Sustaining NY's Farms:
Legal Solutions for Farm Business Futures

October 3, 2018

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Sustaining NY's Farms:

Legal Solutions for Farm Business Futures

October 3, 2018

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Sustaining New York's Farms:
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October 3, 2018

9:00am – 9:30am	Registration
9:30am – 10:30am	Farm Debt Workouts: Bankruptcy Laws to the Rescue Maxsen D. Champion, Esq. Law Office of Maxsen D. Champion
10:30am – 11:30am	Agricultural Land Preservation: Conservation Easements and other Property Law Tools Jerry Cosgrove, Esq. Senior Advisor & Farm Legacy Program Director, American Farmland Trust, and Of Counsel at Scolaro, Fetter, Grizanti, McGough & King, P .C.
11:30am – 12:30pm	Lunch
12:30pm – 1:30pm	Get In or Get Out: Farm Business Entry & Exit Strategies Timothy Veazey Lincoln Financial Advisors Bruce Charleton Lincoln Financial Advisors Jeffrey M. Fetter, Esq. Scolaro, Fetter, Grizanti, McGough & King, P .C.
1:30pm – 3:00pm	Protecting Farm Assets: Trusts and other Estate Planning Tools Shane M. McCrohan, Esq. Scolaro, Fetter, Grizanti, McGough & King, P .C. Steven A. Walker, Esq. Scolaro, Fetter, Grizanti, McGough & King, P .C. Megan B. Harris-Pero, Esq. Harris-Pero Legal Counsel, PLLC

Sustaining NY's Farms:
Legal Solutions for Farm Business Futures

October 3, 2018

SPEAKER BIOGRAPHIES

MAXSEN D. CHAMPION, ESQ., has been engaged in the practice of law at the Law Office of Maxsen D. Champion in Auburn, N.Y., since April 2015, where he is primarily focused on the practice of bankruptcy law, representing consumers in chapter 7, 12 and 13 cases. Mr. Champion previously was Staff Attorney for Chapter 12 and 13 Trustee Mark W. Swimelar (May 2007–March 2015); a Partner at Bentkofsky & Champion, PLLC (January 2004–May 2007); an Associate in general practice at Boyle & Anderson, P.C. (January 2000– January 2004); and a Law Clerk for Francis J. Carey (May 1997– May 1999). During his tenure working for the Chapter 12 Trustee, Mr. Champion gained an extreme compassion for the plight of our local farmers and the economic pressures felt within this community. Mr. Champion received a law degree from the University of Pittsburgh in 2000 and a joint degree in English and history from the State University of New York at Buffalo in 1996. He is admitted to practice in New York.

BRUCE CHARLETON is an Estate and Succession Planning Specialist at Lincoln Financial Advisors. Lincoln Financial Advisors is a select group of estate and succession planning specialists skilled in utilizing strategies for protecting land, business, and one's legacy while minimizing tax consequences and inheritance issues. Mr. Charleton is passionately committed to working with agribusiness owners, as well as their active and inactive family members throughout Upstate New York and northern Pennsylvania. He helps these business-owner clients to accumulate, preserve, and protect wealth for themselves, their children, and future generations. Mr. Charleton employs a client-centric approach to addressing the estate and succession issues that face agribusiness owners today to create a comprehensive plan of action to help meet their individual goals and future objectives. In addition to his work with agribusiness owners, Mr. Charlton also serves on the board of Sagemark Consulting (a division of Lincoln Financial Advisors Corp.) Private Wealth Services Estate Planning Council to ensure the best ideas available nationally are delivered to his clients locally. Mr. Charleton earned a BS in finance from Canisius College of Buffalo and an MBA from the Simon School of Business at the University of Rochester. He holds Series 7 and 66 securities registration and is insurance licensed in several states.

JERRY COSGROVE, ESQ., is Farm Legacy Director and a Senior Advisor for American Farmland Trust, and is Of Counsel at the law firm of Scolaro, Fetter, Grizanti and McGough, P.C. He combines his farming background and legal experiences with a long history of nonprofit work and public service. During his career, Mr. Cosgrove has worked on a range of agricultural, conservation, farm transfer, and rural development issues. He was the Associate Director of the Local Economies Project of the New World Foundation from 2012 to 2015, launching LEP's Hudson Valley Farm Hub initiative, a 1,200-acre teaching, research, and demonstration farm. He oversaw its Food Hubs initiative focused on value chain development, and he developed its farm access programming to address the widening farm affordability gap. Mr. Cosgrove served as a Deputy Commissioner for the New York State Department of Agriculture and Markets from 2007 to 2010, with program responsibility for food policy, food safety, dairy, and agricultural protection and development. He worked for 15 years at American Farmland Trust, a national farmland conservation nonprofit, where he directed AFT's policy development, technical assistance, and advocacy activities in New York and New England as its Northeast Director. Mr. Cosgrove grew up on his family's dairy farm in Clinton, a village in central New York's Oneida County. He is part of a fourth generation farm family (his brother owns the family farm). Mr. Cosgrove graduated from Cornell's College of Agriculture and Life Sciences with a degree in agriculture. He also graduated from Cornell Law School and is licensed to practice law in New York. Mr. Cosgrove is a member of the New York State Bar Association and the American Agricultural Law Association. He can be contacted at jcosgrove@farmland.org or jcosgrov@nycap.rr.com.

JEFFREY M. FETTER, ESQ., is a shareholder and Chairman of the Business Practice Group of Scolaro Fetter Grizanti & McGough, P.C. in Syracuse, NY. His practice focuses on business, estate, tax and succession planning for closely held and family owned enterprises. Mr. Fetter's clients are involved in agricultural businesses, professional service, manufacturing, communications, and retail. He advises his clients on federal and international tax and business planning; estate and long term care planning; business and succession planning; e-commerce planning; employee and shareholder/principal relations and employee benefits; protection of intellectual property; transactional planning; acquisitions, dispositions, mergers, tax-free reorganization of business entities; entity structuring; contract negotiation, dispute resolution and the dissolutions of business entities. Mr. Fetter is a frequent lecturer in the area of business, estate and succession planning. He recently spoke at the National Agricultural Bankers Conference on "Position to Transition—How to Navigate Volatile Times"; the FCC Services Forum for Ag Lending Conference on "New Strategies for Farm Succession Planning"; and the Dairy Farmers of America 2017 Annual Meeting on

"Securing the Next Generation." Mr. Fetter has authored several articles on business and estate planning for various periodicals including *Ag Banking* and *Top Producer*. He is a member of the Onondaga County Bar Association; the NYSBA General Practice Section and Elder Law Section; the Pennsylvania and Washington State Bar Associations; the American Agricultural Law Association; the New York Farm Bureau; the Board of Directors of FarmNet of Cornell University Dyson School of Management; and the Education Foundation for Suffolk County Extension, Inc. Mr. Fetter is a cum laude graduate of the Ohio Northern University College of Law, and he received an undergraduate degree at the University of New York at Geneseo. He is admitted to practice in the states of New York and Washington and the Commonwealth of Pennsylvania.

MEGAN B. HARRIS-PERO, ESQ., is the principal attorney of Harris-Pero Legal Counsel, PLLC in Saratoga Springs, New York, licensed in New York and Pennsylvania. Ms. Harris-Pero completed an undergraduate degree at Duke University before graduating summa cum laude from Duquesne University School of Law. She is also a graduate of Cornell University's LEAD New York, a program for people committed to making a difference in the food, agriculture, and natural resource industries. Ms. Harris-Pero's practice focuses on estate planning, elder law, business planning, and succession. She began her practice with the intention of helping farmers and food entrepreneurs plan for secure life transitions into retirement and long-term care. Ms. Harris-Pero's focus has primarily been on helping small, family businesses that conduct work "at the kitchen table." Her practice includes attention to the details and consideration of integrated planning for a business and estate. Since beginning her firm, Ms. Harris-Pero's client base has expanded but she has always stayed connected to the agricultural community through her commitment to serving agricultural clients and her continued support of the agricultural community.

SHANE M. McCROHAN, ESQ., is a Partner of Scolaro Fetter Grizanti & McGough, P.C. and a member of the firm's Estate Planning & Wealth Preservation and Agricultural Services Practice Groups. Mr. McCrohan's practice is focused on the areas of estate planning, trust and estate administration, succession planning for closely held businesses and income, and gift and estate tax planning for individuals and professionals. He also concentrates in elder law, assisting individuals with long-term care planning. He has presented extensively on the topics of asset protection in the context of nursing home (chronic care) Medicaid qualification and the use of trusts in estate plans. Prior to joining the Scolaro Law Firm, Mr. McCrohan worked in the Boston, MA, area as a financial planner for five years and as an associate for two law firms with practices focused on estate planning, trust and estate administration, and long-term planning. He is a 2001 cum laude graduate of Suffolk University Law School in Boston, MA, and he received a B.A., summa cum laude, from Ursinus College. He is admitted to practice in New York and Massachusetts. Mr. McCrohan is a Certified Financial Planner™ and a member of Phi Beta Kappa.

STEVEN A. WALKER, ESQ., is a shareholder and a member of the Business & Tax Practice Group, Agricultural Services Group, Estate Planning Group, and Real Estate Group of Scolaro Fetter Grizanti & McGough, P.C., in Syracuse, N.Y. Mr. Walker serves as counsel to numerous agricultural clients and other enterprises throughout New York State. He advises owners and operators of farms and agribusinesses in all areas of planning. He has facilitated business structures between non-family members and complex transactions, such as creating limited liability companies for joint ventures among agricultural producers or for preserving the capital of the original corporate entity while allocating future growth to the managing members. Prior to becoming an attorney, Mr. Walker was a partner in a 500-cow dairy and vegetable operation in Western New York, where he was responsible for overseeing the day-to-day operations of the dairy for nine years. He was raised on a 40-cow dairy farm in Cooperstown, N.Y. Mr. Walker is the Northeast Dairy Producers Association representative on the New York Beef Council and Region 1 Vice President on the National Cattlemen's Beef Association. He also serves on the Board for Agri-Business Child Development, a nonprofit organization providing early childhood education and social services to farm workers and other eligible families across New York State. He is a member of the New York Farm Bureau and the Board of Directors of the New York State Federation of Growers' and Processors' Association, Inc. Mr. Walker is a 2008 magna cum laude graduate of Syracuse University College of Law and earned a bachelor's degree in animal science from Cornell University, College of Agriculture and Life Sciences in 1992, where he graduated first in his class. He is admitted to practice in New York and New Jersey.

TIM VEAZEY in an Estate and Succession Planning Specialist at Lincoln Financial Advisors. Lincoln Financial Advisors is a select group of estate and succession planning specialists skilled in utilizing strategies for protecting land, business, and one's legacy while minimizing tax consequences and inheritance issues. Mr. Veazey grew up on a dairy farm in western New York. He spent the first 10 years of his career as an agricultural lender, and has been a financial planner focused on agribusiness clients for more than 20 years. This experience has fueled his passion for helping owners of large farms develop and implement business succession, estate transfer, and personal financial plans. Through a comprehensive financial planning process, working closely with the clients' team of other advisors, he is able to help his clients grow, preserve, protect, use, and distribute their personal and business wealth more effectively. Mr. Veazey's strength is his ability to see the "big picture" regarding the client's situation, while being able to address the necessary details to ensure their goals can be met. The long-term relationships between Mr. Veazey and his clients have proven to be valuable as the financial plans continue to be reviewed and adapted as time and circumstances warrant. In addition to his work with agribusiness owners, Mr. Veazey serves on the Board of NY FarmNet, is an active member of the NY Agricultural Society, and helps with several 4H, Farm Bureau, and Cooperative extension programs and events. He earned a BS in General Agriculture from Cornell University, earned CFP®, CLU and ChFC certification or designation, holds Series 7 and 65 securities registrations, and is insurance licensed in several states.

Farm Debt Workouts: Bankruptcy Laws to the Rescue

Maxsen D. Champion, Esq.

(1) a railroad;

(2) a domestic insurance coıy, bank, savings bank, cooperative bank, savings and loan association, builcind loan association, homestead association, a New Markets Venture Capitaıpany as defined in section 351 of the Small Business Investment Act of 1958USC § 689], a small business investment company licensed by the Small BusiAdministration under section 301 of the Small Business Investment Act of 195; USC § 681], credit union, or industrial bank or similar institution which is ısured bank as defined in section 3(h) of the Federal Deposit Insurance Act [SC § 1813(h)], except that an uninsured State member bank, or a corporation ɑized under section 25A of the Federal Reserve Act [12 USC §§ 611 et seq.], whiıerates, or operates as, a multilateral clearing organization pursuant to sectionof the Federal Deposit Insurance Corporation Improvement Act of 1991 [12 U:4422] may be a debtor if a petition is filed at the direction of the Board of Govґs of the Federal Reserve System; or (d) of section 301 of the Small Business Itment Act of 1958, credit union, or industrial bank or similar institution which insured bank as defined in section 3(h) of the Federal Deposit Insurance Act; (

(3)(A) a foreign insurance ɒany, engaged in such business in the United States; or

(B) a foreign bank, savirınk, cooperative bank, savings and loan association, building and loan assocn, or credit union, that has a branch or agency (as defined in section 1(b) of ıternational Banking Act of 1978) [12 USC § 3101(b)] in the United States.

(c) An entity may be a debtor unhapter 9 of this title if and only if such entity—

(1) is a municipality;

(2) is specifically authorized,3 capacity as a municipality or by name, to be a debtor under such chapter by Staw, or by a governmental officer or organization empowered by State law to authcsuch entity to be a debtor under such chapter;

(3) is insolvent;

(4) desires to effect a plan toıst such debts; and

(5)(A) has obtained the agrent of creditors holding at least a majority in amount of the claims of each claat such entity intends to impair under a plan in a case under such chapter;

(B) has negotiated in goith with creditors and has failed to obtain the agreement of creditors holding ast a majority in amount of the claims of each class that such entity intends toair under a plan in a case under such chapter;

(C) is unable to negotiaith creditors because such negotiation is impracticable; or

(D) reasonably believes tı creditor may attempt to obtain a transfer that is avoidable under section 547 cs title.

(d) Only a railroad, a person thay be a debtor under chapter 7 of this title (except a stockbroker or a commodioker), and an uninsured State member bank, or a corporation organized undetion 25A of the Federal Reserve Act [12 USC §§ 611 et seq.], which operates, oerates as, a multilateral clearing organization pursuant to section 409 of the Fec Deposit Insurance Corporation Improvement Act of 1991 [12 USC § 4422] may debtor under chapter 11 of this title.

(e) Only an individual with regincome that owes, on the date of the filing of the petition, noncontingent, liquid, unsecured debts of less than $383,175* and noncontingent, liquidated, securebts of less than $1,149,525*, or an individual

with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $383,175* and noncontingent, liquidated, secured debts of less than $1,149,525* may be a debtor under chapter 13 of this title.

(f) Only a family farmer or family fisherman with regular annual income may be a debtor under chapter 12 of this title. SEE §101 (18)

(g) Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if—

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

(h)(1) Subject to paragraphs (2) and (3), and notwithstanding any other provision of this section other than paragraph (4) of this subsection, an individual may not be a debtor under this title unless such individual has, during the 180-day period ending on the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

(2)(A) Paragraph (1) shall not apply with respect to a debtor who resides in a district for which the United States trustee (or the bankruptcy administrator, if any) determines that the approved nonprofit budget and credit counseling agencies for such district are not reasonably able to provide adequate services to the additional individuals who would otherwise seek credit counseling from such agencies by reason of the requirements of paragraph (1).

(B) The United States trustee (or the bankruptcy administrator, if any) who makes a determination described in subparagraph (A) shall review such determination not later than 1 year after the date of such determination, and not less frequently than annually thereafter. Notwithstanding the preceding sentence, a nonprofit budget and credit counseling agency may be disapproved by the United States trustee (or the bankruptcy administrator, if any) at any time.

(3)(A) Subject to subparagraph (B), the requirements of paragraph (1) shall not apply with respect to a debtor who submits to the court a certification that—

(i) describes exigent circumstances that merit a waiver of the requirements of paragraph (1);

(ii) states that the debtor requested credit counseling services from an approved nonprofit budget and credit counseling agency, but was unable to obtain the services referred to in paragraph (1) during the 7-day period beginning on the date on which the debtor made that request; and

(iii) is satisfactory to the court.

(B) With respect to a debtor, an exemption under subparagraph (A) shall cease to apply to that debtor on the date on which the debtor meets the requirements of paragraph (1), but in no case may the exemption apply to that debtor after the date that is 30 days after the debtor files a petition, except that the court, for cause, may order an additional 15 days.

payments to victims of international terrorism (as defined in section 2331 of title 18) or domestic terrorism (as defined in section 2331 of title 18) on account of their status as victims of such terrorism.

(11) The term "custodian" means—

(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;

(B) assignee under a general assignment for the benefit of the debtor's creditors; or

(C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

(12) The term "debt" means liability on a claim.

(12A) The term "debt relief agency" means any person who provides any bankruptcy assistance to an assisted person in return for the payment of money or other valuable consideration, or who is a bankruptcy petition preparer under section 110, but does not include—

(A) any person who is an officer, director, employee, or agent of a person who provides such assistance or of the bankruptcy petition preparer;

(B) a nonprofit organization that is exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986 [*26 USC § 501(c)(3)*];

(C) a creditor of such assisted person, to the extent that the creditor is assisting such assisted person to restructure any debt owed by such assisted person to the creditor;

(D) a depository institution (as defined in section 3 of the Federal Deposit Insurance Act [*12 USC § 1813*]) or any Federal credit union or State credit union (as those terms are defined in section 101 of the Federal Credit Union Act [*12 USC § 1752*]), or any affiliate or subsidiary of such depository institution or credit union; or

(E) an author, publisher, distributor, or seller of works subject to copyright protection under title 17, when acting in such capacity.

(13) The term "debtor" means person or municipality concerning which a case under this title has been commenced.

(13A) The term "debtor's principal residence"—

(A) means a residential structure if used as the principal residence by the debtor, including incidental property, without regard to whether that structure is attached to real property; and

(B) includes an individual condominium or cooperative unit, a mobile or manufactured home, or trailer if used as the principal residence by the debtor.

(14) The term "disinterested person" means a person that—

(A) is not a creditor, an equity security holder, or an insider;

(B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and

(C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

(14A) The term "domestic support obligation" means a debt that accrues before, on, or after the date of the order for relief in a case under this title, including

interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title, that is—

(A) owed to or recoverable by—

(i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or

(ii) a governmental unit;

(B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt is expressly so designated;

(C) established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of—

(i) a separation agreement, divorce decree, or property settlement agreement;

(ii) an order of a court of record; or

(iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and

(D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

(15) The term "entity" includes person, estate, trust, governmental unit, and United States trustee.

(16) The term "equity security" means—

(A) share in a corporation, whether or not transferable or denominated "stock", or similar security;

(B) interest of a limited partner in a limited partnership; or

(C) warrant or right, other than a right to convert, to purchase, sell, or subscribe to a share, security, or interest of a kind specified in subparagraph (A) or (B) of this paragraph.

(17) The term "equity security holder" means holder of an equity security of the debtor.

(18) The term "family farmer" means—

(A) individual or individual and spouse engaged in a farming operation whose aggregate debts do not exceed $4,031,575* and not less than 50 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse unless such debt arises out of a farming operation), on the date the case is filed, arise out of a farming operation owned or operated by such individual or such individual and spouse, and such individual or such individual and spouse receive from such farming operation more than 50 percent of such individual's or such individual and spouse's gross income for—

(i) the taxable year preceding; or

(ii) each of the 2d and 3d taxable years preceding; the taxable year in which the case concerning such individual or such individual and spouse was filed; or

(B) corporation or partnership in which more than 50 percent of the outstanding stock or equity is held by one family, or by one family and the relatives of the members of such family, and such family or such relatives conduct the farming operation, and

(i) more than 80 percent of the value of its assets consists of assets related to the farming operation;

(ii) its aggregate debts do not exceed $4,031,575* and not less than 50 percent of its aggregate noncontingent, liquidated debts (excluding a debt for one dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a farming operation), on the date the case is filed, arise out of the farming operation owned or operated by such corporation or such partnership; and

(iii) if such corporation issues stock, such stock is not publicly traded.

(19) The term "family farmer with regular annual income" means family farmer whose annual income is sufficiently stable and regular to enable such family farmer to make payments under a plan under chapter 12 of this title.

(19A) The term "family fisherman" means—

(A) an individual or individual and spouse engaged in a commercial fishing operation—

(i) whose aggregate debts do not exceed $1,868,200* and not less than 80 percent of whose aggregate noncontingent, liquidated debts (excluding a debt for the principal residence of such individual or such individual and spouse, unless such debt arises out of a commercial fishing operation), on the date the case is filed, arise out of a commercial fishing operation owned or operated by such individual or such individual and spouse; and

(ii) who receive from such commercial fishing operation more than 50 percent of such individual's or such individual's and spouse's gross income for the taxable year preceding the taxable year in which the case concerning such individual or such individual and spouse was filed; or

(B) a corporation or partnership—

(i) in which more than 50 percent of the outstanding stock or equity is held by—

(I) 1 family that conducts the commercial fishing operation; or

(II) 1 family and the relatives of the members of such family, and such family or such relatives conduct the commercial fishing operation; and

(ii)(I) more than 80 percent of the value of its assets consists of assets related to the commercial fishing operation;

(II) its aggregate debts do not exceed $1,868,200* and not less than 80 percent of its aggregate noncontingent, liquidated debts (excluding a debt for 1 dwelling which is owned by such corporation or partnership and which a shareholder or partner maintains as a principal residence, unless such debt arises out of a commercial fishing operation), on the date the case is filed, arise out of a commercial fishing operation owned or operated by such corporation or such partnership; and

(III) if such corporation issues stock, such stock is not publicly traded.

(19B) The term "family fisherman with regular annual income" means a family fisherman whose annual income is sufficiently stable and regular to enable such family fisherman to make payments under a plan under chapter 12 of this title.

(20) The term "farmer" means (except when such term appears in the term "family farmer") person that received more than 80 percent of such person's gross

income during the taxable year of such person immediately preceding the taxable year of such person during which the case under this title concerning such person was commenced from a farming operation owned or operated by such person.

(21) The term "farming operation" includes farming, tillage of the soil, dairy farming, ranching, production or raising of crops, poultry, or livestock, and production of poultry or livestock products in an unmanufactured state.

(21A) The term "farmout agreement" means a written agreement in which—

(A) the owner of a right to drill, produce, or operate liquid or gaseous hydrocarbons on property agrees or has agreed to transfer or assign all or a part of such right to another entity; and

(B) such other entity (either directly or through its agents or its assigns), as consideration, agrees to perform drilling, reworking, recompleting, testing, or similar or related operations, to develop or produce liquid or gaseous hydrocarbons on the property.

(21B) The term "Federal depository institutions regulatory agency" means—

(A) with respect to an insured depository institution (as defined in section 3(c)(2) of the Federal Deposit Insurance Act [*12 USC § 1813(c)(2)*]) for which no conservator or receiver has been appointed, the appropriate Federal banking agency (as defined in section 3(q) of such Act [*12 USC § 1813(q)*]);

(B) with respect to an insured credit union (including an insured credit union for which the National Credit Union Administration has been appointed conservator or liquidating agent), the National Credit Union Administration;

(C) with respect to any insured depository institution for which the Resolution Trust Corporation has been appointed conservator or receiver, the Resolution Trust Corporation; and

(D) with respect to any insured depository institution for which the Federal Deposit Insurance Corporation has been appointed conservator or receiver, the Federal Deposit Insurance Corporation.

(22) The term "financial institution" means—

(A) a Federal reserve bank, or an entity that is a commercial or savings bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as agent or custodian for a customer (whether or not a "customer", as defined in section 741) in connection with a securities contract (as defined in section 741) such customer; or

(B) in connection with a securities contract (as defined in section 741) an investment company registered under the Investment Company Act of 1940.

(22A) The term "financial participant" means—

(A) an entity that, at the time it enters into a securities contract, commodity contract, swap agreement, repurchase agreement, or forward contract, or at the time of the date of the filing of the petition, has one or more agreements or transactions described in paragraph (1), (2), (3), (4), (5), or (6) of section 561(a) with the debtor or any other entity (other than an affiliate) of a total gross dollar value of not less than $1,000,000,000 in notional or actual principal amount outstanding (aggregated across counterparties) at such time or on any day during the 15-month period preceding the date of the filing of the petition, or has gross mark-to-market positions of not less than $100,000,000 (aggregated across counterparties) in one or more such agreements or transactions with the debtor

| Chapter | County | Debtor Type | Division | Month |

| County & Chapter | Debtor Type & Chapter | Division & Chapter | Month & Chapter |

| County & Month | County & Debtor Type | Debtor Type & Month | Division & Month |

Filings By Chapter

Includes re-openings (Updated on 9/5/2018.)

