generations
- c. Depending on type of trust, additional tax filings if separate entity trust