

Attention to How Your Farm Business is Organized Pays Off for the Heirs at Tax Time

Amundsen Davis Agribusiness Alert
March 7, 2016

There is a proverbial saying about the inevitability of death and taxes. Leaving aside the former, agribusiness owners are always interested in ways to manage the latter. Federal estate tax structure was last significantly modified in 2010 when the exemption was raised to \$5 million, indexed to inflation. For estates of persons dying in 2016, the exemption eliminates tax on \$5,450,000 of value, doubled that for the estates of a husband and wife. The Illinois exemption remains at \$4 million, and Missouri does not impose an estate tax.

When the value of the farm or business exceeds these limits, federal estate tax is imposed at the rate of 40%, and clients start looking for ways to minimize the burden for their heirs. Tax reduction may be achieved in how the interests held in the business organization are appraised for the estate tax return.

Farm businesses may be organized as partnerships or limited liability companies for a number of reasons:

- Consolidated management of the business when there are multiple owners (especially when some actively participate in the operation of the farm and others don't);
- Protection of business assets from the claims by creditors of the individual owners, including ex-spouses;
- Ease of transfer of partial interests in the business, without disrupting the operation of the business;
- Restrictions on transfer of interests to persons outside the extended family; and
- Provides a forum for communication and education among the family owners.

However, there is an added benefit when tax time arrives. The decedent's interest in that partnership or company may be valued for tax purposes at a substantial discount from the value of the business assets (land, equipment, inventory) that his or her interest represents a claims on.

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After all, it is the business interest that is being valued, not the assets used in business operations. The fair market value of an interest in a closely held family business, particularly if it is a minority or non-controlling interest, is less valuable to an unrelated purchaser since that purchaser would have no power to realize his or her share of the assets held in the business. These discounts are referred to as "lack of marketability" or "minority" discounts – and every dollar of discount to the value of the business assets represents 40 cents of tax savings.

But the Internal Revenue Service is reluctant to let these discounts pass without scrutiny. In a recent case before the United States Tax Court (*Estate of Purdue*, decided December 28, 2015) the IRS argued that the family limited liability company should be disregarded and that the value of the company assets should be taxed directly in the estates of the parents who formed the limited liability company, regardless of the restrictions on transferability of membership interests and the gifts that had been made to family members. But the IRS lost on all of the substantial estate and gift tax deficiencies that it claimed. Why? Because the Tax Court found the limited liability company to be a valid business entity whose structure should be respected. It relied on evidence that the company didn't commingle its assets with personal assets of the company's owners, that it maintained its own bank accounts and that it held meetings at least annually for family owners with written agendas, minutes and meeting summaries. In other words, it was a real company.

In short, the lesson to be drawn from *Estate of Purdue* is that if you have organized your agribusiness in a partnership or limited liability company form, be sure and take advantage of all the operational opportunities that form affords – and if you have paid careful attention to the legal formalities of that organization, your heirs may receive a bonus at tax time.

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