Chapter	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
7	8667	9725	9334	7867	6886	6347	5854	5229	4752	4706	3185
9	0	0	0	0	0	0	0	0	0	0	0
11	35	44	37	37	34	28	22	50	37	22	18
12	6	17	20	12	22	10	7	18	12	7	7
13	2609	2659	2360	1757	1434	1346	1284	1253	1267	1296	939
15	3	0	1	0	0	0	0	0	0	0	0
TOTALS	**11320**	**12445**	**11752**	**9673**	**8376**	**7731**	**7167**	**6550**	**6068**	**6031**	**4149**

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er authorizing such suspension by the giving of a supersedeas bond or other-e, during the pendency of such appeal.

(1) In authorizing any abandonment of a railroad line under this section, the t shall require the rail carrier to provide a fair arrangement at least as protective e interests of employees as that established under section 11326(a) of title 49.

(2) Nothing in this subsection shall be deemed to affect the priorities or timing ayment of employee protection which might have existed in the absence of this section.

71. Priority claims

There shall be paid as an administrative expense any claim of an individual f the personal representative of a deceased individual against the debtor or the te, for personal injury to or death of such individual arising out of the operation e debtor or the estate, whether such claim arose before or after the commence-t of the case.

Any unsecured claim against the debtor that would have been entitled to pri- if a receiver in equity of the property of the debtor had been appointed by a ral court on the date of the order for relief under this title shall be entitled to the e priority in the case under this chapter.

72. Contents of plan

In addition to the provisions required or permitted under section 1123 of this a plan—

(1) shall specify the extent to and the means by which the debtor's rail service is posed to be continued, and the extent to which any of the debtor's rail service is posed to be terminated; and

(2) may include a provision for—

(A) the transfer of any or all of the operating railroad lines of the debtor to other operating railroad; or

(B) abandonment of any railroad line in accordance with section 1170 of s title.

If, except for the pendency of the case under this chapter, transfer of, or opera- of or over, any of the debtor's rail lines by an entity other than the debtor or a essor to the debtor under the plan would require approval by the Board under a f the United States, then a plan may not propose such a transfer or such opera- unless the proponent of the plan initiates an appropriate application for such nsfer or such operation with the Board and, within such time as the court may ot exceeding 180 days, the Board, with or without a hearing, as the Board may mine, and with or without modification or condition, approves such applica- or does not act on such application. Any action or order of the Board approving, fying, conditioning, or disapproving such application is subject to review by the only under sections 706(2)(A), 706(2)(B), 706(2)(C), and 706(2)(D) of title 5.

1) In approving an application under subsection (b) of this section, the Board require the rail carrier to provide a fair arrangement at least as protective of the ests of employees as that established under section 11326(a) of title 49.

(2) Nothing in this subsection shall be deemed to affect the priorities or timing ayment of employee protection which might have existed in the absence of this section.

73. Confirmation of plan

The court shall confirm a plan if—

1) the applicable requirements of section 1129 of this title have been met;

(2) each creditor or equity security holder will receive or retain under the plan property of a value, as of the effective date of the plan, that is not less than the value of property that each such creditor or equity security holder would so receive or retain if all of the operating railroad lines of the debtor were sold, and the proceeds of such sale, and the other property of the estate, were distributed under chapter 7 of this title on such date;

(3) in light of the debtor's past earnings and the probable prospective earnings of the reorganized debtor, there will be adequate coverage by such prospective earnings of any fixed charges, such as interest on debt, amortization of funded debt, and rent for leased railroads, provided for by the plan; and

(4) the plan is consistent with the public interest.

(b) If the requirements of subsection (a) of this section are met with respect to more than one plan, the court shall confirm the plan that is most likely to maintain adequate rail service in the public interest.

§ 1174. Liquidation

On request of a party in interest and after notice and a hearing, the court may, or, if a plan has not been confirmed under section 1173 of this title before five years after the date of the order for relief, the court shall, order the trustee to cease the debtor's operation and to collect and reduce to money all of the property of the estate in the same manner as if the case were a case under chapter 7 of this title.

CHAPTER 12—ADJUSTMENT OF DEBTS OF A FAMILY FARMER OR FISHERMAN WITH REGULAR ANNUAL INCOME

SUBCHAPTER I—OFFICERS, ADMINISTRATION, AND THE ESTATE

§ 1201. Stay of action against codebtor

(a) Except as provided in subsections (b) and (c) of this section, after the order for relief under this chapter, a creditor may not act, or commence or continue any civil action, to collect all or any part of a consumer debt of the debtor from any individual that is liable on such debt with the debtor, or that secured such debt, unless—

(1) such individual became liable on or secured such debt in the ordinary course of such individual's business; or

(2) the case is closed, dismissed, or converted to a case under chapter 7 of this title.

(b) A creditor may present a negotiable instrument, and may give notice of dishonor of such an instrument.

(c) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided by subsection (a) of this section with respect to a creditor, to the extent that—

(1) as between the debtor and the individual protected under subsection (a) of this section, such individual received the consideration for the claim held by such creditor;

(2) the plan filed by the debtor proposes not to pay such claim; or

(3) such creditor's interest would be irreparably harmed by continuation of such stay.

(d) Twenty days after the filing of a request under subsection (c)(2) of this section for relief from the stay provided by subsection (a) of this section, such stay is terminated with respect to the party in interest making such request, unless the debtor or any individual that is liable on such debt with the debtor files and serves upon such party in interest a written objection to the taking of the proposed action.

Bankruptcy Rule Reference: 4001, 7062

§ 1202. Trustee

(a) If the United States trustee has appointed an individual under section 586(b) of title 28 to serve as standing trustee in cases under this chapter and if such individual qualifies as a trustee under section 322 of this title, then such individual shall serve as trustee in any case filed under this chapter. Otherwise, the United States trustee shall appoint one disinterested person to serve as trustee in the case or the United States trustee may serve as trustee in the case if necessary.

(b) The trustee shall—

(1) perform the duties specified in sections 704(a)(2), 704(a)(3), 704(a)(5), 704(a)(6), 704(a)(7), and 704(a)(9) of this title;

(2) perform the duties specified in section 1106(a)(3) and 1106(a)(4) of this title if the court, for cause and on request of a party in interest, the trustee, or the United States trustee, so orders;

(3) appear and be heard at any hearing that concerns—

(A) the value of property subject to a lien;

(B) confirmation of a plan;

(C) modification of the plan after confirmation; or

(D) the sale of property of the estate;

(4) ensure that the debtor commences making timely payments required by a confirmed plan;

(5) if the debtor ceases to be a debtor in possession, perform the duties specified in sections 704(a)(8), 1106(a)(1), 1106(a)(2), 1106(a)(6), 1106(a)(7), and 1203; and

(6) if with respect to the debtor there is a claim for a domestic support obligation, provide the applicable notice specified in subsection (c).

(c)(1) In a case described in subsection (b)(6) to which subsection (b)(6) applies, the trustee shall—

(A)(i) provide written notice to the holder of the claim described in subsection (b)(6) of such claim and of the right of such holder to use the services of the State child support enforcement agency established under sections 464 and 466 of the Social Security Act [*42 USC §§ 664* and *666*] for the State in which such holder resides, for assistance in collecting child support during and after the case under this title; and

(ii) include in the notice provided under clause (i) the address and telephone number of such State child support enforcement agency;

(B)(i) provide written notice to such State child support enforcement agency of such claim; and

(ii) include in the notice provided under clause (i) the name, address, and telephone number of such holder; and

(C) at such time as the debtor is granted a discharge under section 1228, provide written notice to such holder and to such State child support enforcement agency of—

(i) the granting of the discharge;

(ii) the last recent known address of the debtor;

(iii) the last recent known name and address of the debtor's employer; and

(iv) the name of each creditor that holds a claim that—

(I) is not discharged under paragraph (2), (4), or (14A) of section 523(a); or

(II) was reaffirmed by the debtor under section 524(c).

(2)(A) The holder of a claim described in subsection (b)(6) or the State child support enforcement agency of the State in which such holder resides may request from a creditor described in paragraph (1)(C)(iv) the last known address of the debtor.

(B) Notwithstanding any other provision of law, a creditor that makes a disclosure of a last known address of a debtor in connection with a request made under subparagraph (A) shall not be liable by reason of making that disclosure.

Bankruptcy Rule Reference: 2015

§ 1203. Rights and powers of debtor

Subject to such limitations as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330, and powers, and shall perform all the functions and duties, except the duties specified in paragraphs (3) and (4) of section 1106(a), of a trustee serving in a case under chapter 11, including operating the debtor's farm or commercial fishing operation.

Bankruptcy Rule Reference: 2015

§ 1204. Removal of debtor as debtor in possession

(a) On request of a party in interest, and after notice and a hearing, the court shall order that the debtor shall not be a debtor in possession for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor, either before or after the commencement of the case.

(b) On request of a party in interest, and after notice and a hearing, the court may reinstate the debtor in possession.

§ 1205. Adequate protection

(a) Section 361 does not apply in a case under this chapter.

(b) In a case under this chapter, when adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;

(3) paying to such entity for the use of farmland the reasonable rent customary in the community where the property is located, based upon the rental value, net income, and earning capacity of the property; or

(4) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will adequately protect the value of property securing a claim or of such entity's ownership interest in property.

§ 1206. Sales free of interests

After notice and a hearing, in addition to the authorization contained in section 363(f), the trustee in a case under this chapter may sell property under section

363(b) and (c) free and clea any interest in such property of an entity other than the estate if the property is fa land, farm equipment, or property used to carry out a commercial fishing operat (including a commercial fishing vessel), except that the proceeds of such sale sh be subject to such interest.

Bankruptcy Rule Reference: 2002,4, 7001, 8005

§ 1207. Property of the ate

(a) Property of the estate in des, in addition to the property specified in section 541 of this title—

(1) all property of the ki specified in such section that the debtor acquires after the commencement o e case but before the case is closed, dismissed, or converted to a case under ch ter 7 of this title, whichever occurs first; and

(2) earnings from servi performed by the debtor after the commencement of the case but before the c is closed, dismissed, or converted to a case under chapter 7 of this title, which r occurs first.

(b) Except as provided in se n 1204, a confirmed plan, or an order confirming a plan, the debtor shall remain possession of all property of the estate.

§ 1208. Conversion or d issal

(a) The debtor may convert a e under this chapter to a case under chapter 7 of this title at any time. Any waiver of th ight to convert under this subsection is unenforceable.

(b) On request of the debtor any time, if the case has not been converted under section 706 or 1112 of this title e court shall dismiss a case under this chapter. Any waiver of the right to dismiss der this subsection is unenforceable.

(c) On request of a party in i rest, and after notice and a hearing, the court may dismiss a case under this chap for cause, including—

(1) unreasonable delay, o ross mismanagement, by the debtor that is prejudicial to creditors;

(2) nonpayment of any fe and charges required under chapter 123 of title 28;

(3) failure to file a plan ti y under section 1221 of this title;

(4) failure to commence n ing timely payments required by a confirmed plan;

(5) denial of confirmation a plan under section 1225 of this title and denial of a request made for additional t e for filing another plan or a modification of a plan;

(6) material default by th ebtor with respect to a term of a confirmed plan;

(7) revocation of the orde confirmation under section 1230 of this title, and denial of confirmation of a m fied plan under section 1229 of this title;

(8) termination of a confi ed plan by reason of the occurrence of a condition specified in the plan;

(9) continuing loss to or d inution of the estate and absence of a reasonable likelihood of rehabilitation; an

(10) failure of the debtor pay any domestic support obligation that first becomes payable after the date o e filing of the petition.

(d) On request of a party in in est, and after notice and a hearing, the court may dismiss a case under this chapte r convert a case under this chapter to a case under chapter 7 of this title upon a sh ing that the debtor has committed fraud in connection with the case.

(e) Notwithstanding any othe rovision of this section, a case may not be converted to a case under another c pter of this title unless the debtor may be a debtor under such chapter.

Bankruptcy Rule Reference: 1017

SUBCHAPTER II—THE PLAN

§ 1221. Filing of plan

The debtor shall file a plan not later than 90 days after the order for relief under this chapter, except that the court may extend such period if the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable.

Bankruptcy Rule Reference: 3015

§ 1222. Contents of plan

(a) The plan shall—

(1) provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;

(2) provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507, unless—

(A) the claim is a claim owed to a governmental unit that arises as a result of the sale, transfer, exchange, or other disposition of any farm asset used in the debtor's farming operation, in which case the claim shall be treated as an unsecured claim that is not entitled to priority under section 507, but the debt shall be treated in such manner only if the debtor receives a discharge; or

(B) the holder of a particular claim agrees to a different treatment of that claim;

(3) if the plan classifies claims and interests, provide the same treatment for each claim or interest within a particular class unless the holder of a particular claim or interest agrees to less favorable treatment; and

(4) notwithstanding any other provision of this section, a plan may provide for less than full payment of all amounts owed for a claim entitled to priority under section 507(a)(1)(B) only if the plan provides that all of the debtor's projected disposable income for a 5-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

(b) Subject to subsections (a) and (c) of this section, the plan may—

(1) designate a class or classes of unsecured claims, as provided in section 1122 of this title, but may not discriminate unfairly against any class so designated; however, such plan may treat claims for a consumer debt of the debtor if an individual is liable on such consumer debt with the debtor differently than other unsecured claims;

(2) modify the rights of holders of secured claims, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(3) provide for the curing or waiving of any default;

(4) provide for payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured claim;

(5) provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

(6) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

(7) provide for the payment of all or part of a claim against the debtor from property of the estate or property of the debtor;

(8) pre for the sale of all or any part of the property of the estate or the distributioi all or any part of the property of the estate among those having an interest in property;

(9) pre for payment of allowed secured claims consistent with section 1225(a)(5) his title, over a period exceeding the period permitted under section 1222(c);

(10) ple for the vesting of property of the estate, on confirmation of the plan or at ar time, in the debtor or in any other entity;

(11) pre for the payment of interest accruing after the date of the filing of the petition unsecured claims that are nondischargeable under section 1228(a), except that h interest may be paid only to the extent that the debtor has disposable incomailable to pay such interest after making provision for full payment of all allowqaims; and

(12) ince any other appropriate provision not inconsistent with this title.

(c) Except rovided in subsections (b)(5) and (b)(9), the plan may not provide for paymenter a period that is longer than three years unless the court for cause approves a ler period, but the court may not approve a period that is longer than five years.

(d) Notwitlnding subsection (b)(2) of this section and sections 506(b) and 1225(a)(5) ofs title, if it is proposed in a plan to cure a default, the amount necessary to cuhe default, shall be determined in accordance with the underlying agreement ahpplicable nonbankruptcy law.

Bankruptcy Rueference: 3013

§ 1223. Moication of plan before confirmation

(a) The deb may modify the plan at any time before confirmation, but may not modify the plso that the plan as modified fails to meet the requirements of section 1222 of this t.

(b) After thebtor files a modification under this section, the plan as modified becomes then.

(c) Any holof a secured claim that has accepted or rejected the plan is deemed to have acced or rejected, as the case may be, the plan as modified, unless the modification vides for a change in the rights of such holder from what such rights were under t plan before modification, and such holder changes such holder's previous accence or rejection.

Bankruptcy Rulference: 2002, 3019

§ 1224. Conmation hearing

After expedit notice, the court shall hold a hearing on confirmation of the plan. A party in intere the trustee, or the United States trustee may object to the confirmation of the pl Except for cause, the hearing shall be concluded not later than 45 days after theing of the plan.

Bankruptcy Rulference: 2002, 3018

§ 1225. Conmation of plan

(a) Except arovided in subsection (b), the court shall confirm a plan if—

(1) the pl complies with the provisions of this chapter and with the other applicable provons of this title;

(2) any fe charge, or amount required under chapter 123 of title 28, or by the plan, to be pe before confirmation, has been paid;

(3) the pl has been proposed in good faith and not by any means forbidden by law;

(4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed by the trustee or the debtor under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder;

(6) the debtor will be able to make all payments under the plan and to comply with the plan; and

(7) the debtor has paid all amounts that are required to be paid under a domestic support obligation and that first become payable after the date of the filing of the petition if the debtor is required by a judicial or administrative order, or by statute, to pay such domestic support obligation.

(b)(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim;

(B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period, or such longer period as the court may approve under section 1222(c), beginning on the date that the first payment is due under the plan will be applied to make payments under the plan; or

(C) the value of the property to be distributed under the plan in the 3-year period, or such longer period as the court may approve under section 1222(c), beginning on the date that the first distribution is due under the plan is not less than the debtor's projected disposable income for such period.

(2) For purposes of this subsection, "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended—

(A) for the maintenance or support of the debtor or a dependent of the debtor or for a domestic support obligation that first becomes payable after the date of the filing of the petition; or

(B) for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business.

(c) After confirmation of a plan, the court may order any entity from whom the debtor receives income to pay all or any part of such income to the trustee.

Bankruptcy Rule Reference: 3020

§ 1226. Payments

(a) Payments and funds received by the trustee shall be retained by the trustee until confirmation or denial of confirmation of a plan. If a plan is confirmed, the trustee shall distribute any such payment in accordance with the plan. If a plan is not confirmed, the trustee shall return any such payments to the debtor, after deducting—

(1) any unpaid claim allowed under section 503(b) of this title; and

(2) if a standing trustee is serving in the case, the percentage fee fixed for such standing trustee.

(b) Before or at the time of each payment to creditors under the plan, there shall be paid—

(1) any unpaid claim of the kind specified in section 507(a)(2) of this title; and

(2) if a standing trustee appointed under section 1202(c) of this title is serving in the case, the percentage fee fixed for such standing trustee under section 1202(d) of this title.

(c) Except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan.

Bankruptcy Rule Reference: 3010, 3021

§ 1227. Effect of confirmation

(a) Except as provided in section 1228(a) of this title, the provisions of a confirmed plan bind the debtor, each creditor, each equity security holder, and each general partner in the debtor, whether or not the claim of such creditor, such equity security holder, or such general partner in the debtor is provided for by the plan, and whether or not such creditor, such equity security holder, or such general partner in the debtor has objected to, has accepted, or has rejected the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as provided in section 1228(a) of this title and except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

§ 1228. Discharge

(a) Subject to subsection (d), as soon as practicable after completion by the debtor of all payments under the plan, and in the case of a debtor who is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, after such debtor certifies that all amounts payable under such order or such statute that are due on or before the date of the certification (including amounts due before the petition was filed, but only to the extent provided for by the plan) have been paid, other than payments to holders of allowed claims provided for under section 1222(b)(5) or 1222(b)(9) of this title, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan allowed under section 503 of this title or disallowed under section 502 of this title, except any debt—

(1) provided for under section 1222(b)(5) or 1222(b)(9) of this title; or

(2) of the kind specified in section 523(a) of this title.

(b) Subject to subsection (d), at any time after the confirmation of the plan and after notice and a hearing, the court may grant a discharge to a debtor that has not completed payments under the plan only if—

(1) the debtor's failure to complete such payments is due to circumstances for which the debtor should not justly be held accountable;

(2) the value, as of the effective date of the plan, of property actually distributed under the plan on account of each allowed unsecured claim is not less than the amount that would have been paid on such claim if the estate of the debtor had been liquidated under chapter 7 of this title on such date; and

(3) modification of the plan under section 1229 of this title is not practicable.

(c) A discharge granted under subsection (b) of this section discharges the debtor from all unsecured debts provided for by the plan or disallowed under section 502 of this title, except any debt—

(1) provided for under section 1222(b)(5) or 1222(b)(9) of this title; or

(2) of a kind specified in section 523(a) of this title.

(d) On request of a party in interest before one year after a discharge under this section is granted, and after notice and a hearing, the court may revoke such discharge only if—

(1) such discharge was obtained by the debtor through fraud; and

(2) the requesting party did not know of such fraud until after such discharge was granted.

(e) After the debtor is granted a discharge, the court shall terminate the services of any trustee serving in the case.

(f) The court may not grant a discharge under this chapter unless the court after notice and a hearing held not more than 10 days before the date of the entry of the order granting the discharge finds that there is no reasonable cause to believe that—

(1) section 522(q)(1) may be applicable to the debtor; and

(2) there is pending any proceeding in which the debtor may be found guilty of a felony of the kind described in section 522(q)(1)(A) or liable for a debt of the kind described in section 522(q)(1)(B).

Bankruptcy Rule Reference: 4007, 7001

§ 1229. Modification of plan after confirmation

(a) At any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified, on request of the debtor, the trustee, or the holder of an allowed unsecured claim, to—

(1) increase or reduce the amount of payments on claims of a particular class provided for by the plan;

(2) extend or reduce the time for such payments; or

(3) alter the amount of the distribution to a creditor whose claim is provided for by the plan to the extent necessary to take account of any payment of such claim other than under the plan.

(b)(1) Sections 1222(a), 1222(b), and 1223(c) of this title and the requirements of section 1225(a) of this title apply to any modification under subsection (a) of this section.

(2) The plan as modified becomes the plan unless, after notice and a hearing, such modification is disapproved.

(c) A plan modified under this section may not provide for payments over a period that expires after three years after the time that the first payment under the original confirmed plan was due, unless the court, for cause, approves a longer period, but the court may not approve a period that expires after five years after such time.

(d) A plan may not be modified under this section—

(1) to increase the amount of any payment due before the plan as modified becomes the plan;

(2) by anyone except the debtor, based on an increase in the debtor's disposable income, to increase the amount of payments to unsecured creditors required for a particular month so that the aggregate of such payments exceeds the debtor's disposable income for such month; or

(3) in the last year of the plan by anyone except the debtor, to require payments that would leave the debtor with insufficient funds to carry on the farming operation after the plan is completed.

Bankruptcy Rule Reference: 2002

§ 1230. Revocation of an order of confirmation

(a) On request of a party in interest at any time within 180 days after the date of the entry of an order of confirmation under section 1225 of this title, and after notice and a hearing, the court may revoke such order if such order was procured by fraud.

(b) If the court revokes an order of confirmation under subsection (a) of this section, the court shall dispose of the case under section 1207 of this title, unless, within the time fixed by the court, the debtor proposes and the court confirms a modification of the plan under section 1229 of this title.

Bankruptcy Rule Reference: 7001

§ 1231. Special tax provisions

(a) The issuance, transfer, or exchange of a security, or the making or delivery of an instrument of transfer under a plan confirmed under section 1225 of this title, may not be taxed under any law imposing a stamp tax or similar tax.

(b) The court may authorize the proponent of a plan to request a determination, limited to questions of law, by any governmental unit charged with responsibility for collection or determination of a tax on or measured by income, of the tax effects, under section 346 of this title and under the law imposing such tax, of the plan. In the event of an actual controversy, the court may declare such effects after the earlier of—

(1) the date on which such governmental unit responds to the request under this subsection; or

(2) 270 days after such request.

CHAPTER 13—ADJUSTMENT OF DEBTS OF AN INDIVIDUAL WITH REGULAR INCOME

SUBCHAPTER I—OFFICERS, ADMINISTRATION, AND THE ESTATE

§ 1301. Stay of action against codebtor

(a) Except as provided in subsections (b) and (c) of this section, after the order for relief under this chapter, a creditor may not act, or commence or continue any civil action, to collect all or any part of a consumer debt of the debtor from any individual that is liable on such debt with the debtor, or that secured such debt, unless—

(1) such individual became liable on or secured such debt in the ordinary course of such individual's business; or

(2) the case is closed, dismissed, or converted to a case under chapter 7 or 11 of this title.

(b) A creditor may present a negotiable instrument, and may give notice of dishonor of such an instrument.

(c) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided by subsection (a) of this section with respect to a creditor, to the extent that—

(1) as between the debtor and the individual protected under subsection (a) of this section, such individual received the consideration for the claim held by such creditor;

(2) the plan filed by the debtor proposes not to pay such claim; or

(3) such creditor's interest would be irreparably harmed by continuation of such stay.

(d) Twenty days after the filing of a request under subsection (c)(2) of this section for relief from the stay provided by subsection (a) of this section, such stay is termi-

nated with respect to the party in interest making such request, unless the debtor or any individual that is liable on such debt with the debtor files and serves upon such party in interest a written objection to the taking of the proposed action.

Bankruptcy Rule Reference: 4001, 7062

§ 1302. Trustee

(a) If the United States trustee appoints an individual under section 586(b) of title 28 to serve as standing trustee in cases under this chapter and if such individual qualifies under section 322 of this title, then such individual shall serve as trustee in the case. Otherwise, the United States trustee shall appoint one disinterested person to serve as trustee in the case or the United States trustee may serve as a trustee in the case.

(b) The trustee shall—

(1) perform the duties specified in sections 704(a)(2), 704(a)(3), 704(a)(4), 704(a)(5), 704(a)(6), 704(a)(7), and 704(a)(9) of this title;

(2) appear and be heard at any hearing that concerns—

(A) the value of property subject to a lien;

(B) confirmation of a plan; or

(C) modification of the plan after confirmation;

(3) dispose of, under regulations issued by the Director of the Administrative Office of the United States Courts, moneys received or to be received in a case under chapter XIII of the Bankruptcy Act;

(4) advise, other than on legal matters, and assist the debtor in performance under the plan;

(5) ensure that the debtor commences making timely payments under section 1326 of this title; and

(6) if with respect to the debtor there is a claim for a domestic support obligation, provide the applicable notice specified in subsection (d).

(c) If the debtor is engaged in business, then in addition to the duties specified in subsection (b) of this section, the trustee shall perform the duties specified in sections 1106(a)(3) and 1106(a)(4) of this title.

(d)(1) In a case described in subsection (b)(6) to which subsection (b)(6) applies, the trustee shall—

(A)(i) provide written notice to the holder of the claim described in subsection (b)(6) of such claim and of the right of such holder to use the services of the State child support enforcement agency established under sections 464 and 466 of the Social Security Act [*42 USC § 664* and *666*] for the State in which such holder resides, for assistance in collecting child support during and after the case under this title; and

(ii) include in the notice provided under clause (i) the address and telephone number of such State child support enforcement agency;

(B)(i) provide written notice to such State child support enforcement agency of such claim; and

(ii) include in the notice provided under clause (i) the name, address, and telephone number of such holder; and

(C) at such time as the debtor is granted a discharge under section 1328, provide written notice to such holder and to such State child support enforcement agency of—

(i) the granting of the discharge;

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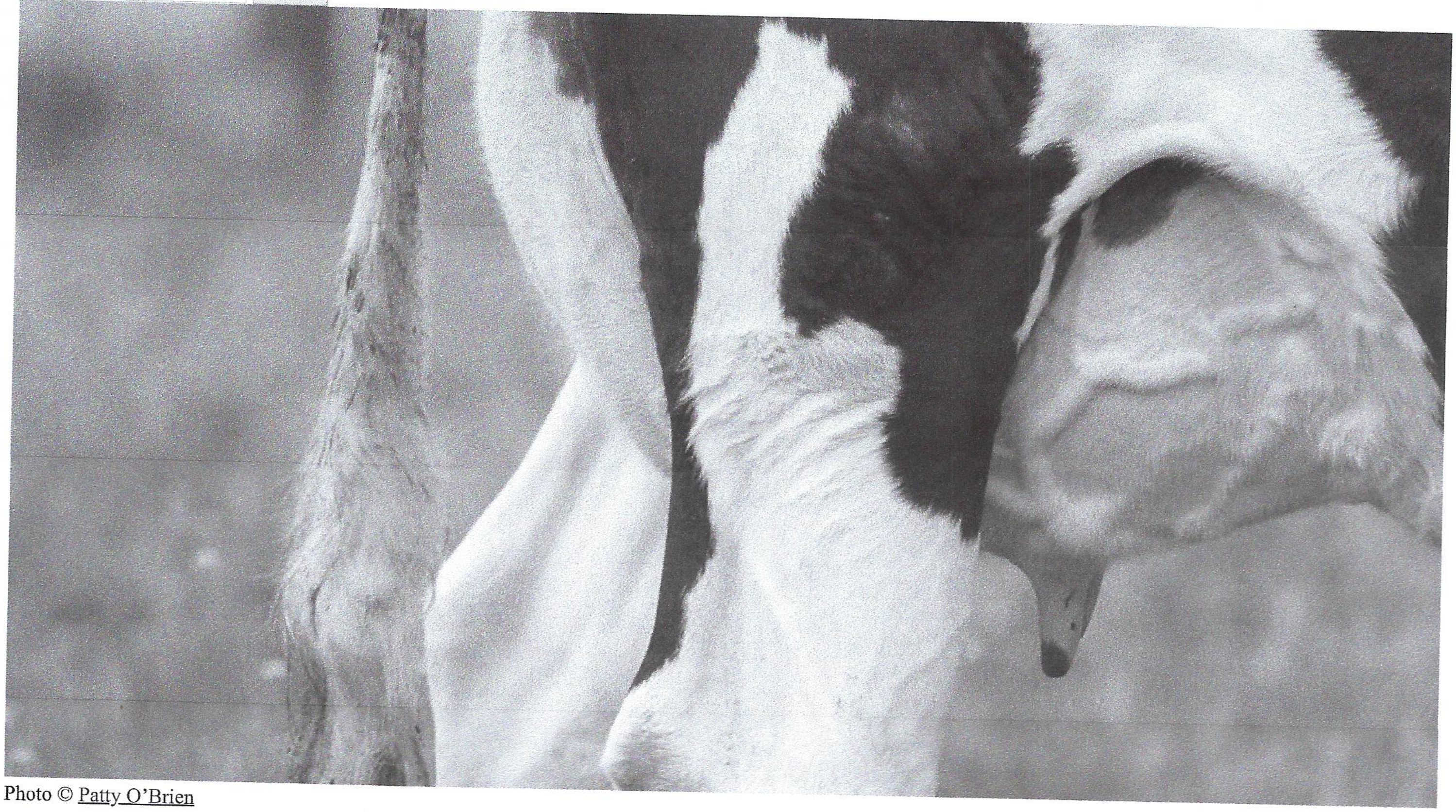


Photo © Patty O'Brien

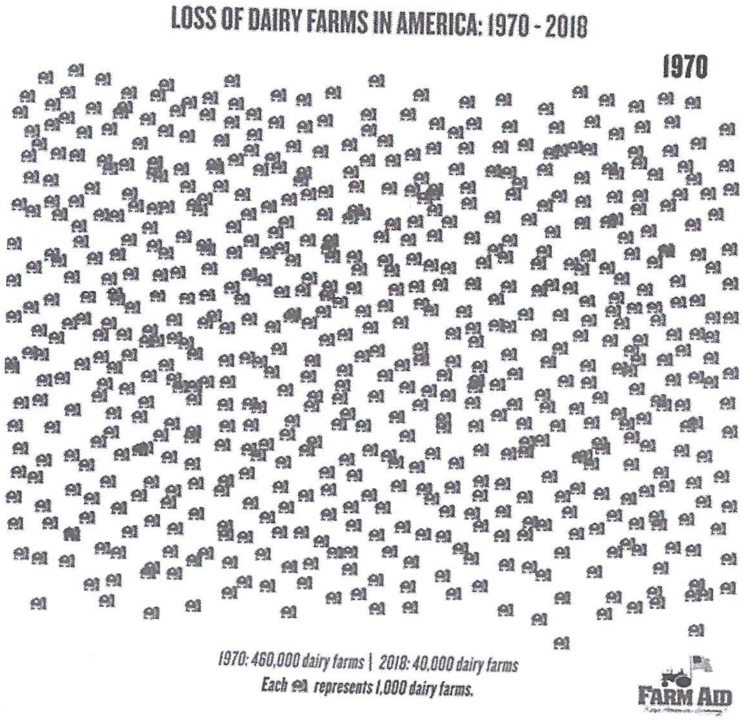
Blog | August 16, 2018

Dairy: Family Farmers in Crisis

Our food belongs in the hands of many

A handful of corporations control our food system from farm to fork. Unchecked corporate power leaves eaters with fewer options to support good food from family farmers and pushes independent family farms out of business. ***Learn more about corporate control here.***

Since 1970, the number of American dairy farms has dropped by more than 93 percent, from more than 640,000 to around 40,000 today.[1] In an industry dominated by corporate interests, family farms are constantly at risk of going under. A consistent, severe slump in milk prices in recent years has pushed many dairy farm businesses beyond the point of survival. In the last year, there's been a 3 percent drop in the number of dairy farms, with the future of those remaining increasingly uncertain. Each day on our farmer hotline, we hear from dairy farmers whose farms are on the brink of foreclosure.



A Sour Pricing System

The dramatic loss of family dairy farms is the result of an unfair pricing system, which is heavily manipulated by major dairy corporations at the expense of farmers and eaters. For example, between 1998 and 2007, dairy farmers saw their share of the retail milk price *drop* by 25 percent, while retail prices *increased* by 40 percent. While farmers were paid less, and consumers paid more, corporate processors recorded windfall profits. Today, dairy farmers are paid far below their cost of production—leaving them with a financial loss each time they milk their cows. As of July 2018, dairy farmers received just $1.39 for a gallon of skim milk that retails for $4.49.[2]

This has been a trend, rather than the exception, over the last decade. In 2009, the milk market tanked, with prices plummeting and droves of family dairy farms closing their doors. While milk prices recovered somewhat in 2010 and 2011, it was not enough to help farmers recover from the previous year's losses. Prices dipped again in 2012 just as persistent drought—the worst seen in the U.S. since the 1950s—and skyrocketing feed costs plagued dairy farmers. In the worst months of 2012, dairy farmers were losing up to $8.65 per hundredweight of milk they produced, translating to losses of tens or hundreds of thousands of dollars in a given month and draining rural economies. While milk prices peaked in 2014, today they have dropped to the lowest levels seen since 2009, hovering around $15 per hundredweight, far below the average cost of production of $22. Experts estimate a 19 percent drop in net cash farm income for dairy farmers in 2018.

Milk: Cost of Production vs. Price Paid to Farmers

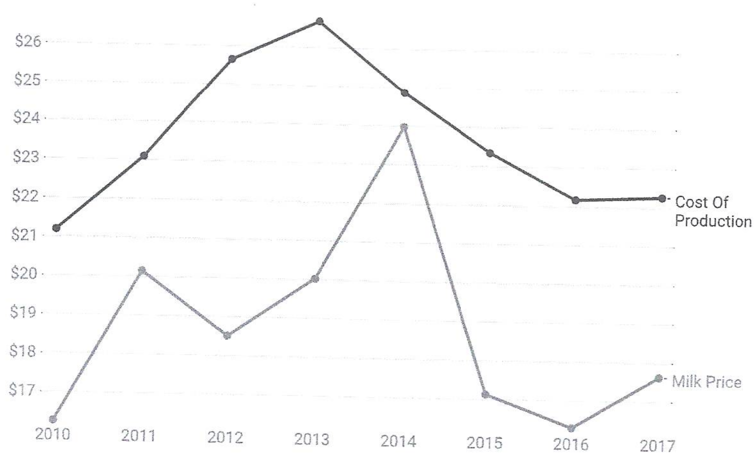


Chart: Farm Aid • Source: USDA • Get the data • Created with Datawrapper

Rise of Factory Farms and Growing Corporate Power

In recent years, the number of extremely large dairy farms has been on the rise, fueled by lax regulatory policies in several states and a flow of federal farm subsidies. The resulting overproduction of milk has slashed prices (now in their fourth consecutive year of falling below the cost of production) and flushed out small- and mid-sized dairies across the country.

Meanwhile, other players in the industry are taking over segments of the supply chain, vertically integrating in the same troublesome manner that we have see in the contract poultry industry. In March 2018, mega-retailer Wal-Mart unveiled the construction of its own dairy plant in Indiana, supplied by just 30 farms. This move is widely believed to have influenced Dean Foods' decision to abruptly sever contracts with more than 100 dairy farms in eight states.[3]

How does the dairy crisis affect rural America?

As dairy farmers are forced into bankruptcy, a ripple effect on the local services that farmers use – such as banks, equipment dealers, seed and feed suppliers – further taxes rural economies. In regions like New England and the Upper Midwest, where multigenerational dairy farms have shaped the landscape and undergirded the regional economy, the shuttering of barn doors is sparking severe social and mental health crises and straining rural communities. For eaters, the loss of local dairies limits access to fresh, local milk products and often means a permanent loss of precious farmland to development. With fewer family farmers, the fate of our dairy products is left in the hands of factory farms and giant milk processors who have repeatedly cut corners with additives and processes that compromise the health and safety of milk.[4]

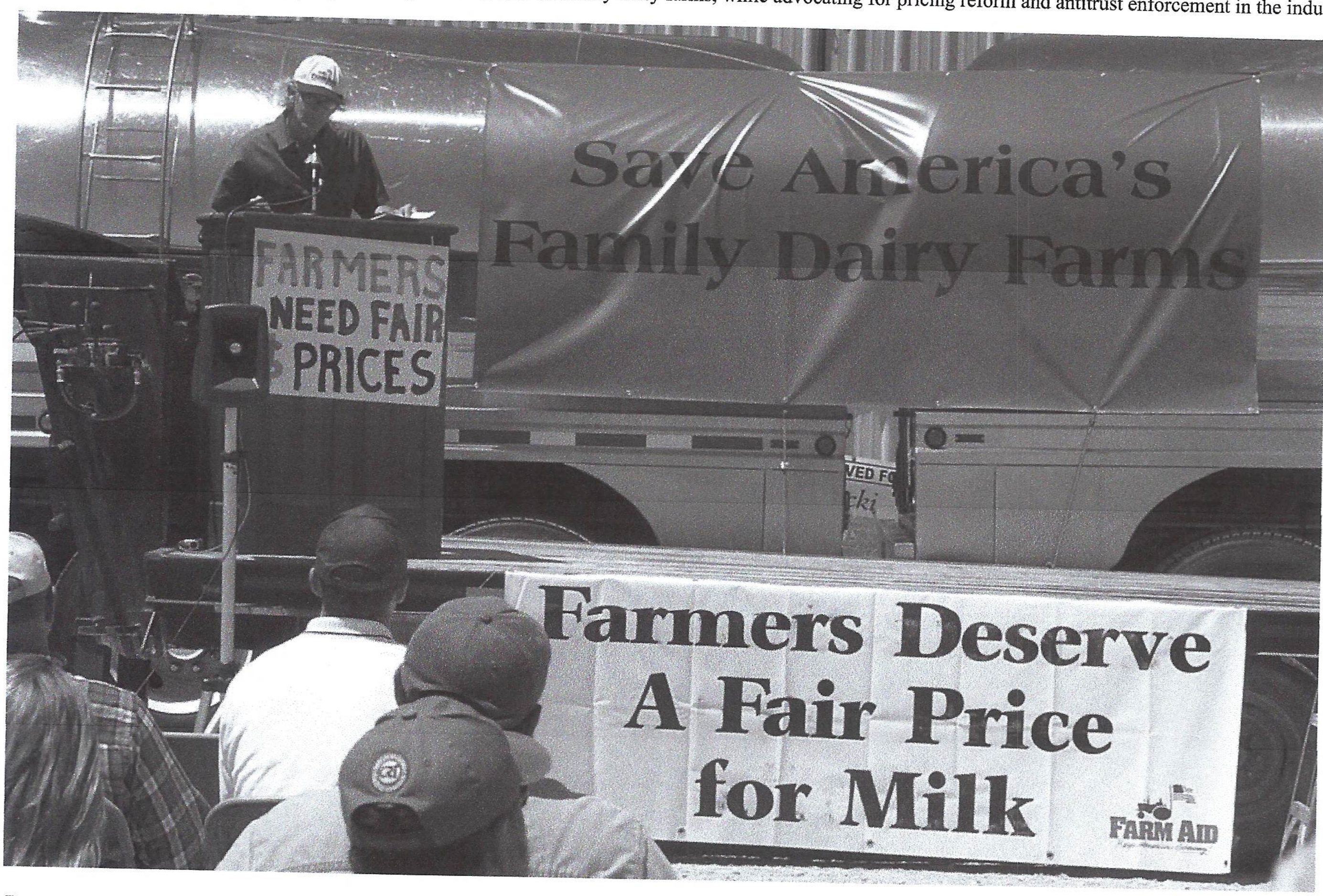
What can be done?

Until our milk pricing system pays farmers' a fair price *above* their cost of production, dairy farmers remain at risk. So far in 2018, milk prices are 30 percent below the average cost of production. The U.S. Secretary of Agriculture has the authority to adjust milk prices when economic conditions severely affect farmers' financial viability. In addition, Congress could make important changes to foster a fair marketplace for farmers, such as floor prices or supply management programs. Many dairy farmers are calling for this today, so we can finally and officially fix the milk pricing system.

In addition, eaters can seek out local dairy products at grocery stores, farmers' markets and farm stands to support dairy farmers close to home. Buying as directly as possible from local farmers helps them capture as much of the food dollar as possible, and in turns boosts the local economy.

What is Farm Aid doing to address the crisis?

Through our hotline, Farm Aid provides counsel and distributes emergency funds to dairy farm families in crisis. Over the last decade, we've stood side-by-side with farmers and partner organizations to call attention to the dairy crisis, as dairy farmers have organized rallies nationwide. In addition, Farm Aid has helped fund trips for dairy farmers to Capitol Hill to highlight the impact of the loss of family dairy farms, while advocating for pricing reform and antitrust enforcement in the industry.



Farm Aid at a 2009 dairy rally. Photo © Fritz Nordengren

Farm Aid met with U.S. Secretary of Agriculture Tom Vilsack in 2009, delivering petitions signed by more than 13,000 farmers and eaters calling on the USDA to establish a fair floor price for milk. In 2010, when the USDA and Department of Justice launched a series of public workshops to examine antitrust conditions in agriculture, Farm Aid attended each one, including one specific to dairy, and helped support farmers to be there in person to be sure the voices of family farmers were heard loud and clear. In March 2018, Farm Aid advocated for a return to supply management in an op-ed published in *The Hill*, using the Canadian milk management system as an model. In April 2018, Farm Aid joined 53 organizations in calling on Congress and the Trump Administration to implement an emergency floor price for milk and institute a series of measures to respond to the dairy crisis.

Sources

1. USDA NASS. Milk Production (February 2018) https://release.nass.usda.gov/reports/mkpr0218.pdf.

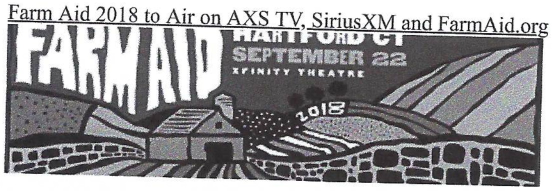
2. National Farmers Union. The Farmer's Share.

3. Walmart Opens Indiana Milk Plant. June 13, 2018. Farm Journal's MILK Business.

4. Food & Water Watch. Milk Protein Concentrates; *International Business Times* (2013). "Aspartame in Milk: Big Dairy Wants to Sneak in Sweeteners Without Labels."

Next

Farm Aid 2018 to Air on AXS TV, SiriusXM and FarmAid.org



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Agricultural Land Preservation: Conservation Easements and other Property Law Tools

Jerry Cosgrove, Esq.

Drafting Conservation Easements for Agriculture

Jerry Cosgrove

Attorney and Co-author of

Your Land is Your Legacy, A Guide to Planning the Future of Your Farm

Legal Framework

- Environmental Conservation Law Article 49, Title 3
- General Municipal Law 247
- Internal Revenue Code 170(h)

Basic Structure and Function

- Negative covenant
- Usually no requirement for agricultural use
- Flexibility for agricultural use
- No public access required
- Development "rights" not transferable

Key Drafting Issues

- Purpose Clause
- Agricultural Structures
- Farmworker Housing
- Other Rural Enterprises
- Farming Operations
- Renewable Energy
- Affordability
- Affirmative Farming Covenant

Drafting Issues Cont.

- Residential Building
- Subdivision
- Mining
- Extinguishment/Termination
- Resource Protection Areas

IRC Requirements

- Perpetual duration
- "Qualified" organization
- Exclusively for Conservation Purposes:
  – Recreation/Education
  – Natural Habitat
  – Open Space(including farmland)
  – Historical Importance

IRS “Two Prong” Test for Open Space

- Must further a clearly delineated government conservation policy *and* yield a significant public benefit
- *Or* provide scenic enjoyment for the general public *and* yield a significant public benefit

Purchase of Development Rights

- Benefits – can strengthen farm business and help transfer the farm operation
- Disadvantage – limited funding and potentially complex transaction process

Planning with PDR / CE'S

Issues –

- Land Planning
- Business Planning
- Financial Planning
- Estate/Succession Planning

Tax Implications/Opportunities with PDR

- Capital Gain
- Allocation of Basis
- 1031 Like-kind exchange
- Bargain sales

Donation of Conservation Easements

- Tax benefits – Income (170(h), Gift (2522(d), Estate (2055(f), 2031(c))
- Valuation – “before and after” appraisal
- “Qualified” Appraisal required (form 8283)

Funding Sources

- New York State – EPF
- Federal – ACEP / ALE
- Private matching funds –
  - Nonprofits
  - Neighboring landowners
  - Bargain sale

Tax Implications and Opportunities with Purchase of Development Rights (PDR)

Jerry Cosgrove
Of Counsel, Scolaro, Fetter, Grizanti & McGough
Co-author of Your Land is Your Legacy,
A Guide to Planning the Future of Your Farm

Description

The purchase of development rights (PDR) programs provide funding for the purchase of conservation easements on farms that protect farmland and environmental resources. These programs protect agricultural land from non-farm development by acquiring agricultural conservation easements on productive agricultural soils and forestry easements on working forestlands. These programs free up capital for producers to reinvest in their operations, acquire additional land, invest for retirement or reduce debt. By removing the development value of the land, PDR helps keep farmland affordable for intergenerational transfer and for beginning farmers.

Issues and Options

Agricultural conservation easements are substantial conveyances of real estate interests and should be undertaken with careful thought and planning. Four main planning issues to consider include:

- Land planning – how does the easement-restricted land relate to the agricultural operation or any other agricultural land that is owned or operated?
- Business planning – will the easement provide the flexibility needed to adapt to changing business conditions?
- Financial planning –will the sale or other conveyance of an easement affect taxes and other finances?
- Estate planning – is the easement transaction integrated with other estate planning and transfer efforts?

Participants may receive an initial down payment of a portion of the appraised value of the easement and the remaining balance at the closing in exchange for removing the non-agricultural development potential of their property.

An easement is considered a capital asset and so when it is sold, it is treated as capital gain to the extent that the proceeds exceed the basis in the property. IRS Revenue Ruling 77-414 allows a taxpayer to apply the proceeds from the sale of a conservation easement first directly to reduce the taxpayer's basis in the property (rather than apportioning it between the easement and the property subject to the easement) under circumstances when it would be impractical or impossible to apportion basis in such sales. For example, if agricultural Landowner A sells an easement on Greenacre for $1,000 and his basis in the property is $100, he would owe federal and state capital gains tax on $900 in gain. Federal capital gains tax is currently up to 20% for assets held for at least one year. Many states impose capital gains taxes as well.

Because an easement is considered an interest in property in most states (including New York), the landowner may utilize a 1031 like-kind exchange to trade the value of the easement for additional land. Several IRS private letter rulings confirm that the taxpayer will not have to recognize gain on the sale of the easement and will need to allocate basis between the retained acreage (now subject to the conservation easement) and the carryover basis of the easement now allocated to the newly acquired property. (PLR 9621012, 9851039, 9232030, 9215049.)

Benefits

- Considering the sale of an easement can serve as a catalyst for landowners to develop an estate plan;
- Selling an agricultural conservation easement can generate cash for retirement or life insurance, or provide liquid assets that can be given to heirs – even those who do not wish to farm.
- Selling an agricultural conservation easement can help facilitate intergenerational farm transfer by reducing future market value to agricultural or restricted land value.

Drawbacks

- Selling an easement is considered the sale of a capital asset and is treated as capital gain to the extent that the proceeds exceed the basis in the property.
- While cost-share payments are excluded from income under Section 126 of the Internal Revenue Code, this provision does not apply to easement payments as set forth in a tax court decision.[1]

[1] (C. Graves, 88 Tax Court Decision # 43617)

Drafting Conservation Easements for Agriculture

Judy Anderson and Jerry Cosgrove

October 2018

Introduction

Over the past 50 years, agriculture and the rural landscape have changed dramatically. Numerous farms and ranches have gone out of business while others have expanded, consolidated, diversified or changed enterprises entirely in order to survive. At the same time that agriculture was undergoing this rapid change, we have witnessed a new threat to agriculture ─ unchecked suburban and other non farm development in and around our urban centers. According to the findings of *Farms Under Threat: The State of America's* Farmland by American Farmland Trust (AFT), between 1992 and 2012, almost 30 million acres of agricultural land were irreversibly lost to development, much of it the prime and unique soils best suited to agricultural production.

In response, many states and local governments, primarily in the northeast and west coast, have developed farmland protection programs utilizing deed restrictions much like conservation easements. In fact, the concept of purchase of development rights (PDR) was pioneered in Suffolk County on Long Island in the mid-1970's and pre-dated most conservation easement statutes around the country including New York State. Several Northeastern states soon followed and a growing number of states and local municipalities have established purchase programs. As a result, many of the agricultural easements currently used are found in state, county or township purchase of agricultural easement (PACE) or PDR programs.

In addition, a number of conservation organizations have been created that focus explicitly, and in some cases, exclusively, on farm and ranch land. These include American Farmland Trust, founded in 1980, the Marin Agricultural Land Trust in California, the Agricultural Stewardship Association in New York's Hudson Valley, the Colorado Cattlemen's Agricultural Land Trust, the Connecticut Farmland Trust, the Maine Farmland Trust, the New York Agricultural Land Trust and the Texas Agricultural Land Trust to name a few.

This article examines the fundamental premises underlying agricultural easements and will discuss key drafting issues that reflect those premises and objectives. Some of the key drafting issues include the easement purpose, construction of agricultural buildings and improvements, construction of residential and farm worker dwellings, agricultural practices, subdivision and rural enterprises, and emerging issues, such as affordability, climate change and renewable energy.

Context

The broad-based support for "working landscapes" masks some fundamental and differing perspectives involving the issue ─ differences that create tensions that surface inevitably as we draft agricultural conservation easements.

One of the most basic involves the notion of "preservation" in contrast to "conservation". There is nothing more unrealistic to farmers and ranchers than the prospect of preserving the landscape status quo "as is". Agriculture is a human activity that has altered the landscape for tens of thousands of years, and for farmers and ranchers, the more dynamic and adaptable term, "conservation", usually better fits their perception of what agricultural easements should be about.

Another basic tension is how to balance inevitable trade-off between economics and the environmental attributes of the property. For farmers and ranchers who make their living from the land, economic decisions are a critical factor because it means short-term survival and long-term viability. For others, the other environmental resources like soil, water quality or wildlife habitat will take precedence. Finding a balance that is workable and sustainable is the skill of drafting a well constructed and durable agricultural easements that will withstand the test of time.

Those involved in farm and ranchland conservation recognize that there is an inevitable need to balance flexibility to the landowner and certainty to the holder. For farmers and ranchers who have witnessed incredible change in agriculture in their lifetimes, it stretches credibility to think that we can draft an easement that will last unless it is flexible and can be adapted to future change.

Agricultural Conservation Easements

What are they?

We sometimes overlook the fact that in almost all states, conservation easements are a product of a specific state law that creates them - and provides for a special set of rules for their interpretation and enforcement.

It is important to understand that conservation easements are negative covenants generally created by state law. The latter fact is critical because it is state law, and not the Internal Revenue Code, that will govern easements interpretation and enforcement into the future. And this is a legal reminder about limitations of conservation easements generally—they impose restrictions on uses like non-farm development and subdivision and do not usually contain affirmative obligations to continue farming or ranching. However, it should be noted that some land trusts and public programs are adding affirmative obligations to their agricultural easements such as affirmative farming covenants. In general, the conservation easement statutes enacted in most states eliminate all of the common law defenses to these "easements in gross" and provide legislative sanction for the conservation purposes that they are intended to protect.[1]

What do they look like?

The majority of the first agricultural easements evolved from publicly funded PACE or PDR programs and tended to be fairly short, simple and deferential to most agricultural uses and structures. By contrast, many land trusts tended to draft more complex, detailed easements in part because the easements were donated and needed to comply with the requirements of Section 170(h) of the IRC and its accompanying regulations in order for taxpayers to receive a charitable deduction, and in part because land trusts and other conservation organizations were as concerned with other conservation attributes as with the agricultural resources. Additionally, many public programs are structured so that landowners can make use of "bargain sales" and the IRC requirements come into play in order for the sellers to utilize the tax deduction for the "bargain" component of the transaction.

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[1] See generally, Gustanski and Squires, *Protecting the Land: Conservation Easements, Past, Present and Future,* Island Press, 2000.

Over time, it appears that agricultural easements from the public and private sector are merging toward middle ground on issues like the purpose(s) of the easement, structures, dwellings, subdivision, agricultural practices and rural enterprises. Some land trusts, like the Agricultural Stewardship Association (ASA), the Columbia Land Conservancy and Scenic Hudson in the Hudson River Valley of New York have created agricultural conservation easement templates because the traditional scenic/open space easement does not allow enough long-term flexibility for agricultural enterprises and market adaptations necessary to sustain the working landscape. That said, for federal income tax deduction purposes, IRS requirements must be satisfied, but it has been noted on more than one occasion that the IRS has a three-year statute of limitations. Landowners and easement holders will be living with the easement for much longer.

Key drafting issues

Purpose

Any easement's purpose clause becomes its "touchstone" for future readers. A clear statement of purpose should provide a standard for future interpretation. Over time, through easement monitoring and discussions with the present (and future) landowners, the easement language will be revisited by both the holder and the landowner to determine whether future use continues to be consistent with its stated purpose as set forth in the purpose clause.

Not surprisingly then, agricultural easements will state clearly that working agriculture is the primary purpose. Some, including the ASA's standard easement, include agricultural viability in the purpose clause to recognize the economic link in the working lands equation.[2] Other purposes clauses focus exclusively on the conservation of productive agricultural land and leave the inherent connection to agricultural viability implicit rather than explicit.

Purpose clauses can also be written to create a hierarchy of purposes with agriculture as the primary purpose and other stated purposes, including scenic or natural features, as secondary. These easements explicitly recognize and reference other important attributes of agricultural land, but acknowledge the potential for tension and even conflict between multiple conservation purposes.

Still other easements have dual, or sometimes multiple purposes without any explicit mechanism to reconcile potential tensions or conflicts. The dual-purpose easement used in the New York City Watershed by the Watershed Agricultural Council in its easement program utilizes performance standards relating to the form, location and density of development and adherence to an approved whole farm conservation plan to address this tension. However, many other easements, drafted to comply with the Internal Revenue Code requirements in Section 170(h), will use a "shotgun" approach that lists "open space", "natural", "scenic" and "agricultural" values of the property as multiple purposes. This approach presumes that all of the above values are some how compatible and reconcilable. While in some circumstances this is certainly true, many other situations point to potential for conflict between these values as agriculture evolves in a new century. Interestingly, many of the easements with single purpose agricultural protection clauses are found in state or local purchase programs, programs that evolved unaffected by 170(h) until the growth of the land trust movement in the 1980's and 1990's.

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[2] The ASA easement purpose clause states: "The Primary Purpose of this Easement is to conserve viable agricultural land and soil resources by preventing uses of the Property that will significantly impair or interfere with the Property's agricultural and forestry viability and productive capacity.

Regardless, the purpose clause will serve as an important indicator about how commercial agriculture and the business of farming and ranching are likely to fare under future interpretation of the various easement clauses that follow in the conservation easement document.

Definition of Agriculture and Farming Practices

Agricultural easements frequently strive to define current and anticipated agricultural practices to avoid confusion about whether a current or future farming practice is permitted. From a farmer's or rancher's perspective, this issue of what is agriculture, or more importantly, who decides what is agriculture, can conjure nightmare scenarios of a "fixed" definition of agriculture into the future, or worse, a subjective or arbitrary determination by the easement holder.

As a result, agricultural easements usually attempt to define "agriculture" in broad terms that presume an evolving definition of agriculture and changes over time. Generally structured in a clause separate from the Purpose Clause, an Agricultural Definition section can vary from including a broad and non-exclusive list of permitted uses to stating a definition of agriculture as determined by state law that will be modified over time to reflect changes in agriculture. The Vermont Land Trust utilizes a consistent set of guidelines to help them make determinations about the definition of agriculture in their easement. They expect to periodically revisit the guidelines to ensure that the guidelines reflect the changes in agriculture that will inevitably occur over time.

Similarly, agricultural easements usually incorporate standards that define acceptable agricultural practices in ways that the agricultural community trusts. These standards are by their nature flexible; they are often defined within state or federal programs (such as the Natural Resources Conservation Service or local soil and water conservation districts) that are updated periodically to reflect changes in agricultural best management practices ("BMP's"). By utilizing state-defined or federal standards, the easement holder may avoid difficult discussions with farmers or ranchers about "who best knows" how to farm.

Agricultural easements may also be silent about standards for farming practices, relying on other on-going farm/conservation management programs such as NRCS's "Conservation Plans". Incorporating detailed land management requirements into agricultural easements, such as requiring organic production, also has serious ramifications for the long-term stewardship obligations of the holder and need to be considered carefully. As with other specific easement clauses, each holder will need to decide whether it has the knowledge and resources over the long term to evaluate and enforce any specific farming practices or standards. Local NRCS and soil and water conservation district offices can serve as technical advisors about conservation plans and how they might be incorporated into an agricultural easement.

Agricultural Structures

During our discussions with farmers and ranchers about agricultural easements, we have found that one of the most critical and potentially contentious issues is the amount of flexibility they will have to add or alter agricultural structures, including greenhouses and crop covers, feedlots and barnyards. Across the country, agricultural easements recognize the necessity of providing maximum flexibility for agricultural buildings (and in most jurisdictions, local governments do as well).

The most common easement language allows farmers to construct, modify or demolish any farm building necessary to the farm operation without prior permission from the easement holder. This approach, followed in most of the purchase of agricultural easement (PACE) or PDR programs, acknowledges that the farmer or rancher knows what is most important for his or her agricultural operation and needs to act accordingly. It also highlights the importance of the purpose clause and the definition of agriculture since each will affect what is actually an "as of right" structure.

However, as land trusts have become more involved in farmland protection, and as existing farmland protection programs attempt to address multiple conservation values as well as agricultural resources, other techniques are being utilized. Some farmland protection programs, and many land trusts, require some kind of prior permission for construction of agricultural structures. Others blend "as-of-right" construction within a large building envelope (where the majority of agricultural structures and housing will be located in the future) and only require advance permission for any construction outside the designated building area. In such easements, the landowner can generally build, enlarge, modify or demolish any agricultural structure within the building envelope without permission. Farm structures outside of the building envelope would be allowed if they meet performance standards set forth in the easement. (For example, the holder will grant permission if the structure does not unnecessarily impact important soil resources.)

Another approach establishes a threshold at which construction of agricultural structures of a certain size outside of the building envelope is permitted if they are necessary for the agricultural enterprise and are consistent with the purpose of the easement; prior approval is required for larger buildings under this approach. Surface coverage limits (usually as a percentage of the total easement acreage), while less common, may also be used. The Natural Resources Conservation Service (NRCS administers the federal program, now known as the Agricultural Land Easements, or ALE) has issued rules for impervious surface limits (including residential buildings, agricultural buildings and other paved areas like feedlots and barnyards) of two percent because it concluded that extensive impervious surfaces have the potential of limiting future agricultural uses and create the potential for extensive erosion.[3] For perspective, this guideline would limit impervious surfaces to a total of 5 acres on a 250-acre farm.

The NRCS guideline highlights the point that restrictions on buildings and other impervious surfaces will have a significant impact on farmland protection programs because they will affect whether agricultural landowners will participate in the first place; and they will affect what acreage is included, or not, in the proposed easement.

We believe that it is critical for those drafting agricultural easement and program managers to work with their agricultural community to evaluate the best way to allow for construction necessary for current and future agricultural enterprises so that agricultural easements are not viewed as overly restrictive "straightjackets" for future farmers and ranchers as well as evaluate their long term organizational capacity as easement holders.

Residential Structures

While agricultural easements allow for farm employees housing necessary to conduct the agricultural operations (as determined by the farmer or rancher and in accordance with local zoning), they can vary in their treatment of residential structures that are not specifically designated for farm workers (such as the principal farm house).

[3] However, NRCS has also issued waivers and will allow impervious surfaces up to 10% on a case-by-case basis. Notwithstanding the waivers, several state programs have strongly objected to this requirement because they disagree with its premise and believe that it unduly restricts agricultural business management decisions.

Agricultural easements attempt to minimize land fragmentation and future farmer/neighbor conflicts by allowing only a few subdividable future non-farm employee residences on the property. Limiting land fragmentation is probably one of the most important functions of an agricultural easement, and probably the restriction that will be most clearly enforceable over the long term. Consequently, the location of these future building envelopes or subdividable parcels is very important and should factor in wind dispersal, of noise, chemicals, dust and smell, in addition to land fragmentation and provide for future flexibility to accommodate future diversity of farming enterprises.

Based on our review of agricultural easements there are three basic approaches to residential structures:

- Omit subdividable, non-worker, house sites from the easement. To do so, these future house sites, usually on a two to three acre lot that is large enough to support a septic system and a replacement system, is surveyed out and excluded from the easement. Easement monitoring is therefore simplified with a clear delineation that no residential dwellings (other than farm owned employee housing) are permitted on the property.
- Include house sites within the easement, therefore ensuring that any additional non-residential uses would be prohibited.
- Create building envelopes large enough to allow for the residential structure and the establishment of a substantial farm operation with supporting buildings and structures – or expansion of an existing farmstead – on an as-of-right basis. Under this approach, the easement provides for a variety of uses within the building envelope (or "Farmstead"/ "Acceptable Development Area"), including housing for the farmer, farm-based enterprises, non-farm enterprises, and housing for farm employees and /or family members as long they do not negative impact the property's agricultural viability.[4]

Under the last scenario, farm worker housing and related structures constructed outside of the building envelope generally require prior permission. The appropriate size of these building envelopes will vary based on the region's agricultural activities; however, designating building envelopes that are too small will likely restrict future farming enterprises and undermine support for easements within the agricultural community and create pressure to amend easements in order to "loosen" an overly restrictive easement.

Subdivision

While provisions that govern subdivision of protected agricultural land vary, the primary rationale underlying this particular restriction focuses on reducing the potential for land fragmentation that would render agricultural land unusable for a commercial agricultural enterprise.

An agricultural easement may create a performance standard that allows subdivision if it does not harm the property's long-term agricultural viability or limit the size of the subdivision, based on the amount of land generally considered a viable farming unit, or limit the total number of permitted subdivisions. One factor is critical: what is deemed a viable farming unit today may be very different in the future. Requiring farms to remain in large acreages and/or to retain the traditional farmstead may create a

[4] It should be noted that rental of these structures can be important farm income and can resolve vacancy challenges when the farm enterprise shifts and no longer needs the housing for farm labor. In addition, seasonal housing may evolve into eldercare housing as farmowners age. If the housing stock is not subdividable, and if it is controlled within a building envelope, it balances the likelyhood of speculative housing and interferring with the farm business.

long-term property tax burden that is unsupportable when profit margins are slim or nonexistent. Such a requirement might force a farmer or rancher to sell the entire operation as one large unit, rather than being able to divest unneeded acreage and retain an appropriate amount of acreage for their agricultural enterprise. Ironically, it is possible that the only buyer that could afford to own the parcel would be a non-farm owner (or one with significant nonfarm income or other assets).

As farming practices and economics evolve, it is not unreasonable to expect a landowner to focus his or her efforts on a portion of the farm that supports their financial and personal resources. For example, an agricultural producer may decide to focus on producing a niche product (like vegetables, herbs, flowers or small fruits) on the 15 acres of prime soils on the farm, and no longer wish to own and maintain (including paying the taxes) the other 200 acres of less productive pasture and woodlot on the farm. From an economic perspective, requiring 100 acres as minimum subdivision acreage may well force the sale of the entire farm unnecessarily.[5] Easement holders therefore grapple with reducing non-farm land fragementation while allowing for economic viablity. Additional organizational capacity will be required to build and support future landowners with each subdivision, therefore requiring consideration from an easement management perspective as well.

Farm support housing (housing and/or apartments for farm employees and family housing) are not allowed to be subdivided as separate, stand-alone, residential properties unless those units are designated as "non-worker" house sites up front in the easement (and valued as such if the easement is purchased or if a tax deduction is sought by the landowner).[6]

Rural Enterprises

Increasingly, agricultural easements recognize the importance of allowing diversification of the agricultural operation and/or other business enterprises in order to generate enough income to support the family standard of living or subsidize the agricultural operation if it is not profitable. The need for provisions that allow rural enterprises is likely to increase as agricultural conditions and markets change, as well as where it is currently more uncertain. While there are numerous twists to the rural enterprise clause, there are at least two basic approaches:

- Allow the rural enterprise as long as it is a subordinate business to the agricultural operation. This might entail part-time or off-season businesses such as bed and breakfasts, machinery repair or woodworking. These are often restricted within a building envelope.
- Allow rural businesses to operate within the farm-building envelope. Such businesses may be directly related or completely unrelated to the production, processing or sale of farm products, and may include home offices, computer repair, day care, etc. These uses may require prior permission from the easement holder to ensure that the agricultural purposes and intent of the easement are not negatively impacted. Preventing subdivision of the building envelope controls potential land fragmentation and reduces the likelihood of non-farm management conflicts.

[5] Some easements prohibit subdivision entirely, including many under the NRCS ALE program. Others only permit subdivision for agricultural purposes.
[6] Restrictions on farmworker housing (limiting it only to farmworkers) also raises some challenging stewardship and enforcement issues.

Recreational Uses

Almost all agricultural easements provide for continued recreational use by the grantor including traditional rural recreational activities like hunting, fishing, trapping, snowmobiling, skiing, hiking and camping. In most cases, the landowner retains the right to use the property for such recreational activities as well as allow others to do so.

In addition to personal recreation use however, there are issues of commercial recreational activities (hunting and fishing leases, campgrounds, fee-based skiing and snowmobiling trail use) and permanent structures for recreational use (personal or commercial). Most agricultural easements significantly restrict the construction of large permanent recreational structures outside the approved building envelopes, whether the "use" is personal or commercial. Large camps, extensive playing fields, airstrips or golf courses could have a potentially significant impact on the agricultural resources of a particular farm or ranch and are usually either restricted in placement, duration, or scale; excluded from the easement property; or simply prohibited.

Commercial recreational use, separate and apart from any structures that might be built, raises the issue more akin to rural enterprises – is it the use per se, or the associated structures and their location that would negatively impact the agricultural resources? Just as rural enterprises provide a potential source of diversified income (in fact, commercial recreation may be more accurately characterized as one of the possible rural enterprises), the opportunity to benefit financially from commercial recreational opportunities like hunting and fishing leases, dude ranches and working farm vacations as well as snowmobiling, skiing, horseback riding, hiking and mountain biking trails may be critically important to the future viability of a farming or ranching operation. The question really comes down to: what, if any, negative impact will there be on the agricultural resources?

Approvals

Some agricultural easements require the landowner to obtain prior approval for significant agricultural improvements and such permitted uses as farm stands, bunk silos, machine sheds and livestock barns, particularly if the easement is drafted primarily with soil resources in mind. Not surprisingly, farmers and ranchers prefer minimal approval requirements to allow them to respond to changing markets, new technology, opportunities for construction cost-share assistance and costs of materials. When permission is required, most easements establish a default time period after which, if the holder does not respond in writing to the landowner's request, permission is deemed granted. This allows the farmer or rancher the security of knowing that he or she will be able to make decisions and take action within a reasonable length of time (often 60 days).

When permission for construction of agricultural improvements is required, easements should include language that clarifies on what grounds permission would be granted in support of the purpose statement as well as requiring the holder to state why it is denying permission and to provide the landowner with examples of possible remedies. In many cases, the criteria, and burden of proof, are clearly set forth in the easement – usually based on whether the proposed improvement would unnecessarily harm the property's agricultural resources or agricultural productivity.

If prior approval is required by the easement, the holder should recognize the significant stewardship burden it is undertaking (as well as imposing on the landowner), and establish protocol to identify the decision-maker (board or staff) and a consistent process for handling requests (written requests, type of information needed, etc.). Timeliness of response and consistency of outcome will be critically important to making the approval process work. Just as with issues concerning farming practices, each holder will need to decide whether it has the knowledge and resources over the long term to evaluate and render decisions on requests that require prior approval, especially those requests involving agricultural improvements or subdivision for agricultural purposes.

Resource Protection Issues

Increasingly, easement holders are protecting other natural resources in agricultural easements, including wetlands, steep slopes, stream corridors, habitat areas and scenic view sheds. One strategy to address these additional resource protection issues is to include them explicitly in the purpose clause and create a dual or multi-purpose easement, often with a related hierarchy of preference or importance. Because the other natural resources issues are usually only relevant to, or located on, a part of the entire property that is protected, many easement drafters will create specific "resource protection areas" that identify the particular resource at issue (a stream buffer or wetland area) spatially on a property map and impose additional use restrictions that will protect that resource (in some cases restricting or prohibiting agricultural use of an resource protection area entirely). Within each "use" area, the easement needs to be clear about whether agricultural uses are allowed and if so, under what conditions or limitations.

Some of the basic issues that need to be addressed up front include: what are the resource protection concerns and how might they evolve over time (vegetative buffer, soil disturbance, filter strip, habitat management, scenic vista); what is the primary purpose of the easement, easement program and easement holder and how does it relate to farming and ranching (agriculture, wildlife habitat, watershed protection, scenic views); what will the agricultural community support (comfort level with additional use restrictions in certain areas); and what can the easement holder manage from an easement stewardship perspective (complex easements increase organizational capacity needs for ongoing communications and engagement with landowners, and enforcement obligations dramatically). And lastly, are there other programs or approaches that are available to address particular resource management issues that therefore would not need to be addressed within the easement? In other words, is an agricultural easement the proper tool to protect wetlands or wildlife habitat or a scenic view?[7]

Typical use restrictions in resource protection areas range from limits on large structures and impervious surface areas to prohibiting agricultural buildings, or curtailing cultivation (or prohibiting it) for the purpose of active management for a particular non-agricultural resource (like maintenance of grass buffer strips or annual mowing of grassland bird habitat or burning for prairie grasses.)

Other Issues

While not an exhaustive list, the following issues frequently are on the table when drafting agricultural easements, and in most cases, should be addressed explicitly up front in the negotiating/drafting process.

- *Amendment* – Amendment clauses are included as a matter of course in agricultural easements. Notwithstanding the time and care spent on drafting flexible easements that encourage agricultural use, a properly drafted amendment clause serves as an important "safety valve" or adjustment mechanism for both the landowner and the holder down the road. A growing

[7] Overlay easements or additional restrictions may also be utilized to protect a particularly critical resource like riparian corridors, wetlands or scenic viewsheds.

number of land trusts now provide for future amendments in accordance with an established organizational amendment policy.

- *Extinguishment of Development Rights* – Unless specifically desired as part of a transfer of development rights or development rights “bank”, any nonagricultural development rights that are not reserved, or deemed incompatiable with the overal eaesment goals, are usually explicitly extinguished to avoid their unanticipated “use” in the future for density averaging or density bonus purposes. Such a clause also serves to reinforce the fact that, in most cases, farmland development rights agreements, or agricultural easements remove the majority of future residential development potential from the land (a restriction that is therefore valued when appraising the purchase of those development rights and justifying the funds used to purchase those “rights” or afford a potential federal or state tax deduction.)
- *Mining* – For donated easements, mining can prove to be a challenging issue. Read literally, and construed strictly, Section 170(h) appears to prohibit any surface mining at all. However, most agricultural easement drafters have interpreted the regulations to allow very limited extraction of materials like stone, shale, sand and gravel for on-site use. For purchase programs, this is less of an issue because 170(h) does not come directly into play unless there is a “bargain sale”. For very cautious drafters, active gravel or sand pits are simply excluded from the easement entirely. Subject to the site impact mitigation requirements set forth in the Treasury Regulations, subsurface mining is allowed. Given the number of existing subsurface gas and oil leases on agricultural land as well as future income opportunities for agricultural landowners, the Treasury Regulations take a very practical approach on this issue. However, with the growth in hydraulic fracturing techniques (“fracking”), the potential surface impact of fracking sites as well as water quality concerns have drawn heightened scrutiny about whether this type of subsurface mineral extraction can be sufficiently minimized or mitigated to meet the IRS regulatory standards.
- *Termination/Extinguishment* – As with other conservation easements, the issue of termination by the parties (subject to court approval) or extinguishment by virtue of the exercise of eminent domain, is routinely addressed in agricultural easements, and usually in a similar fashion. Just as the Treasury Regulations articulate a standard based on the traditional property law doctrine of changed conditions[8], most agricultural easements utilize a similar standard that requires a showing that the purpose (agricultural use) is impracticable and/or impossible (and not merely inconvenient.) However, with single purpose agricultural easements, the concern has been raised that it might be easier to extinguish the easement than if it had multiple or secondary purposes included. Without any precedent to guide us, it would certainly appear that such single purpose easements would be simpler, though not necessarily any easier, to terminate because of their singular focus.
- *Waste* – These clauses need to be carefully considered because common “catch-all” waste clauses can create headaches for farmers and ranchers from the outset. For example, if old farm equipment is considered prohibited “waste” or “junk”, any required clean-up could be cost prohibitive for a cash-strapped farmer or rancher. From an agricultural resource perspective, the question needs to be asked about whether such a restriction is even necessary. Many agricultural easements will draw a distinction between “waste” that is generated on the farm or

[8] 26 CFR Section 1.170A-14(g)(6).

ranch and other waste in order to avoid creation of new or expanded dumping or waste disposal areas on the property.

- *Water Rights* – While critical to the future viability of many operations in the western part of the United States in particular, it is an issue that should be considered in the context of its relationship to the agricultural resources and productivity. In some areas, this issue may be more important to the future of the farm or ranch than any threat of development or land fragmentation. The availability of ground water, as well as evolving precipitation patterns impacting surface water, will certainly impact the type and intensity of agriculture in the future.

Emerging Issues

Easement drafting continues to evolve as new issues emerge and need to be addressed. Some newer drafting concepts relate to issues like land affordability, climate change, and allowing the dynamic nature of agriculture and its relationship with other economic, environmental and social issues to evolve and be responsive to changing needs and farming practices.

- *Affirmative Farming Requirements* – While most agricultural easements do not impose an affirmative farming requirement, there is increasing interest in how best to protect the public or philanthropic investment in farmland conservation in cases where the land may not be used for agricultural purposes (or is not in a cycle of fallow to productive for agricultural viablity) or is under utilized to some degree. Natural area management associated with farm or ranchland, as well as flood mitigation and stream management, is likely to change in light of climate change and these issues will need to be factored into agricultural easements to allow the land to adapt to changing circomstances and community needs. This potentially raises complex drafting and stewardship issues, especially in the context of a permanent deed restriction for the landowner and corresponding stewardship obligation on the part of the easement holder.

- *Affordability* – Because one of the rationales for agricultural easements is that they may help make farm and ranchland more affordable, the "estate" value issue is generating increasing attention. Restricted values that exceed the agricultural value will undermine the affordability of protected farms and ranches and make it increasingly difficult for the next generation of farmers and ranchers to own their land. The Massachusetts state farmland protection program (Agricultural Preservation Restriction --"APR" as it is known) now includes an option to purchase at agricultural value ("OPAV") in every agricultural easement purchase transaction in order to help ensure affordable resale values of agricultural land. The Vermont farmland protection program is now requiring a similar agreement for use in its program.

  Thus far, Massachusetts has not actually had to exercise its option, but its terms have served to deter "estate sales" and have facilitated transfers of protected land to commercial farmers. In the Hudson Valley of New York, several land trusts (including the Agricultural Stewardship Association, the Columbia Land Conservancy and Scenic Hudson, are utilizing a Preemptive Purchase Right (PPR) that would function similar to an OPAV in an effort to restrict estate sales and maintain the agricultural value of the conserved farm. Equity Trust, a nonprofit based in Amherst, Massachusetts has initiated a Farm Affordability Program in New York's Hudson Valley that seeks to address both access and affordability issues, building on prior work in New England and New York. And earlier this year, New York State passed the "Working Farm Protection Act" which helps address farmland access and affordability by making provisions such as the PPR permanently eligible for funding through the State's Farmland Protection Implementation Grants (FPIG) program.[9]

- *Climate Change* - Inevitably climate change will impact agriculture in significant ways. Extreme weather events including flooding, drought, wildlife fires and periods of heavy snow, will increase costs of production as well as facility maintenance. Energy costs are also likely to rise for animal agriculture for heating, cooling, and water management. Pests, molds, and invasive plant species are also expected to increase in many parts of the country, requiring new approaches to managing both livestock and crops.[10] Present agricultural operations and farming practices may become impractical, very costly, or impossible thereby testing the flexibility and foresight of present easement provisions to allow agriculture to evolve both from a business and a production perspective.
- *Renewable Energy* – As climate change increasing impacts agriculture, and efforts continue to promote and expand renewable energy sources on farms and ranches such as wind, solar, geothermal and methane digesters, there will be increasing discussion and debate about the rationales for either restricting or encouraging renewable energy capacity on farms – both for on farm use and for transmission to the wider electric grid. Some organizations, such as Tug Hill Tomorrow Land Trust, are exploring ways to integrate generation of renewable energy and drafting easements to allow for greater production within building envelopes, siting standards and/or square footage allowances. For many, the question becomes how much is too much and on what basis is that determined in an effort to conserve the soil base yet also allow for conserved agricultural lands to play a role in mitigating climate change in addition to sustainablity of the enterprise.
- *Soil Health and Nutrient management* - Given extreme weather, including drought, increased tempatures, and sudden and heavy rains, there is a growing likelihood that soil health generally, and nutrient management in particular, will continue to be a challenge for the agricultural community, as well as easement drafters. Depending on the organizational capacity of the easement holder, as well as the community's expectations, easements may or may not dictate stricter requirements for nutrient management as part of a supporting farm plan referenced by the easement. Soil enhancements, such as composting off-site materials on the farm for sale or incorporation, as well as bio-char and other soil management strategies will need to be reviewed to ensure flexibility for both the property itself as well as related enterprises to advance soil health and potential for carbon sequestration within the community.

Inherent Limits of Conservation Easements

In addition to the basic organizational capacity questions that the easement holder (as well as landowner and his or her advisors) should ask, many of the drafting issues relate to the nature of agricultural easements, the tensions inherent in "working" landscapes, and the limits of conservation easements generally as a natural resource conservation tool.

One of the most fundamental tensions in drafting an agricultural easement is the trade-off between the economics of farming and ranching and the environmental attributes that are part of, or could be impacted by, the property. While those of us who work in the field of agricultural and farm/ranchland conservation believe that the two are not mutually exclusive, we must be realistic and recognize that in

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[9] The State had already made PPR eligible for funding adminstratively in its recent Round 16 Request for Proposals.
[10] See research and references at Cornell Climate Change; http://climatechange.cornell.edu/

many instances there will be some environmental impact from the working landscape of farms and ranches; and that farms and ranches will not survive without some type of economic return.

The tendency of some holders to dictate complex size and location requirements and use limitations for the construction of agricultural structures and agricultural operations serves only to reinforce this point. In fact, many of the drafting "tensions" in the agricultural easements result from the fact that the landowner and holder are often asking different questions about the impact of a particular paragraph or clause. Landowners are usually concerned with the impact on the agricultural business and the future economic viability of the farm or ranch; and holders are concerned about the impact of the structure or activity on the soils, or water quality, or wildlife or scenic view. We believe that very restrictive agricultural easements will jepordize an agricultural enterprises ability to adapt to changing circumstanes. It will also prove more difficult to monitor and enforce over the long haul because of this fundamental tension. Ultimately this could erode the functionality of farm and ranchland protection which would in turn distract us from the ongoing larger issues of how we manage and use our agricultural lands in this country.

The second major tension in agricultural easements relates to the level of management restrictions or requirements that are integrated into the easement itself. It is nearly impossible to separate land use from land management because the latter can strongly impact whether the former is perceived as "good" or "bad". Most agricultural easements incorporate some kind of management requirement in the form of general "best management practices" or "conservation plan", but do not require much detail in terms of what that would really mean in practice. Critics of this approach desire a higher level of accountability and/or performance standard to ensure that the best management practices or conservation plan is really meeting its objectives. The challenge with agricultural easements as the tool to achieve this result is that they are designed to be "perpetual" and somewhat cumbersome (by design) to amend or modify. We believe the better approach is to accept the limitations of easements as a land management tool, and to either rely more short-term management agreements clarifying mutually agreed upon goals set forth in the easement and then tailored to the current farming/ranching practices, or to simply recognize that outright ownership by the conservation entity is required for certain highly complex and restrictive management practices to achieve the desired management and protection of some kinds of natural resources.

Conservation easements, agricultural or otherwise, will only deliver on the promise of perpetuity if the holders of these easements can monitor and enforce them over time—and if the landowner community continues to support them as a viable and desirable tool in landownership and land stewardship. The challenge with agricultural easements is not only to draft them to allow and encourage agriculture over generations, but to monitor and enforce them in similar fashion.

Conclusion

We have found that there are no better advocates for agricultural land conservation than the farmers and ranchers who are living, and working, with agricultural easements. Easements that are drafted to protect soil resources, allow for the evolution of agriculture as an economic enterprise and diversify and allow for other ways to generate income as necessary are central in maintaining a the long-term viablity of agricutlure on conserved land. In general, these easements are farmer and rancher oriented and are written with the knowledge that farmers and ranchers, perhaps more than any other group of landowners, must make countless decisions on a daily basis about how they work the land and respond to the tight economics of agriculture and unpredictable weather.

In addition to conservation, agricultural easements, especially purchase programs, can help resolve difficult estate planning issues[11] and provide capital for reinvestment in the farm or ranch business.

Change is inevitable in agriculture; and agricultural easements must be drafted to accommodate those changes. Otherwise, we run the risk of making agricultural easements irrelevant in the 21st century.

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Thanks to Renee J. Bouplon, Associate Director at the Agricultural Stewardship Assoication for her review and comments on this article. As the Associate Director of the Agricultural Stewardship Association, she oversees the land conservation and stewardship programs. She previously served as Director of Conservation Easement Programs at Columbia Land Conservancy and co-authored the Land Trust Alliance's curriculum book Conservation Easement Stewardship. Renee has a BA from Hamilton College and received a Master's in Environmental Law from Vermont Law School. She can be contacted at renee@agstewardship.org

[11] For a more detailed discussion of conservation options in estate planning, see Cosgrove and Freedgood, *Your Land is Your Legacy*, 5th ed., American Farmland Trust, 2008.

Get In or Get Out: Farm Business Entry & Exit Strategies

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Get In or Get Out:

Farm Business Entry & Exit Strategies

Sustaining NY's Farms

October 3, 2018

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CRN-2037473-022318

Introduction

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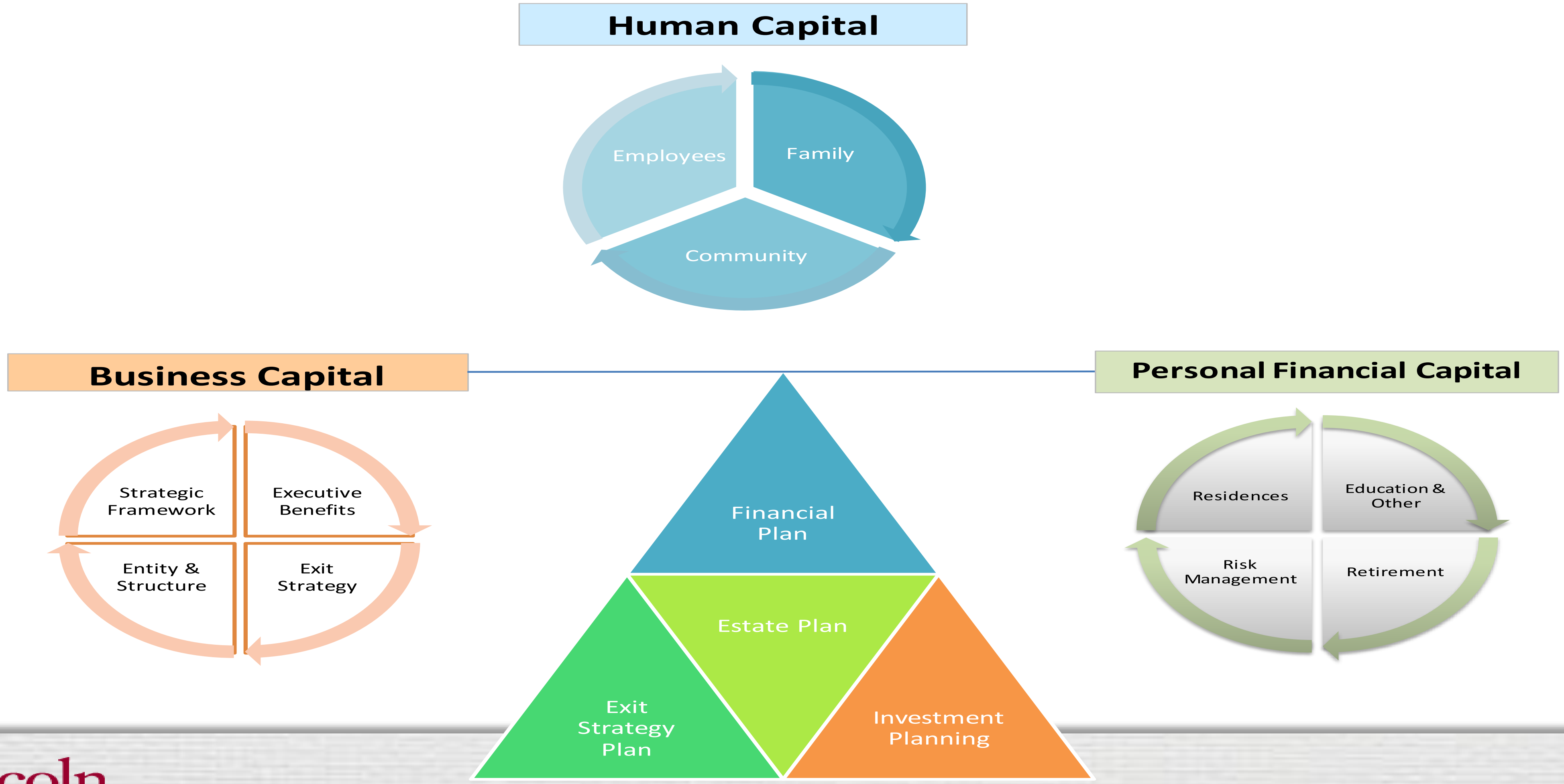
Urgency \ Importance	Low	High
High	Not Important Urgent	**Important** **Urgent**
Low	Not Important Not Urgent	**Important** **Not Urgent**

The things we will discuss today fall here.

These things, if not done, can create a major crisis once they occur, with no planning.

Integrated Capital Strategies



Agenda

1. Business Planning

2. Equity Transfer Planning

3. Personal Financial Planning

4. The Planning Process

Business Planning

- Entity Structure
- Business Culture & Strategy

Entity Structure

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Primary Considerations

1. **Liability Protection to Owners**
   - Do liabilities (debt/other) of the business pass through to the owners?
2. **Income Tax Attributes**
   - Do profits/losses pass through to owners or taxed to the entity?
   - Tax treatment for buy-seller or after assets pass through estate
3. **Restrictions on Ownership** (for S-Corporations)

Entity Structure

S-Corporation

- Pro's
  - Self employment tax benefit
- Con's
  - Tax inefficiency of stock sale
    - Buyer needs $1.67 pre-tax to net $1.00 to pay seller
    - Seller gets $1.00 nets $.75
  - Step-up in basis of stock – not business assets
  - Lack of flexibility (profits, growth, distribution, ownership)

Limited Liability LLC

- Pro's
  - Tax efficiency of LLC sale (underlying assets can be deductible)
  - Step-up in basis can be allocated to business assets
  - Greater flexibility (profits, growth, distribution, ownership)
- Con's
  - Self employment tax cost on all earned income

Common Entity Structure:

- Operating Asset Ownership:
    - Best owned by those actively involved
    - LLC is preferable due to greater flexibility and favorable tax attributes
- Land Ownership:
    - Tends to be best to hold this separate from operating assets
    - Can be effective (create income) for retired or passive owners
- Every situation is unique – every solution should be customized!

Tax Law Change

Impact of 2018 Legislation

- Section 199 domestic production activities is repealed
- Bonus Depreciation : 100% bonus depreciation for assets acquired from 9/28/17 through 12/31/22
- Section 179 Increased to $1,000,000 (with phaseout starting at $2.5M investment)
- New Section 199A – Pass through entities/ C corporations
  - 20% deduction on pass through income
  - 21% flat C corporation tax rate

Don't jump into a conversion from one tax status to another: Each situation is different and needs to be carefully reviewed with your tax advisor.

In many cases, the decision is irreversible and we may see corrective legislation and/or regulations.

Business Culture & Strategy

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As the business grows and continues beyond the founding generation, it becomes imperative to articulate and record the business culture and strategy.

This helps keep the key stakeholders aligned and focused on moving the business forward.

Key Questions Answered

- What does it mean to be part of this business?
- What behaviors are acceptable or desired?
- Where are we going?
- How will we get there?

Business Culture & Strategy

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- Shared Core **Values:** What values are important to us?
- Business **Mission:** What is our primary business purpose?
- Business **Vision:** What does success look like?
- **Strategic Initiatives:** How should we focus our resources?
- **Action Plan:** **Who** needs to do **what** by **when** to carry it out?

Business Culture & Strategy

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ABC Inc.

Strategic Framework - Updated 3/13/17

Culture

Shared Vision	Shared Values	Mission
Why we exist. Where we are going.	What we value and how we behave.	What we do.
ABC Enriches the lives of those who live, learn, heal, and play in the environments we create. We believe that the quality of people's experiences, the depth of their interactions, vitality, and dignity can be enhanced through creative design that is sensitive to their wellbeing.	**Thought Leadership** **Excellence** **Integrity** **Engagement** **Collaboration** **Social Responsibility** **Innovation** **Fun**	*Through our collaborative design process, ABC works diligently to understand our clients mission, culture, and the specific needs of the community they serve. Empowered with this insight and informed by research-based knowledge, ABC engenders thoughtful and innovative design solutions, tailored to each project's unique goal.*

Strategic Priorities - *How will we succeed? (3-5 Year Priorities)*

Enhance Our Business Development and Marketing Processes	Improve Our Sales and Design Processes	Enhance Our Financial Capital	Cultivate our Culture	Develop our Human Capital

Equity Transfer Planning

- How to **Get In**?
- How to **Get Out**?

Why Exit Planning?

At some point, you ***ARE*** going to leave your business.

The question is ***When?***

And on what ***Terms?***

Exit Strategies

Your equity is (potentially) my debt

Assume business with 2 equal owners

Assets	$10,000,000
Debt	$ 4,000,000
Equity	$ 6,000,000

40% leveraged

Owner A	$3,000,000
Owner B	$3,000,000

Exit Strategies

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If Owner B terminates

Assets	$10,000,000
Existing Debt	$ 4,000,000
<u>Buyout Debt</u>	**<u>$ 3,000,000 (B's Equity)</u>**
Total Debt	$ 7,000,000
Equity	$ 3,000,000

Owner A owns 100%, but now is 70% leveraged

Owner A $3,000,000

Exit Strategy Planning

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Assess three forms of Readiness

1. Personal Readiness
2. Business Readiness
3. Market Readiness

Who is the likely or desired buyer?

1. Internal – Partner, manager, business heir
2. External – sale to third party

Personal Readiness

A) **Mental** Readiness – what will you do with your time and talent after retirement?

B) **Financial** Readiness - what is your Value Gap?

Asset Base Required
$____________

Value Gap
$__________

Current Savings
$_____________

Business Readiness

- How well can the business function without you there?
- Can the balance sheet and cash flow withstand the required equity withdrawals?

Market Readiness

- Do you have something the market wants?
- Do economic conditions support needed capital?
- Do you have a backup plan?

Buy-Sell Agreements

Buy-Sell Agreement <u>defines the liability</u>

When is the agreement triggered?

- Death, Disability, Retirement, Termination, other

Who buys?

- Entity, other owners, combinations

How is the price determined?

- Agreed to annually, financial statement value, appraisal

What are the payment terms?

- Down payment, note term and rate, collateral, guarantees

Buy-Sell Agreements

How to Fund the liability?

- Death
- Disability
- Retirement
- Termination of Employment
- Divorce & other Creditor

Entry Strategies

BUSINESS INTELLIGENCE INSTITUTE

Three ways to acquire equity

1) **Buy it** from Senior Generation

2) **Gifts or Inheritance** from Senior Generation

3) **Earn value** from “sweat equity”

Entry Strategies

Buy it from Senior Generation

- Tax implications can be significant
- Cash flow and leverage issues can be significant

Entry Strategies

Gifts or Inheritance from Senior Generation

- Timing of transfers
- Risk of working a long time with no transfer
  - Someone changes their mind
  - Some event (ie long term care) adversely impacts the assets or cash flow

Entry Strategies

Earn value from "sweat equity"

- Stock (or equity) Bonus Plans – taxable event
- Stock Options (Corp)
- Profits Interests (LLC)

- Stock options and profits interest offer Tax Deferred Growth (if structured properly)

Personal Financial Planning

- Financial Independence
  - Retirement
  - Risk Management
- Investments
- Estate Plan
- Tax Strategy overlay

Financial Independence

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Financial independence means that:

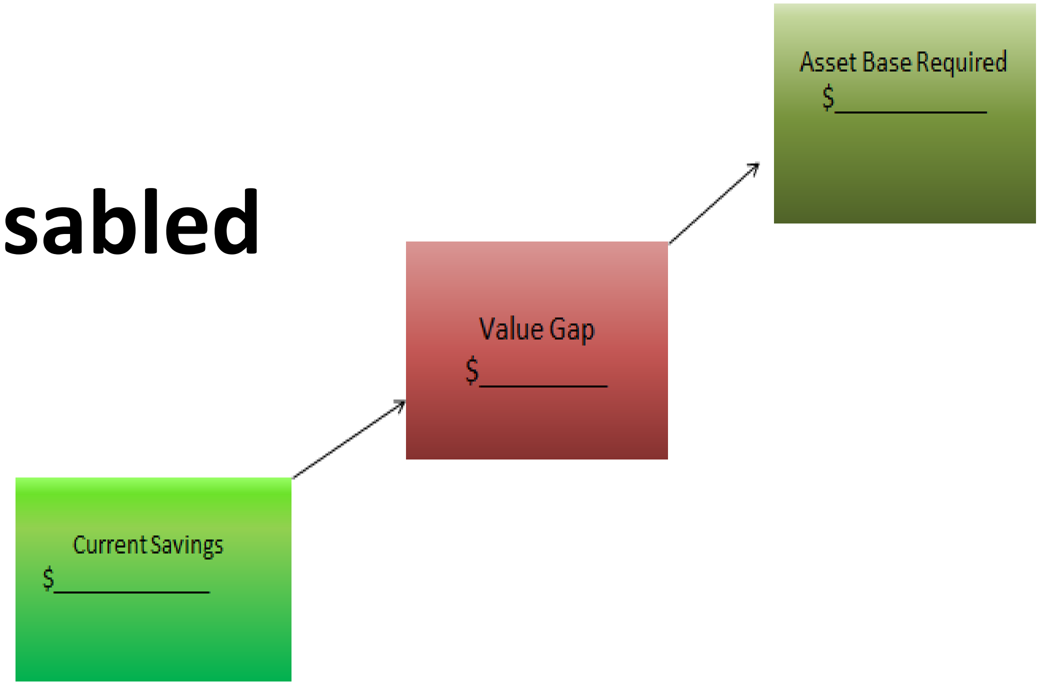
- You have the financial resources to meet your goals.
- You are no longer dependent on a paycheck.
- If you are working – it is because you want to

Financial Independence

Determine the **capital needed** to provide for your family:

To replace income:

- In **retirement**
- If either spouse becomes **disabled**
- If one spouse **dies**



Financial Independence

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Additionally, identify sources of capital to provide funds for:

- **Education** for children/grandchildren
- **Other goals** (i.e. travel, vacation home, etc.)
- **Gifting** to family or charity
- If either spouse needs **Long Term Care**

Estate Planning

Goals and Issues

1. **Income for spouse**
2. **Estate and Income Taxes**
3. **Family Legacy** (children/grandchildren)
4. **Estate Equalization** - Business vs non-business heirs
5. **Charity**

Estate Planning

Documents Needed

1. **Will**
   - Direct what happens to your assets
     - **Who** will inherit **what**?
     - **When** will they inherit?
     - In **Trust or outright**?
   - Named representatives
     - **Executor, Trustees, Guardian** for minor children
2. **Trusts (if applicable)**
3. **Powers of Attorney** – Agent for legal transactions if incapacitated
4. **Health Care documents** – Living Will and Health Care Power of Attorney

The Planning Process

What has been done?

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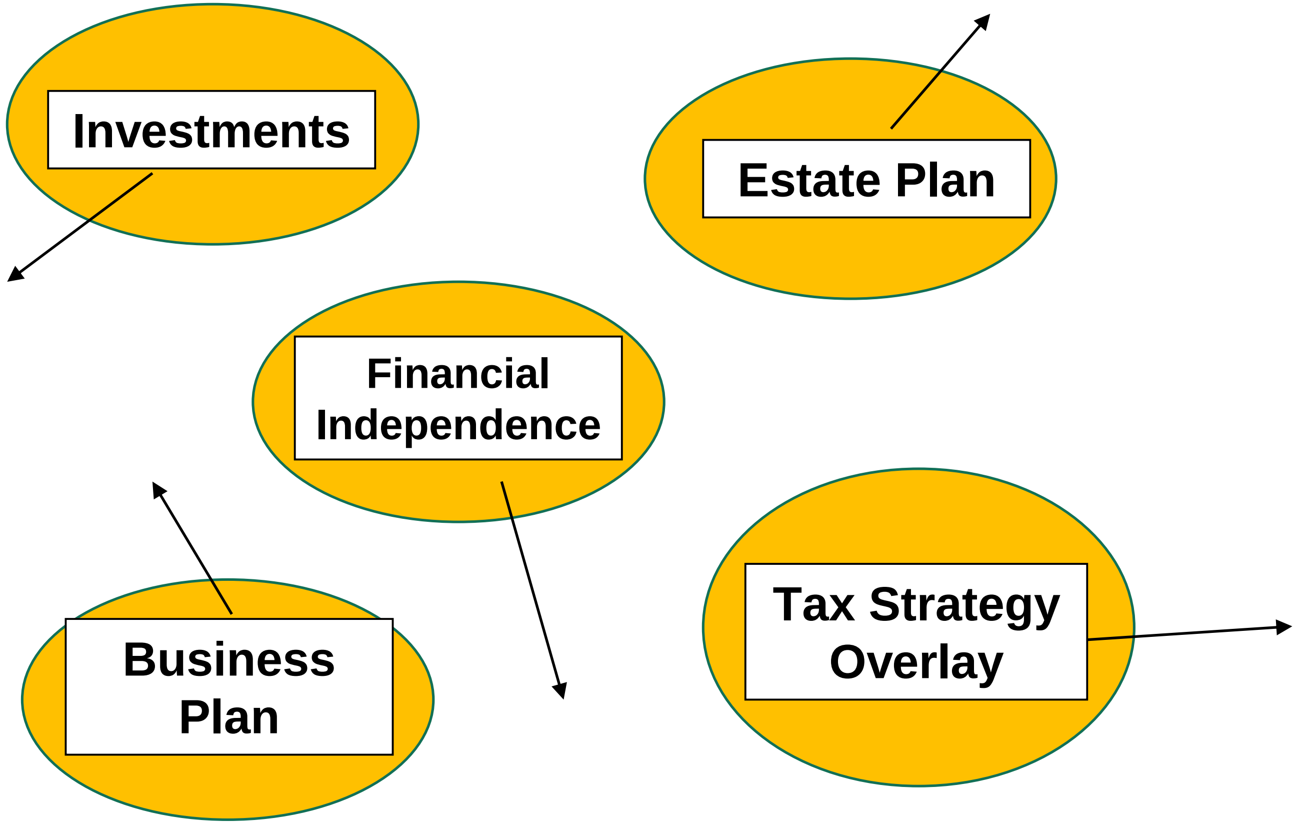

Often – these were done at different times with different people for different purposes

What We Do

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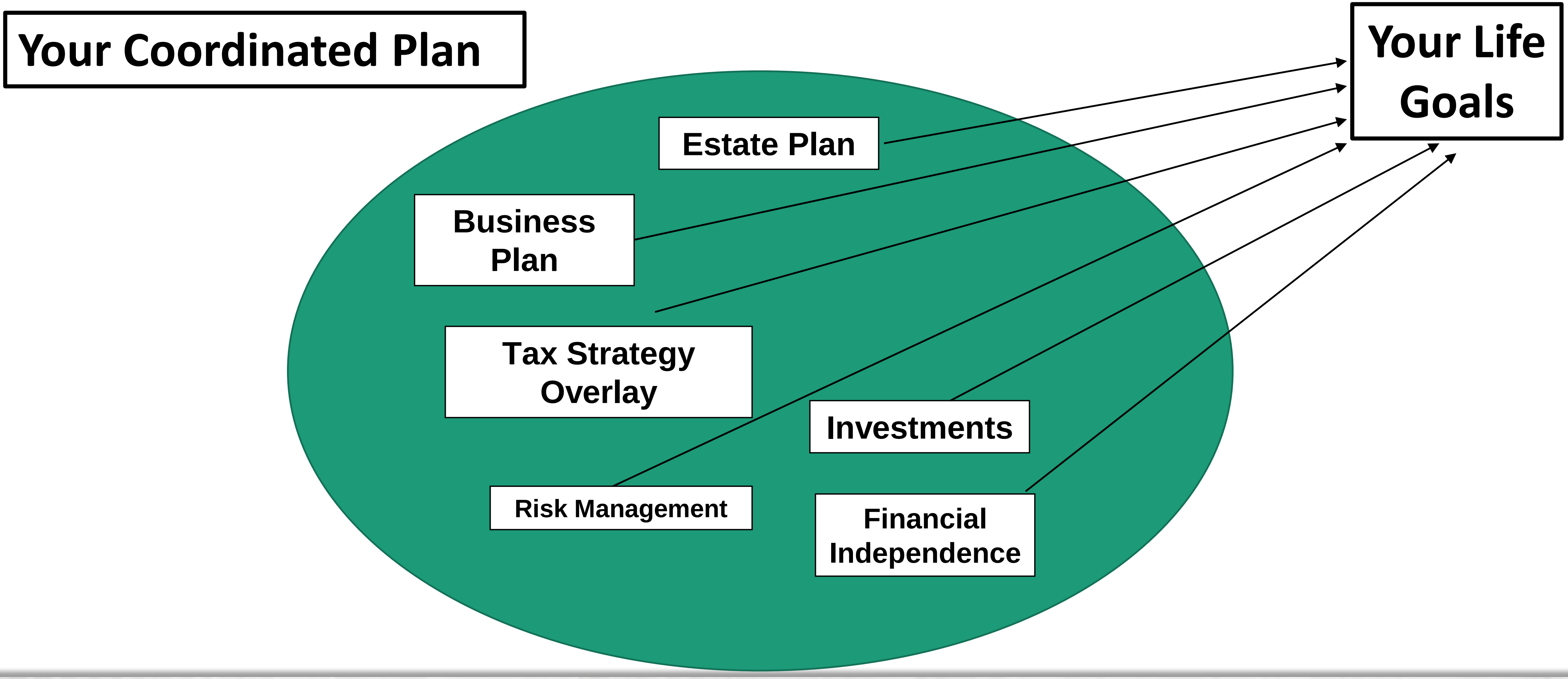
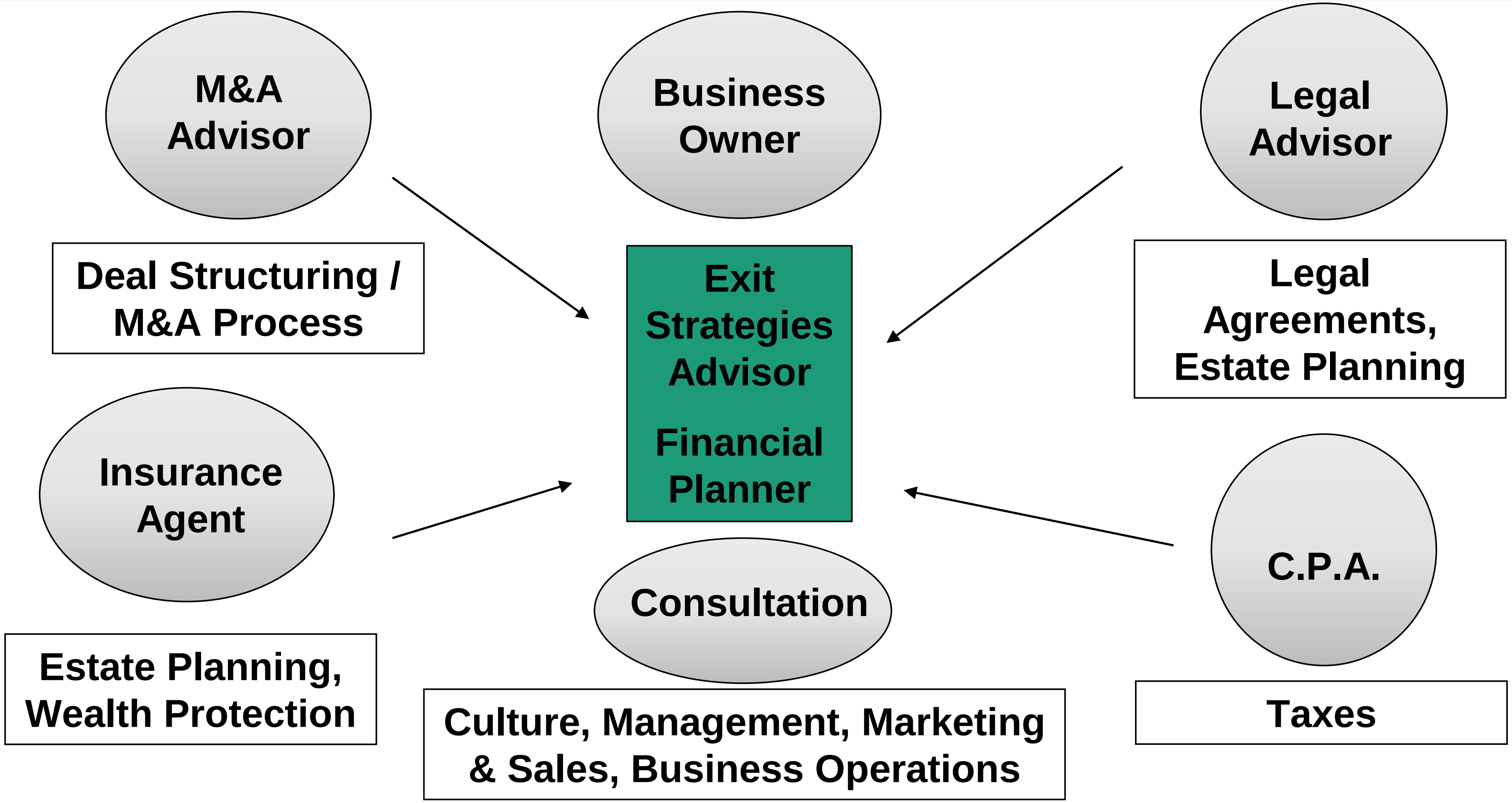


How We Do It


M&A Advisor
Business Owner
Legal Advisor
Deal Structuring / M&A Process
Exit Strategies Advisor
Financial Planner
Legal Agreements, Estate Planning
Insurance Agent
C.P.A.
Consultation
Estate Planning, Wealth Protection
Culture, Management, Marketing & Sales, Business Operations
Taxes

The Planning Process

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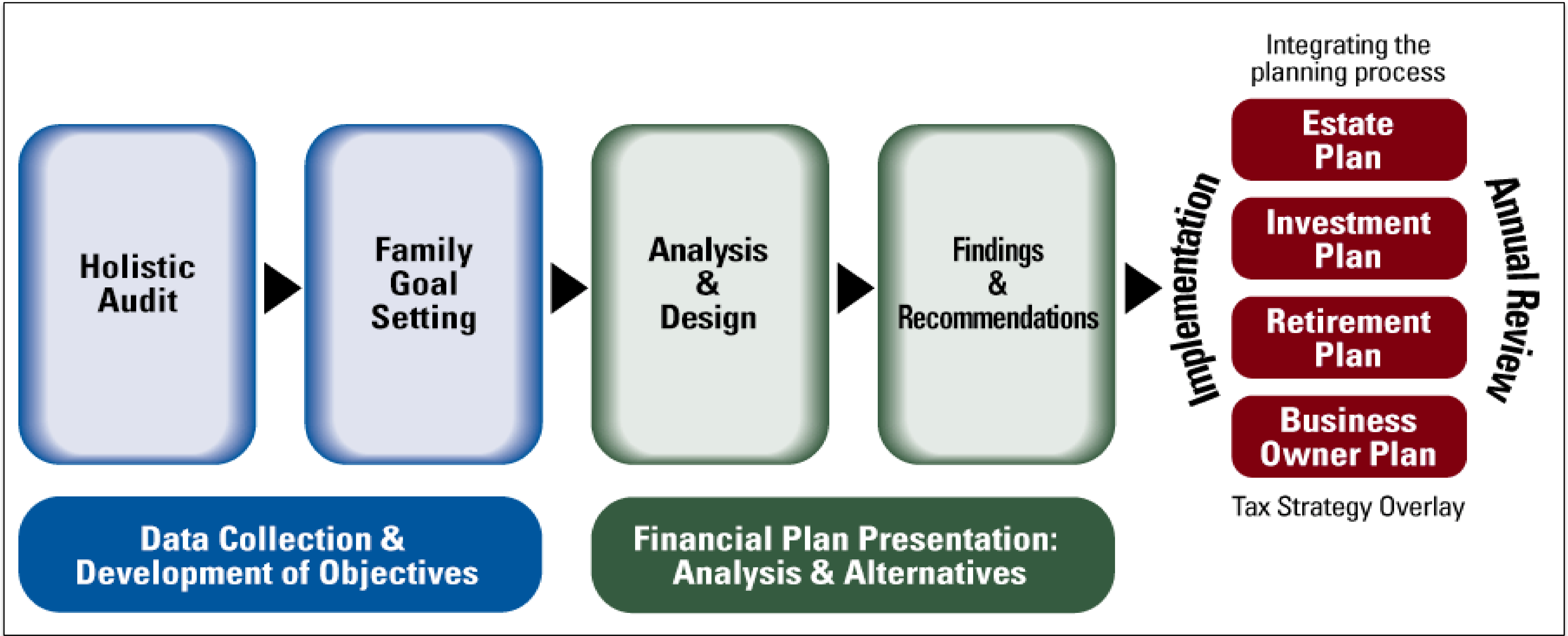

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SECURING THE FUTURE

2018 FARM SUCCESSION PLANNING

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Our 40th Year of Providing Dedicated Client Services to the Agriculture Community

Jeffrey M. Fetter is admitted to practice law only in the State of New York, the State of Washington and the Commonwealth of Pennsylvania. The information contained in these materials is not intended to be legal advice, but is for discussion purposes only and is intended to merely convey general information related to legal issues commonly encountered in estate and business succession planning. Legal counsel should be consulted with respect to any specific issues on which advice is desired.

AGRICULTURE-RELATED SERVICES

Scolaro Fetter Grizanti & McGough, P.C. has established itself as a leading provider of legal and counseling services to the Agriculture community. The firm represents farms, farm families and farm related businesses such as equipment dealers, equipment and product manufacturers, consultants and other service organizations in such diverse area as:

- Estate, Asset Protection and Trust Planning and Estate Administration
- Business Entity Selection, Organization and Representation
- Farm Succession and Transition Planning
- Farm Sales, Acquisitions, Mergers, Reorganizations and Development of Strategic Alliances and Partnerships Among Farm Businesses
- Tax Planning for Farms, Farm Related Businesses and their Owners
- Contract Negotiation, Dispute Resolution and Litigation
- Real Property Purchases, Leases, Sales, Subdividing and Dispute Resolution between Adjoining Landowners
- Representation of Farms in Stray Voltage Matters
- Personal Injury Matters for both Plaintiffs and Defendants
- Governmental Support Program Applications and Disputes
- Employment and Labor Matters
- Establishment of Retirement Plans for Owners and Employees
- Long Term Care Planning for Purposes of Protecting the Family Farm

The firm has participated in thousands of successful farm transfers, each case presenting unique facts and circumstances that must be addressed. When representing farms and farm families, it is important to not only understand the general principles of business, estate and tax planning that are applicable to all businesses, but to also have a very clear understanding of the specific needs of the farm and its owners. Many farms and farm related businesses remain within the same family for many generations. As a result, it is necessary to understand and address the needs of multiple generations within and without the operation. Special emphasis is needed on ensuring that both the senior generation and the junior generations objectives are met when developing and implementing a farm succession plan. In many cases, there are both farm and non-farm heirs within the family and care must be taken to properly provide for everyone while protecting the primary asset of the family - the family farm.

Although there are many similarities within various farm businesses, each has unique and diverse needs. In most cases, this depends on the structure of the family, the structure of the farm business and the present state of the agriculture industry and the economy in general. Today's farm economy presents many challenges to the farm business and to its advisors. Farm income and expenses may vary greatly year to year and unlike many non-agriculture businesses, are influenced by factors outside the control of the farm's owners and management. It is important that the farm advisors work together as a team to address these challenges and to best serve the farm client. Over the past several years, the firm has established itself as an integral part of that team.

Agricultural Services Team

Jeffrey M. Fetter
Steven A. Walker
Chaim J. Jaffe
Kelly J. Graves
Shane M. McCrohan
Daniel J. Fetter
Mark N. Levy

Farm Estate and Business Transfer Planning

PREAMBLE

A few initial planning thoughts

*Regardless of whether your plan is simple or complex, involves merely a will or sophisticated agreements among family and nonfamily members, the most important part of any plan is to **get it in writing!!!***

Remember, the only time you need to use an agreement is if you cannot agree or if you're not there to speak for yourself. The parties to an agreement can always agree to something else but, ... if you cannot agree you need to go back to what you put down in writing.

Having your plan in writing helps to avoid disputes, confusion, tension, deterioration of the farm and the time and expense of having to end up in court.

Finally, the best time to implement a plan is yesterday!!

I. INTRODUCTION

A. Business Objective and Purposes. In any closely held corporation, limited liability company or partnership, the ongoing health of the business largely depends on keeping ownership of the business in the hands of those employees and/or family members who actually conduct the business. This is especially true in farm businesses where steps should be taken with respect to the business and estate plan to assure the owners' interest and investment in the business is protected and the interest is passed to the next generation or to the surviving owners with as little difficulty as possible. The objectives to be attained in a farm succession plan are:

1. Develop management and decision making structure for operation.

2. Minimize income taxes during operation and an estate tax as to both transferor and transferee upon transfer.

3. Establish terms under which plan will operate in the future to avoid need for future negotiations and to give all parties comfort that plan will be implemented.

4. Minimize personal liability and protect assets from third party claimants, including plaintiffs in legal actions, creditors and spousal claims in matrimonial actions in which farm embers are parties.

II. SUCCESSION PLANNING STRATEGIES

In implementing a farm succession plan it may be appropriate to utilize entity selection, estate planning documentation and agreements to establish the basis on which the succession plan will be structured, to provide retirement income to senior owners, to provide benefits, including incentive benefits to key employees and to establish a tax favorable means for passing the farm to the next generation whether family or non-family.

A. Senior Generation's Objectives.

1. Retirement income and security.
2. Farm continuation after retirement and death of parents.
3. Equitable or non-equitable treatment of farm and non-farm heirs.
4. Minimizing estate and income taxes for the parents and the next generation.
5. Reduction or elimination of management responsibilities for the parents (or the surviving spouse).
6. Protect assets for children and grandchildren with little if any exposure to creditors or spouses of children.

B. Junior Generation's Objectives.

1. Assumption of management responsibilities.
2. Attain or increase ownership.
3. Assure income needs of parents in retirement do not impair junior generation's earning capacity on farm.
4. Avoid involving nonfarm heirs in management of operating entity.
5. Avoid unnecessary imposition of estate taxes/plan for payment of estate taxes through insurance policies on parents and/or partners.
6. Deductibility of retirement income payments to parents.
7. Establish credibility in community and with lenders/vendors/customers.
8. Establish operating agreements with partners setting forth terms under which operations will be managed and how an owner's interest will be transferred upon the occurrence of certain triggering events (e.g. death, disability, termination).

C. These documents and agreements may include the following:

1. **Buy Sell Agreements**. The buy sell agreement among the owners of the farm sets forth not only the terms under which owners will hold their interest while employed or associated with the farm, but also sets forth the terms and conditions under which an owner's interest will be transferred upon the occurrence of certain triggering events such as death, disability and termination of the owner's relationship with the farm.

   Critical to the structure of a buy sell agreement is ensuring that the cost of any potential buyout is properly anticipated and the plan is appropriately funded, whether through life insurance or other assets. In some cases, operations believe that the obligation can be taken care of through cash flow which can be a dangerous gamble. The uncertainties of a farming operation such as milk and crop prices can quickly make a manageable obligation an impossible obligation.

In addition, in many cases, the buying out of an owner is coupled with the need to replace the services of the deceased or departed owner. Again, the impact on cash flow must be carefully managed and the obligation must be regularly reviewed through updated valuations, meetings with lenders, advisors, etc.

If life insurance is to be utilized for funding an obligation under a buy sell agreement, ownership of the policies is critically important. Failure to have the policies properly owned may result in unintended income as well as estate taxes. In some cases, owners own policies on each other and in some cases the entity owns policies on the owners. Both of these structures can have their advantages, but both structures can cause unanticipated problems with income taxes, estate taxes, alternative minimum taxes and even the problem of retrieving a policy on a living owner from the estate of a deceased owner. Careful consideration must be given to how the policies are owned and in many cases utilization of an insurance partnership is the most beneficial structure. This is discussed below.
[See BCL §620 (Shareholder Agreements)]

2. **Management Agreements**. Setting forth how decisions will be made and the authority each of the managers and owners may have assures all principals that the decisions are being made by the appropriate individual or individuals.

3. **Prenuptial/Postnuptial Agreements**. **[DRL §236, Part B 3F, DRL §250]** Keeping the family farming operation out of an owner's personal matrimonial proceeding not only reduces expenses to the farm operation, but can greatly reduce the emotional impact such an action may have on the entire enterprise.

4. **Estate Planning Documents**

The Absolutely, Positively Essential Estate and Health Care Planning Documentation (and then some).

a. **The Will**. An owner's will sets forth the terms under which the owner's "estate" will be distributed upon death. Included within the "estate" is all assets owned by the owner at the time of death. Because the farm owner has both business and personal assets, it is important that a properly prepared will is in place to insure that the business assets pass in accordance with all the farm members' intentions.

Without a properly prepared will, assets will be transferred in accordance with the applicable statutes [See EPTL §4-1.1-4-1.6]. For example, if a farmer dies without a will and leaves a wife and three children, the applicable state law may provide that the wife will receive only a portion of the assets. The remaining assets will be divided equally among the children (regardless of who is involved in the farm and who is not).

The estate plan should specifically address how farm assets as well as nonfarm assets are to be handled at the time of death. In many farms, the active farm members do not want to have to involve their nonfarm siblings in the day to day decisions that have to be made on the farm and what could be even worse is when the nonfarm siblings have a financial stake in the operations. Properly prepared estate planning documents together with business planning agreements avoid these problems.

b. **Updated Health Care Power of Attorney.** Sometimes known as a health care proxy, this document ensures that people you have appointed are making health care decisions on your behalf in the event you are unable to do so on your own. An "updated" proxy is necessary that (1) specifically grants your agent authority to obtain records that are considered private under recently enacted "HIPAA" privacy regulations and (2) appoint an alternate agent as well as a primary agent. [See www.nysba.org for Health Care Proxy Forms; See Public Health Law - PBH §2981 [Authority to Appoint Agent] [Statutory Form at Article 29-C of the PPH]

c. **Living Will.** The burden of having to make a decision as to whether life continuing measures should continue is a tremendous one. The living will sets forth your own wishes if such a situation arises and relieves your family and friends from having to be faced with such a decision. The living will sets forth your wishes and the conditions under which such a decision will be made.

d. **Updated Durable Power of Attorney**. A durable power of attorney appoints your agent or "attorney in fact" as the person who can take care of personal, business, financial and legal matters on your behalf. A power of attorney may be an "immediate power" or a "springing power". An immediate power of attorney grants this authority (which is great) in the hands of a person immediately. A "springing power" states the conditions under which such a power will come into place at some point in the future. E.g. in the event of your disability or illness which renders you unable to act on your own. [Powers of Attorney signed after September 10, 2010 must be in compliance with NYGOL §5-1513 et seq.]

Because of the great power given under such documents, they should be carefully thought out before signing, but they are critically important to have in place to ensure that bills are paid, checks are cashed, assets are managed, children are provided for etc. in the event you are unable to act on your own.

Similar to the health care power of attorney, the durable power of attorney should also be updated if you already have one to include specific references to HIPAA and also to authorize your agent to make transfers of assets on your behalf in excess of $13,000.00 if those are your wishes. Under the form that is usually signed, there is a limitation on the amount of gifts that may be made. In some situations gifts in excess of that amount may be appropriate for medical, estate and financial planning. Again, care needs to be taken in designing the document that meets your wishes and expectations.

e. **The Sometimes Essential Trust Documents.** Trusts may also be used in connection with a farmer's estate and succession plan. These trusts may be created during lifetime or at the time of the farmer's death. In both cases, the documents should be structured with the farm succession plan in mind.

(i) Revocable Trusts - purposes
  A. For avoidance or minimization of probate
  B. For asset management

(ii) Irrevocable Trust Purposes
  A. estate tax planning
  B. asset protection planning
  C. long term care planning
  D. special needs planning
  E. income tax planning

[See EPTL §7-1.9 Revocation of Trusts]

5. **Operating/Retirement Agreements**.

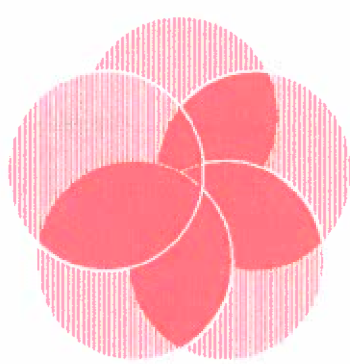
a. **Deferred Compensation Wage Continuation Agreements**. It is not unusual to provide a reasonable amount of compensation to the withdrawing shareholder/ employee or partner/employee in the form of a nonqualified deferred compensation agreement. Payments under a deferred compensation plan may avoid unnecessary FICA payments if properly structured. [See IRC §3121(v)(2); 2016 Chief Counsel Memorandum at w.w.w.irs.gov/pub/Ianoa/am-2017 - 01.pdf]

b. **Consulting Agreements**. Similar in tax substance to an employment agreement. However, consulting agreement payments will be subject to self-employment tax.

c. **Employment Agreement**. In some cases, an employment agreement with the parent may be appropriate for security purposes; e.g., if the father wants to be assured he will receive guaranteed income, health insurance, etc., during his "active" and retirement years, an employment agreement would be a contractual obligation on the part of the farm to provide these benefits.

d. **SIMPLE Plans, 401(k) Plans, IRA Options, etc.** [Such plans are governed under the complex rules of The employee Retirmenet Income Security Act of 1974 (ERISA). [Pub.L.93-406, 88 Stat. 829, enacted September 2, 1974 (29 U.S.C. ch18)]

It All Comes Together as One Coordinated Comprehensive Plan



III. ESTATE TAX PLANNING

A. **Traditional Planning**. An estate plan primarily involves taking steps so that in the event of your death, your assets (whatever they may be) pass in the manner that you desire. However, estate planning also needs to take into consideration the possibility of estate taxes being due at the time of your death. These taxes are not paid by the decedent but by the estate of the decedent. If not planned properly, there may be the need to liquidate assets in order to pay estate taxes. In a typical farming entity this is not a desirable option because there is very little liquidity in the assets owned by the farmer.

With properly structured estate planning documentation in place and the proper steps taken to reduce an estate during lifetime, estate taxes can be minimized or even avoided (legally). However, without the proper documentation and plan in place, it is possible that there will need to be a liquidation of assets in order to pay estate taxes. Although the IRS has payment plans, they are not always available and are not necessarily beneficial to the taxpayer.

Presently, federal law provides that the exemption is $11,180,000. As discussed below, there is also the unexpected and unique opportunity to make gifts in amounts up to $11,180,00 without incurring a gift tax. This presents unique planning strategies that may only be with us for a short period time. [26 USC Subtitle B §2001-2210 - Estate Tax; §2501-2524 - Gift Tax]

Several states still impose an Estate Tax and/or an Inheritance Tax on Estates and Beneficiaries. The following states still have an Estate Tax and the implications of the estate tax on a succession plan should be carefully analyzed in structuring the plan:

Connecticut	Delaware*	District of Columbia	Hawaii	Maine
Maryland	Massachusetts	Minnesota	New Jersey*	Oregon
Rhode Island	Vermont	Washington	New York	Illinois

*** New Jersey repealed 2018**

The following States have an Inheritance Tax (which in some cases is in addition to the Estate Tax):

Indiana	Iowa	Kentucky	Maryland	Nebraska	New Jersey*	Pennsylvania

***Note: Estate Tax Repealed - Not Inheritance Tax**

Estate taxes are assessed on the value of the deceased owners estate, including in most cases, both probate as well as non-probate property such as retirement accounts, life insurance policies, annuities and other assets that pass by beneficiary designation rather than through a will. In most cases, there are exemptions for transfers to spouses at death. Each state has its own level of estate tax exemption. E.g. New York is $5,250,000 as of April 1, 2018. However, New York also has a "cap" on its exemption. If the estate is 105% or more of the exemption, the exemption is for the most part lost. Therefore, each state's rules must be carefully examined. New York's rates are between 3.06% to 16% for estates greater than $10.1 million. [New York Tax Law, Article 26, Parts 1 §951-961]

An inheritance is similar to the estate tax, but may differ significantly from state to state. Generally, the inheritance tax depends on who receives or inherits the property. Depending on whether the beneficiary is a child, sibling, etc. the rates may be different. Again spousal transfers are generally unlimited. But, again careful analysis must take place because in some states certain assets are not taxable. E.g. Pennsylvania has an inheritance tax exemption, but does not tax family farms or in most cases, life insurance policies.

Because of the possible difference between the State and the federal exemptions, any estate plans that were previously put in place should be reviewed to ensure that State estate taxes are not unnecessarily due and payable upon the death of a person who leaves a surviving spouse.

A "portability" feature was added to the estate and gift tax laws in 2013 that has continued to be in effect through the changes in the law [See 26 USC §2010(c)(4)]. Portability essentially means that if one spouse passes away and does not utilize his or her full federal estate tax exemption, the surviving spouse is able to have that remaining exemption passed to him or to her. This is accomplished through filing a federal estate tax return and making the appropriate elections. There are very strict time limitations and very specific rules regarding how the exemption may be used and or retained by the surviving spouse which should be carefully reviewed in the event of the death of the first spouse to pass away. **Portability is for federal estate and gift tax purposes only, not state.**

Relying on "portability" is not generally advisable in a succession plan for a number of reasons. Should everything be going to the surviving spouse at the first death? The answer is many times "no" for a number of reasons including asset protection, long term care issues, future appreciation of value leading to greater estate taxes at the second death, etc.

Although estate taxes should not be the sole factor in structuring a farm succession plan, when structuring such a plan, it is important to at least know what the possible implications are and how they can be minimized. Advance planning is certainly necessary to avoid surprises.

B. **Long-Term Care Planning**. Family farm businesses are for the most part more likely to pass from one generation to another than nonagricultural business operations. In addition, unlike many non-farm businesses there is significant value in the assets of the farm, but very little liquidity. These unique characteristics of a farm business present very challenging obstacles in one or more family members require long-term care assistance, whether at home or in a long-term care facility. It is important to consider the disastrous impact these expenses can have on a farm and a farm succession plan. Early planning is needed. State law sets forth how the federal Medicaid program will be administered within the State. Under federal legislation implemented in 2006 [Deficit Reduction Act of 2005], the ability to transfer assets through gifting in order to qualify for Medicaid has become significantly limited. In most cases, transfers made within five (5) years of the date on which a Medicaid application is submitted will be disregarded.

There are, however, planning opportunities that may be available depending on the facts and circumstances. In addition, consideration should be given to obtaining long-term care insurance while still healthy. The annual cost of such insurance is in most cases less expensive than the cost of one month's stay in a nursing home. In addition, the insurance expense may be partially or fully deductible at the federal level.

C. **Gifting**. As noted above, the estate tax exemptions have been increased to $11,180,000 for 2018 - 2024 at which time the exemption is scheduled to be reduced to the 2017 levels ($5,490,000). Historically, gift tax exemptions were not 'unified' with the estate taxes but now they are for federal purposes. Most states have repealed their gift tax legislation, but Connecticut still imposes a. gift tax after Minnesota and Tennessee recently repealed their gift tax statutes. Some states do not have a gift tax, but still impose an estate tax based on Gifts Made In Contemplation of Death and the rules differ state to state.

The "lifetime" gifting exemption can be utilized at any time and the amounts in excess of any "annual exclusion" are then charged against the remaining estate tax exemption of the grantor. The "annual exclusion" gift is presently $15,000.00 per "grantee" and may be used for as many "grantees" as desired each year.

Example: If a grantor gifts $115,000.00 to his son in either cash or other asset value, $15,000.00 is ignored for gift tax purposes and the remaining $100,000.00 would be credited against the $11,180,00.00 lifetime exemption thereby reducing the remaining exemption to $11,080,000.00.

In cases where a gift is in excess of $15,000.00 a gift tax return must be filed with the Internal Revenue Service setting forth details of the gift, how its value was determined, etc. If the gift is made utilizing any "discounts" in valuation a gift tax return must be filed regardless of the value. "Discounts" that may be utilized in valuing family or closely held businesses include "lack of marketability" (i.e. the asset is non-marketable because of its nature or because it is subject to a buy sell agreement among the owners of the business) or "minority interest" discounts which apply if the interest being conveyed does not carry with it control of the entity (e.g. nonvoting stock, minority ownership being transferred etc.).

With increased gifting, opportunities exist for "freezing" the value of an asset in a person's estate. E.g. If $500,000.00 worth of land is transferred from parents to child, the future increase in the value of that land is outside the parents' estate. This then has been an effective "estate reduction" strategy because although a portion of the parents' lifetime exemption was utilized in making the gift, the increase in the value after the gift will no longer be charged against the parents' estate tax exemptions. Of course, asset selection is important because if the value of the "gift" decreases, there is no future recovery of the exemption that was unnecessarily utilized.

As with any strategy there are advantages and disadvantages to making gifts during lifetime either to individuals or to trusts, including the following:

1. Once a gift has been made it may be outside the future control of the grantors (exceptions may exist if the gift does not consist of a controlling interest).

2. If a gift is made outright to an individual, that asset is now subject to the creditors of that individual, possibly spouses in matrimonial matters, plaintiffs, etc. If transferred to trust, there is much greater protection.

3. From a tax perspective a lifetime gift results in the forfeiture of a "step up" in basis upon death (which could have considerable tax savings in the future).

Any gifting plan should be carefully incorporated into the overall operations, management, estate and succession plan of the family farming operations.

D. **Key Man Protection/Profits Interest.** In many cases, "key employees" represent the next generation of the family farming operation even if not related. There are many strategies that can be considered in ensuring that the key employees are properly compensated and have an incentive for the future growth of the operations and in many cases are able to share in the ownership in the future. Some of these plans include the following:

1. Employee incentive plans based on profits, revenue, etc.

2. Deferred Compensation Plans that offer a retirement plan to key employees. These can be structured in a manner so that there are "vesting schedules" which provide that the longer an employee stays with the farm, the greater the benefit upon his or her retirement or departure.

3. Key man life insurance protection for the families of the key people.

4. "Profits Interests" in partnerships of LLC partnerships, pursuant to which the key employee can share in the growth of the value of the operations with very little if any up front tax consequences.

5. Restricted "stock" or "ownership" plans under which a key person is entitled to the issuance of ownership in the operations over a period of years.

These types of "key man" plans are not necessarily limited to non-related employees of the operation and can be utilized with family members as well. In such an event they are coordinated with the retirement plans of the "senior generation".

E. **Health Care Powers of Attorney, etc**. Although not technically "estate planning" documents, it is important to have up to date health care powers of attorney, living wills, and financial powers of attorney in place to ensure that in the event the "principal" is not able to make decisions involving personal or health matters that the agent appointed by the principal is making these decisions on their behalf instead of some other third party.

Also because of HIPAA regulations, it is important to have properly prepared and signed health care powers of attorney in effect for any individuals over the age of 18 to ensure that parents, family members, appointed agents, etc. are able to have access to medical information to provide assistance to the person. Otherwise, HIPAA does not allow the sharing of information vital to making decisions on behalf of an injured or incapacitated person.

F. Funding the Buy Sell Agreement - The Insurance Partnership.

UTILIZATION OF LIFE INSURANCE PARTNERSHIPS IN BUSINESS SUCCESSION PLANNING

The following reflects the current status of the law, regulations and IRS pronouncements on establishing a partnership for holding life insurance policies. The historical concern is whether a partnership established for the holding of life insurance policies is respected by the IRS as being a viable business purpose. Secondly, is what benefits are derived from having partnership owned policies as opposed to individual, cross owned policies or corporate owned policies on the lives of the shareholders.

1. IRS Position

Priv. Ltr. Rul. 93-09-021 (Dec. 3, 1992) expressly approves of a partnership created for the sole purpose of receiving and maintaining insurance policies. The ruling indicated that the life insurance proceeds would be reflected in the surviving partner's distributive share under I.R.C. § 705(a)(1)(B) as tax-exempt income. The rulings also hold that any proceeds of the life insurance policies distributed to the surviving partner would not be taxable. See also Priv. Ltr.Rul. 96-25-013 (Mar. 20, 1996) and Priv. Ltr. Rul. 96-25-019 (Mar. 20, 1996). For this to work, it is important that the partnership contain two critical provisions:

a. a special allocation of the proceeds (in excess of cash values) to the remaining members or partners under I.R.C. § 704(b); and

b. a prohibition against the insured exercising any "incidents of ownership" over the policy.

If the deceased partner shared in the allocation of tax-exempt income, the surviving partners or members may not have enough basis to absorb the distribution of the policy proceeds, which would result in gain to the surviving partners upon distribution of the proceeds to them. Further, if the proceeds are allocated and distributable to all the partners or members (including the deceased), the value of the deceased's interest in the partnership would be increased, thus providing less money to the survivors to purchase the deceased's interest as well as increasing the amount necessary because of the cost of purchasing the deceased's interest in the partnership would go up.

2. Other Benefits of Partnership Ownership of Policies

a. Funding the premium payment is relatively easy with a partnership. Distributions from the corporation or other entities whether in the form of dividends, compensation or bonuses can be used by the partners to contribute to the partnership sufficient funds for the payment of premiums. Contributions can be made on an equal basis which avoids the problem that arises when premiums are not the same for different partners/shareholders. In some cases, a younger healthier partner may end up paying considerably more in premium payments for his or her partner if the policies are cross owned. This is avoided with a partnership.

b. The buy-sell agreements will provide for the purchase of the deceased or terminating partner's interest in the partnership. This will also work ideally if and when another member of a family becomes a shareholder in the corporation or a member of the LLCs without having to acquire policies on the present owners or moving ownership around (which could in some cases have tax implications). If, however, the same shareholder leaves the corporation, it would not be necessary to retrieve the policy or policies on the remaining

c. The use of a partnership avoids the necessity of multiple policies in those situations when there are three or more shareholders in an entity. That is, for example, when there are two owners, one may own the policy on the other, but when there are three, two of them own a policy on the third and this becomes circuitous. Another problem that arises with cross owned insurance is that the living partner needs to get back his policy from the estate of a deceased partner. This is not necessary with a life insurance partnership because the policies are owned by the partnership. Even if there are only two partners, it is easier for the surviving partner to distribute his policy out to himself or to a family trust without involving the deceased partner's estate.

d. The control of a partnership can be determined by the partnership agreement, thus governance and control is in the hands of select individuals including the insured without concern that the proceeds of the policies will be includable in the insured's estate. The extent of inclusion should be limited to the fair market value of the insured partner's interest in the partnership determined under § 2033 of the Code. That is, the value of the capital account for the most part. But, no one can have control over the policies. Otherwise, there could be inclusion in the estate of a deceased partner.

e. If insurance proceeds are owned by and payable to an entity such as one of the LLCs, a portion of such proceeds or cash values would be taken into account in determining the value of the insured's interest in the entity. In other words, the value of the deceased owner's interest in the corporations will be increased by the value of the proceeds which is an unintended result of having the insurance policies. Because the insurance partnership owns the policies and the proceeds are not allocated to a deceased partner, there is no inclusion.

f. Although with proper planning, policies owned by the LLC and having the LLC as a beneficiary will receive the proceeds tax free, if the intention is to pay out the deceased shareholder's /member's interest, this does not provide the best case for the remaining shareholders from a tax basis perspective. Also, if there is a desire to have proceeds from the life insurance used to pay out shareholders/members or their family members for other reasons, the entity may need to make taxable distributions out to them. When proceeds are payable to the partnership, the tax results are entirely different.

g. In cases where there is significant value in the entities and multiple entities, family trusts can be partners in the partnership. The benefit of this type of a structure for example would be if Shareholder A passed away, his interest should not be purchased by Shareholder B because all that does is result in increasing Shareholder B's estate. Another possible problem is that if Shareholder A's ownership interest is "separate property" for marital purposes, if proceeds are payable to A and he purchases B's interest, the purchase could be "marital property" because he or she is now married at the time of the purchase. The options would be to have Shareholder B's trust buy the interest or if Shareholder A's family was continuing on with the family operations, Shareholder A's family trust could acquire the interest. In that case, proceeds are available to the family and the works well with multiple families with no real intention to have a "buy out".

h. If life insurance proceeds are payable to a "C Corporation", they are subject to Alternative Minimum Tax ("AMT"). If payable to an "S Corporation" or an "LLC" or "Partnership" (i.e., any of the pass through entities), there is no AMT assessed.

The partnership agreement will have a requirement that any proceeds that are received by the partnership will be first applied toward the purchase of a deceased owner's interest in the corporations. The remaining proceeds can then be distributed out to the deceased owner's estate or to the remaining partners or entities for key man purposes to the extent there are excess proceeds and this is the intention of all of you.

IV. CHOICE OF FARM BUSINESS ENTITY

A. Objectives.

1. Limited Liability and Protection of Assets.
2. Transferability of Interests.
3. Centralization of Management.
4. Minimizing Income Taxes.

Note that the 2017 tax legislation has changed many of the tax rates for entities as well as farmers who file under their own Schedule F as sole proprietorships. Whether there is an advantage to selecting one form of structure over another can only be determined after having a careful analysis of your own personal situation done by your tax advisors. Although on the surface, a tax rate may appear to be very favorable, your own operations may have an effect on whether such a rate applies to your operation and/or whether it is really favorable when taking into consideration all tax implications. It is important to be cautious when changing from one tax structure to another (e.g. from S status to C corporation status), because of in many cases, it cannot be reversed.

B. **Tax and Non-Tax Considerations in the Selection of a Farm Business Entity.**

Sole Proprietorships	**Corporations**
General Partnerships	**Limited Liability Partnerships**
Limited Liability Companies	**Limited Partnerships**

1. **Sole Proprietorship**. A sole proprietorship is a farm owned and operated by a single person. A business certificate may be filed in the county clerk's office if the business is operating under an assumed name. Income of the owner is reported on the taxpayer's 1040, Schedule F. Eighty percent of farming operations are operated as sole proprietorships.

a. **Advantages:**

(1) Very informal operation.
(2) No formal requirements to organize.
(3) Owner makes all decisions without having to be accountable to others.
(4) No double taxation of an entity – all income reported on owner's returns.
(5) Owner bound by acts of others in entity.
(6) Ownership interest freely transferable.

b. **Disadvantages:**

(1) No limitation of liability for owner from contractual or tort liability.
(2) Reporting of all income on Schedule F may be disadvantage – i.e., no opportunity to shelter income or to allocate between Self-Employment (SE) Tax Income and non-SE Income.
(3) Limitation on ability to deduct certain benefits provided to owner and owner's family.
(4) Tax liability is at owner's rate. If separate entity utilized could be opportunity to have lower tax rate or to share tax liability with others who have lower tax rate.
(5) Unless preliminary steps are taken, entity disappears upon death of owner. Assets and real estate must be transferred individually.

2. **General Partnership**. A general partnership is an organization which is composed of two or more persons. A partnership can be created without a written agreement. However, it is advisable to have a partnership agreement. A certificate of doing business as partners must generally be filed in the county clerk's office. Partnerships are not taxed as a separate legal entity. They are "pass through" entities.

a. **Advantages:**

(1) Very easy to organize – few formalities, nominal operating costs.
(2) Decision making process may be very informal if desired.
(3) Detailed statute provides guidance on decisions making and on other matters concerning operation and dissolution if no agreement in place.

(4) Pass through tax treatment for owners avoiding double taxation on operating income on the sale of assets.
(5) Entity files Form 1065, not Schedule F.
(6) Partnership interests are not freely transferable.
(7) May generally be liquidated tax-free/no double taxation.
(8) Flexibility in capitalization.
(9) May be easily converted to another entity (e.g. LLC or Corporation LLC Law Section 1007).
(10) Farm partnerships can elect cash or accrual accounting.

b. **Disadvantages**:

(1) Unlimited personal liability for owners for acts of entity and acts of partners and employees acting in name of entity.
(2) Partnership interests are not freely transferable.
(3) Entity dissolves upon occurrence of certain triggering events (death, bankruptcy or withdrawal of a partner).
(4) Any partner may dissolve partnership by withdrawal.
(5) Each partner may obligate the partnership.
(6) Taxable year generally calendar year – partnership must conform taxable year to the taxable years of partners. I.R.C. §706(b)(1)(B)(i).
(7) Partners are not employees for purpose of deducting fringe benefits or for payroll tax requirements.
(8) Partnership return required even if no income. Exception for "small partnerships" under I.R.C. §6231(A)(1)(b) [ten or fewer partners, each of whom is natural person or an estate, and equal sharing of profits and losses].
(9) Partners taxable on income whether distributed to them or not. I.R.C. §701 (i.e., if a partnership has non-deductible expenses (e.g. mortgage principal or life insurance premiums), these may be taxable income although there is not necessarily cash to pay for those taxes to the partner.

3. **Corporation**. A corporation is a legal "person" that is created by filing of a certificate of incorporation generally in the Secretary of State's office. A corporation generally has perpetual existence. The owners or shareholders of a corporation have limited liability for the corporation's activities. A corporation is taxed as an entity separate and apart from its owners (unless S status is elected by the entity and its shareholders). S Corporation status is for income tax reporting only – no statutory differences between S Corporation and C Corporation under most states' laws.

a. **Advantages:**

(1) Limited liability of owners for tort and contractual liability of entity: liability limited to capital contribution that is utilized for purchase of shares. Exception: May also be state law exceptions for certain taxes (sales/payroll).
(2) Owners are not liable for acts of co-owners.
(3) Entity not terminated upon death, bankruptcy or withdrawal of owners (unless otherwise agreed in writing). Entity's existence may be perpetual.

(4) Interests (stock ownership) are freely and easily transferable (unless restricted by agreement).
(5) Ability to have centralized management (i.e., several owners but board of directors/officers selected to manage day to day operations.
(6) Ownership interests may be different among owners (i.e., voting/nonvoting interests, preferred/common interests)(there are limitations on S Corporations).
(7) If low profits, C corporation may allow use of lower tax bracket than pass through entity.
(8) C corporation offers the ability to deduct benefits payable to owners. S corporation's ability may be limited, similar to a sole proprietorship.
(9) Ability to retain profits and avoid taxation at personal level.
(10) Corporation laws throughout country are very similar and have long history of interpretation.
(11) Simple to create.
(12) Flexible capitalization requirements.
(13) Ability to select fiscal year.
(14) S corporation distributions not subject to self-employment tax. However, the IRS has announced it will begin review of wages and dividends paid through S corporations.

b. **Disadvantages:**

(1) Certain operating procedures must be followed to avoid piercing of corporate veil and resulting in personal liability for owners (i.e., annual meetings of shareholders, directors; maintenance of corporate minutes, etc.).
(2) Depending on tax structure (C vs. S) double taxation in operations and upon disposition of assets.
(3) S Corporation is restricted from having entities, certain trusts and nonresident aliens as shareholders. Maximum number of shareholders - 100.
(4) Upon incorporation, if liabilities assumed by the corporation exceed shareholders' basis in assets contributed, taxable gain results; I.R.C. §357(c). Otherwise, tax-free; I.R.C. §351. The basis of stock or securities received by the transferors is the basis of property transferred, less boot, plus gain recognized if any. I.R.C. §358(a)(1). If the corporation assumes a liability of the transferor or takes property of the transferor subject to any liabilities, the liability reduces the basis in the transferor's hands. I.R.C. §358(d). If there is debt in excess of basis, a taxable transaction results and gain is realized. I.R.C. §357(c).
(5) A corporate level tax is assessed against sales or exchanges of appreciated assets, that were acquired while the corporation was a C corporation, which are disposed of within 10 years after election of S corporation status. I.R.C. §1347(a). The rule does not apply to assets acquired after S election is made. This may reduce impact to agricultural operations if equipment, machinery are replaced. Except for land, most farm assets are replaced in three to six years (cattle, equipment, etc.). Therefore, built-in gains tax may not be a burden to a farm corporation.
(6) May be state-level assessments, minimum tax or filing fees applied each year.

4. **Limited Liability Company**. A limited liability company is a legal entity that offers its owners protection from personal liability but allows the entity's owners to be taxed as a partnership (unless the owners elect to be taxed otherwise). An LLC is created by filing "Articles of Organization" with the Secretary of State and entering into an operating agreement (LLCL §203) or by converting a general partnership to an LLC on a tax-free basis. [LLC Law §1007] Some states allow for a statutory conversion. In other states, an LLC is created and general partnership interests are transferred to it. An Operating Agreement is the equivalent of the Partnership Agreement LLC Law §417.

   a. **Advantages:**

      (1) Owners enjoy limited liability for obligations and liabilities of entity and other owners.
      (2) If Pass through entity – avoids double taxation.
      (3) Flexibility in management and governance. Management may be by members or by managing members (similar to a board of directors).
      (4) Ownership interests may be structured in a manner similar to corporation (i.e., voting/nonvoting interests, preferred/common interests).
      (5) Common form of business operation internationally.
      (6) Single Member LLC does not need to pay annual filing fee or to file separate tax return (report income on Schedule F).
      (7) Simple to create. General partnership can convert to LLC tax-free. *PLR 9618021* (Feb. 2, 1996).
      (8) Multiple LLCs can provide allocation of income, protection of assets from liabilities of the other LLCs, etc.
      (9) If taxed as a partnership, flexible allocation of income, distribution of assets, etc.
      (10) LLC can elect whether to be taxed as a partnership, C Corporation or S Corporation.

   b. **Disadvantages**:

      (1) Similar to a corporation technical operating requirements must be followed in order to enjoy limited liability and to avoid piercing of the veil.
      (2) Certain steps must be taken in operating agreement aid procedurally in order to avoid dissolution upon death, bankruptcy or withdrawal of an owner/member.
      (3) May affect eligibility for ASCS/FSA payment programs.
      (4) Must be careful to avoid unnecessary self-employment tax for those not active in farm. An LLC member is subject to self-employment tax or income of LLC if a member is a manager or if the LLC has no designated manager. Prop. Treas. Reg. §1.1402(a)-18.
      (5) May be annual filing fees or minimum assessments imposed under state law. E.g. In 2007, New York state increased the annual filing fees for Limited Liability Companies and certain other entities by a significant amount depending on the "gross" revenues of the entity.
      (6) May not be easily converted to another entity (e.g. corporation).

5. **Limited Liability Partnership**. A limited liability partnership is a general partnership, the owners of which are protected against tort and contract liability for acts of the other partners or acts of the partnership itself. In some states LLPs may be composed only of certain professional firms (i.e., architects, accountants, physicians, lawyers, etc.).

6. **Limited Partnership [Revised Limited Partnership Act Sections 101-1300]**. A limited partnership is a partnership which has "general" and "limited" partners. General partners have unlimited liability for the acts of the partners and of the entity. Limited partners are not liable for the acts of the partners or of the entity itself and may not participate in management. LPs are taxed as a general partnership (i.e., a "pass through" entity). Limited Partnerships are created upon filing a certificate of limited partnership in the Secretary of State's office.

   a. **Advantages**:

      (1) Offers all advantages of partnership.
      (2) Allows creation of interests that have limited liability (more attractive to investors).
      (3) Having general and limited partners allows for centralization of management in the hands of the general partners.
      (4) Flexibility as to allocation of losses and profits among general and limited partners.
      (5) Limited partner interests are not subject to attachment by creditors – limited to charging order.
      (6) Ability to transfer equity interests to others while retaining control by general partners. Note: IRS has recently been active in Tax Court challenging such arrangements.
      (7) Form of entity may allow for greater valuation discounts to enhance ability to reduce estate values for owners' estate plans. Note: Entity must have a business purpose. It cannot be merely to discount value of interests.
      (8) Only general partners may dissolve the partnership.
      (9) A partner may be both a limited partner and a general partner at the same time.
      (10) A limited partner's distributive share is not subject to self-employment income tax. 42 U.S.C. §411(a)(11), I.R.C. §77(c). Exception: If guaranteed payments are made as remuneration for services.

   b. **Disadvantages:**

      (1) General partners are personally liable for farm activities as in a general partnership.
      (2) Limited partners may not participate in management or they risk loss of protection from liability for acts and obligations of entity and partners. A limited partner should have no participation in management. Personal guarantee of partnership's obligations could subject limited partner to liability for all partnership liabilities. Limited partner should not provide more than 500 hours of service per year. Prop. Treas. Reg. §1.1402(a)-2(h).

(3) Interests are not freely transferable.
(4) More costly and complex to organize than general partnership (filing requirements, publication requirements).
(5) May affect eligibility for FSA payments.
(6) General Partners subject to Self-Employment Taxes.

C. **Issues to Consider in the Selection of an Entity**.

1. Taxability of the entity and its owners.

2. Ability of owners to obligate the entity and other owners. Personal liability of the owners for actions and liability of themselves, each others and the entity.

3. Centralization of management within the entity.

4. Transferability of interests in the entity. Ability to restrict transferability by agreement.

5. Perpetual or limited existence of entity.

6. Expense of formation and technical requirements which must be followed in the operation of the entity.

7. Form of ownership interests; e.g., S corporations may not have entities and certain trusts as owners and number of owners is limited.

8. Flexibility with respect to allocations of profits and losses of entity.

9. Form of capital contributions being made, equity and non-equity, voting and nonvoting interests being created.

10. Does the entity fit within the owners' estate plans; e.g., only certain trusts may be shareholders of S corporations, may be desire to limit liability of estate for actions of entity etc.

11. What requirements are set forth in the statutes for resolution of shareholder, director disputes? (For example, the ability of a minority shareholder to petition a court for dissolution.) May a shareholders or partnership agreement govern instead of statute?

12. Events which may cause or result in dissolution and tax effects of dissolution.

13. Annual or other regular filing requirements are there for the entity? (For example, tax returns, filing requirements for state, confidentiality issues, etc.)

14. Need for keeping owners' participation on an anonymous basis.

15. Creation of multiple entities may meet family objectives (e.g., land held in one entity [e.g., LLC] with machinery, equipment, livestock in separate operating entity).

V. GETTING STARTED! - - THE ESTATE AND BUSINESS PLAN AUDIT

A. Estate Plan Audit.

1. Review, create or update wills, trusts, powers of attorney, health care planning documents **for everyone involved in the farm.**

2. Are distributions outright? **Consider distributions to trust for asset protection.**

3. Are farm assets specially provided for in the plan? Farm Trusts, Real Estate Trusts, **are Farm Assets for Farm Heirs?**

4. Do the "non-probate" assets reflect the overall intentions for farm and non-farm assets? Beneficiary designations need to be reviewed and/or updated to reflect senior generation's plan. i.e. Retirement plans, life insurance/annuities, jointly held assets - **none of these pass through the will.**

B. Business Succession Audit

1. Review and update Operating Agreements, Partnership Agreements and Shareholder Agreements.

   a. Are management issues properly addressed? **Is there a procedure for appointing successors?**

   b. Does the agreement contain necessary tax related provisions to support the positions taken on the tax return? **Guaranteed Payment Provisions, Profit Interest Provisions, Allocation of Profits and Losses?**

   c. Are minutes and other governance documents up to date?

   d. Have entities been created to limit liability exposure?

   e. Are written leases in place between entities to support tax returns, minimize income, possibly payroll taxes, etc?

2. Review of Buy Sell Agreements.

   a. Are the parties correctly set forth?

   b. Are multiple generations properly reflected?

c. Are triggering events correct? Death, disability, voluntary and involuntary termination? **All events may not apply to all owners.**

d. Is the value for purchase properly stated and updated? Certificate of value, appraisal, etc.

e. Is the agreement properly funded or do the terms protect cash flow of the entity? **E.g. life insurance should be obtained where possible. In cases where life insurance is not available or applicable are payment terms properly structured so as to not adversely affect the farm's cash flow?**

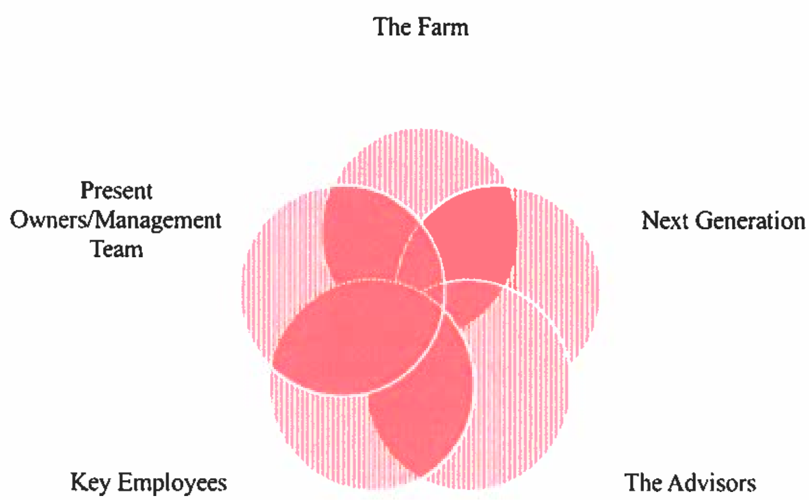
VI. SUMMARY

In a closely held agriculture business, generally the assets of the business make up most of the owners' estates. Although the objective of a family may be to perpetuate a family farming operation for as long as family members wish to farm, outside pressures weigh heavily on the ability to do so. Estate and income taxes, dealing with farm and nonfarm children, retirement issues, land value issues, long term care issues, commodity and input prices, etc. all add to the complexity of putting together a plan that can withstand these outside pressures and result in a successful multi-generational plan.

It is important to plan early in order to develop a comprehensive plan that can address all the "what ifs" that come along in the life of a family business. **Once implemented, the plan needs to be monitored and maintained in order to ensure that it continues to be up to date and reflect the intentions of the family and the owners**. Laws continually change as do the facts and circumstances surrounding a family and a family owned business. To ignore these changes can be as devastating as not having any plan in place at all.

Regardless of how large or small an operation is, it is imperative to have an advisory team working with the family and the family farm owners. These advisors can provide valuable insight not only to family members but to other members of the advisory team to ensure that the plan is properly structured and works well into the future.

The Successful Farm Succession Planning Team


The Farm
Present Owners/Management Team
Next Generation
Key Employees
The Advisors

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Protecting Farm Assets: Trusts and other Estate Planning

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Sustaining NY's Farms

Legal Solutions for Farm Business Futures

October 3, 2018

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FOR A SECURE FUTURE

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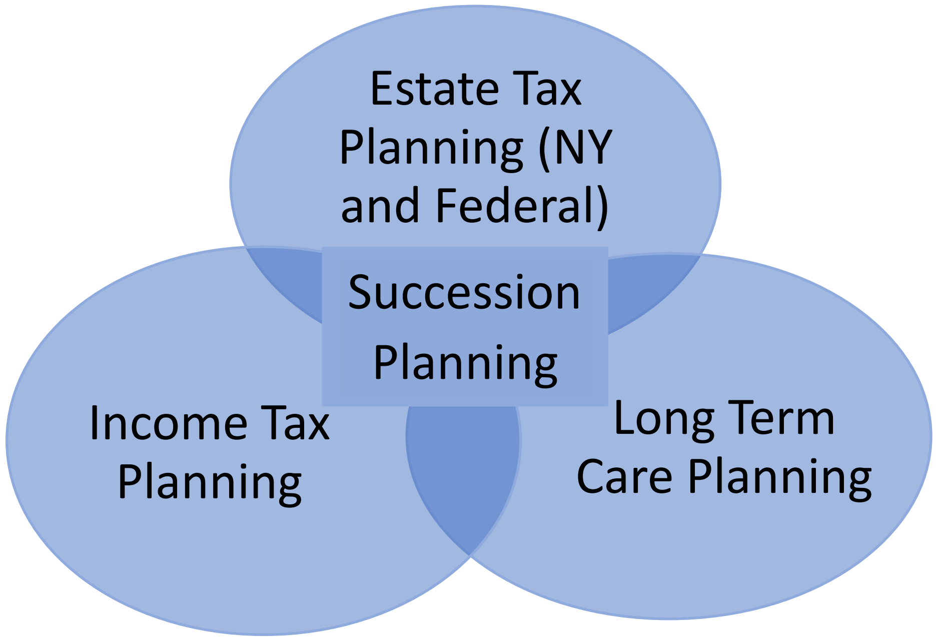
Protecting Farm Assets: Trusts and Other Estate Planning Tools

The information provided is a summary outline for education purposes containing important concepts for considering how to protect farm assets. This is not a substitute for consulting with an attorney or for attorney review of specific laws and rules for updates and information pertinent to a client matter.



Protecting Farm Assets During Life:

1. **Durable Power of Attorney,** New York Statutory Power of Attorney, NY Consolidated Laws, General Obligations Law- GOB § 5-15101B

Basics of Power of Attorney:

1. Gives authority to designated Agent to be the "**Attorney in fact**" for the client (the "**Principal**");
2. Every adult should have this document to help designate someone to take over their affairs if needed. None of us are immune to emergency (car or tractor accident etc.)
3. **Durable** means the authority is given now, regardless of the condition of the Principal to make own decisions;
4. **Nondurable** (aka "springing") takes effect under circumstances such as incapacity. More difficult to get doctors, banks, etc. to agree on accepting a nondurable power of attorney without Court order and approval.

Important for:

1. Avoiding the need for Guardianship Proceeding (Including a Revocable Living Trust for stronger guardianship avoidance could be better planning);
2. Extensive powers in Modifications section may be drafted by attorney and are necessary for additional planning for potential long term care needs, etc.
3. Statutory Gifts Rider necessary for any gift and note planning. Executed at the same time as the Power of Attorney.

Caution:

(a) These are frequently executed incorrectly. There are only certain sections that can be modified. **<u>Do not recommend to Clients to download form and try to do it themselves.</u>**
I have heard of financial planners and bankers recommending this and it is very dangerous (this document may look like a form but there is significance in what is added to it, how it is signed etc.)

(b) Powers granted should be initialed, not check marked.

(c) Some sections allow for one initial to be made to accept a list of powers. Make sure all powers you want are included on that line.

(d) Choose your Attorney-in-Fact wisely. Similar to selecting a Trustee, Client should be warned that agent for power of attorney would have authority to take money out of accounts, etc.

(e) Attorney-in-Fact has a fiduciary duty but Client and Attorney should prefer not to have to police the agent and waste money and energy in litigation. Consider succession instructions. See "Important Information for the Agent" in paragraph (n) of *GOB § 5-1513*.

(f) Consider whether to appoint a Monitor.

(g) Consider if Client establishes a new residence out of state (you might have some powers in modifications that may be needed for planning in other states, e.g. Florida). *See* Solkoff, Scott, "The Snowbird Client," NYSBA Elder Law and Special Needs Journal Vol. 28 No. 2 Spring 2018.

(h) Include modification to allow agent access to digital assets (email accounts, cloud accounts etc.). It won't guarantee that providers will allow access but it is good to show Principal's intent to grant access to electronic records.

Problems with Current New York Statutory Durable Power of Attorney:

1. The statute calls for the Agent to sign and date the power of attorney. The standard durable power of attorney has a signature line without a place to date. It is best practice to have your agents date, although the date should be inferred by the acknowledgment (notary).
2. Many banks are refusing to accept it. NYSBA in its recommendations to the legislature has recommended a penalty for banks not accepting. You may wish to have a modification allowing your clients to have a separate power of attorney with a bank with an intent not to replace the one you prepare.
3. Complicated to fill out correctly but it is also important to have attorney knowledge and thought in preparing and completing. **<u>Clients should use a knowledgeable attorney for completion.</u>**
4. Statutory Gifts Rider is a separate component and often forgotten. It may be important to complete this and to allow for gifting over the annual gift tax exclusion limits for clients who may need to be Medicaid eligible.

Long Term Care- Planning for Possibility that Clients will need Nursing Home Care:

Planning to Pay for Long Term Care:

1. Consider **Long Term Care Insurance** or hybrid policy (life insurance with a long term care rider). Have Clients talk to insurance agents or financial advisors for details on these policies.
Cons: costly for many clients; must pass health assessment to qualify; fewer companies are offering these policies and premiums are increasing.

Pros: Great alternative to privately paying; a responsible choice for paying for your care by planning ahead; State Partnership Plan policies provide Medicaid coverage if policy benefits exhausted without meeting asset test (income still applied to cover cost of care).

2. **Private Pay**- means Client pays for nursing home out of their own assets.

3. Transfer to an **Irrevocable Trust** (trust may be called different names by different practitioners)

a. Client contributes assets to Trust (irrevocable- loses control over assets and cannot be the Trustee);

b. Consider whether it should be a grantor trust- client continues to have income of trust attributed to client's individual tax return during life (upon Client's death, trust must obtain EIN if it does not have it's own already and trust taxed on income); Some practitioners prefer non-grantor trust so that no income will be attributed to Client.

c. Client may be an income beneficiary but **CAN NEVER receive PRINCIPAL** from the Trust. Some practitioners do not allow Client to be an income beneficiary.

d. **5 Year Look Back Applied:** If 5 years pass after assets are contributed to the Trust, those assets that were contributed prior to the 5 year lookback are not countable as Client's assets for Medicaid purposes and Client is not penalized in application process for the transfers under current law.

e. Typically Trustee or Trustees may be adult children of the Clients. Adult children are often named as beneficiaries of the Trust. You do not need to provide equal distribution of income or principal.

f. Assets that can be held in Trust include farm real estate; LLC interest; bank accounts; investments (other than individual retirement accounts); life insurance (Trust can be named as Owner and Beneficiary)

g. Real Estate is a good choice for these trusts because you can preserve the right of the Client to live in any real estate and retain STAR exemption for principal residence, and structure to include STEP-UP in basis at death. None of this would be possible with an outright gift and holding the land in Trust provides creditor protection that an outright gift or life estate deed could not.

h. Land in trust can be sold and new land purchased without it being a new transfer of the Client (not triggering another 5 year look back). *Caution* – it can be more difficult and a little more costly to obtain a mortgage loan for an Irrevocable Trust. Banks that provide such loans do this through their private banking portfolio as Fannie and Freddie will not buy these types of mortgages so most banks won't sell them. If your clients already have a mortgage, the due on sale clause should not be triggered for a residential property in which they retain occupancy rights. (*See Garn-U.S. St. Germain Act*, 12 U.S.C. §§ 1701j-3(d)(7) and (8)).

For farmland or non-residential properties where you may be concerned about a "Due on Sale Clause," see if you can get the lender to provide a simple written consent to the transfer, state that the bank's mortgage shall maintain priority and that that the transfer will be subject to the mortgage. Ask a banker to sign and return to you for your file. Do not ask for lender to release grantor from the note, you do not want debt forgiveness.

i. STEP-UP- Consider reserving a limited power of appointment for Client to change ultimate beneficiaries of the Trust at death among children or charities. This preserves STEP-UP in basis. Consider giving a Trust Protector the power to grant a general power of appointment to beneficiaries, which would help beneficiaries who receive the property to obtain a step up in basis at their death (remember in order to receive a STEP-UP in basis at death it means that property is included in the beneficiary's estate).

4. **Gifting**
    a. Lifetime gifting to reduce a Client's assets may be used to help the Client qualify for Medicaid; gifts would be subject to current 5 year Medicaid lookback period at the time of application
    b. A gift is forever and now, it cannot be given under a condition to be returned. Gifting during lifetime means the person receiving the gift receives the donor's basis. You lose an opportunity for an increase in basis at the donor's death that you would otherwise have by leaving property in an irrevocable trust or will for transfer at death.
    c. If your client gifts now, there is no telling what could happen to recipient of the gift (creditors, divorce, etc.) that could affect your gift and your plans.
    d. For Clients who are actively applying for Medicaid or need nursing home care right away, you may consider creating a **Gift and Note Plan** whereby you utilize a gift from the client to another person, thereby triggering a penalty period and have a promissory note start at the same time with payments in an amount needed to help the client privately pay through the penalty period caused by the transfers. This type of last minute planning involves a close analysis of all of the clients assets and liabilities and caution in calculations to make sure you the client will be "otherwise eligible" for Medicaid but for the transfers made for the gift and note plan.
    e. **Another option - deed with a retained life estate**. Client can retain STAR exemption, however, if the property is sold while Client is receiving Medicaid, some of the proceeds is non-exempt and could make your Client ineligible. It can also be problematic if the holders of the remainder interest of the life estate deed have creditor problems, the property can be subject the rights of those creditors.
5. **Business Entity Use**
    a. If your Client's farm and farm assets are owned by a business entity, there is greater protection due to shared ownership and rules generally not counting business assets of an active business for Medicaid purposes. (Caution - there are limits to these rules).
    b. Depending on Client's desired goals and desire for asset protection and involvement of others, you can design LLC or other business structure with unanimous or supermajority voting or different classes of involvement. You may also wish to designate a Farm Manager (perhaps your Client) and allow for income to the Farm Manager.
    c. You do not need to have an LLC or business structure to put the farm property into a Trust but it might make more sense for your business to use this type of structure and then preferably have your Client's interest in the LLC held by an irrevocable trust.
6. **Testamentary Trusts -** It is a good practice in wills for Farm Family Members to include contingent or specific testamentary supplemental needs trusts so that if a beneficiary of a Will is or becomes a person with special needs, any assets passing to that person through a Will would have to be given to a supplemental needs trust in order to protect that beneficiary's access to benefits.

7. **Veteran's Programs -** There are other options, including Aid and Attendance that may be available to Veteran's; there are differences between Medicaid and the VA benefits and Clients will not necessarily pursue both.
8. **Ethics in Planning -** An attorney can assist a client with Medicaid planning so long as such planning does not constitute a fraudulent conveyance under the law. Fraud "does not include conduct, although characterized as fraudulent by statute, or administrative rule, which lacks an element of scienter, deceit, intent to mislead, or knowing failure to correct misrepresentations which can be reasonably expected to induce detrimental reliance buy another." New York Rules of Professional Conduct 1.0 (I). The prohibition against an attorney committing fraud does not extend to counseling or assisting a client in transferring property because of the possibility that the transfer will, in hindsight, be determined a fraudulent conveyance. Bottom line- be clear with Clients that you will not help them hide anything. This planning is transparent

If Planning to Apply for Medicaid - Some Medicaid Basics – there are many rules and details beyond these basics:

1. Medicaid is a public assistance program that provides coverage as a payor of last resort for eligible persons – there are different programs and eligibility; this outline reviews current qualifications for Non Modified Adjusted Income (non-MAGI) threshold – those that are over 65, certified blind or disabled, and SSI recipients. Very important to find out about all client's income and resources (assets).
2. Medicaid has Resource Limits - *See* Medicaid Reference Guide for information on Resources: https://www.health.ny.gov/health_care/medicaid/reference/mrg/
   Resources include all types of property, including our resources within the applicants control or control of a guardian. There is a 5 year look-back for all uncompensated transfers (transfers for less than fair market value).
3. Income and Resource Limits are different for Individual Applicants and Couples- if two spouses need care, you have to consider applying for each as an individual, otherwise one spouse is the institutionalized spouse and the other is considered the community spouse.
   For couples there is a **Minimum Monthly Needs Allowance (MMNA)** and a community spouse resource allowance (CSRA). Non-exempt amounts are contributed to the cost of the institutionalized spouse's care. The MMNA is an amount established by regulation that is supposed to be enough to provide adequate support for the community spouse. 18 NYCRR § 3 60–4.10 (A) (8). A Client may consider spousal refusal, refusing to contribute any of their own monthly income to care for their spouse. Even if a Client is ultimately unsuccessful, this strategy could potentially save the Client some money if spouse receives care at a lower Medicaid rate rather than a private pay rate. Reimbursement to Medicaid would be lower than private pay. That strategy should be weighed against added costs for appeal.
4. NY is a **Spend Down State** - **Excess income** will only disqualify you if your income exceeds all your medical expenses, which theoretically should mean you would not need Medicaid. Before you tell Clients to spend down, consider alternatives. Some clients may be able to have excess income go to **Pooled Income Trust** (supplemental needs trust sponsored by a non-profit organization). If your client qualifies, these trusts hold income for individuals and pay their bills for them, any money not spent on the behalf of the Client is left in the pool (not given to Client's family or any Client designated beneficiary).

5. **Home Exempt:** An applicant/recipient can make their home exempt as a resource during their lifetime if the client indicates an intent to return home. If it is clear that the recipient will not be returning home Medicaid may place a lien on the home to collect after the recipient's death in order to recover for Medicaid expenses paid on behalf of the recipient.
6. Medicaid also offers a **Community Home Care** program. There is no 5 year lookback period for Community Medicaid so it is possible for Clients to transfer assets quickly and become eligible. The trouble is, most Clients who need home care will eventually need nursing home care and therefore should plan ahead for the 5 year lookback. Even if a Client can be awarded a sufficient number of hours for home care, there is no guarantee that caregivers will continue to show up for work. The most successful scenarios for home care are when a Client can identify their own caregiver and enroll for home care through "Consumer Directed Personal Assistance Program."
7. Below are **Charts of Income and Resource Levels for Medicaid taken from NYC Human Resources Administration** located as http://www.wnylc.com/health/entry/15/ (retrieved 9/12/2018). These numbers are for Non-MAGI applicants/recipients – meaning someone who are 65 or older, certified blind, certified disabled or receiving SSI. An individual receiving Community Home Care can only keep non-exempt income that does not exceed $864 (the income level plus a $20 income allowance). There are limits for other Medicaid programs for other groups of people that qualify based on Modified Adjusted Gross Income (MAGI).

2018	**Non-MAGI** Disabled, 65+ or Blind ("DAB" or SSI-Related) and have Medicare	
	1	2
Income	**$842** (up from $825 in 2017)	**$1233** (up from $1,209 in 2017)
Resources	**$15,150** (up from $14,850 in 2017)	**$22,200** (up from $21,750 in 2017)

3.	**Spousal Support and Resource Levels**
Income (MMMNA) - $3,090.00 (Inst Spouse) - **$50**	**Resources** – (Minimum) - $74,820 (Maximum) - $123,600 (Inst Spouse) - $15,150

8. **Exempt resources include**: Homesteads (with a Clients subjective intent to return home), Life insurance policies and burial spaces (up to $1500 total value counting total cash value), Reparation accounts, essential personal property, pensions of legally responsible relatives, assets of person is insured under long-term care partnership policies, and certain trusts and supplemental needs trust assets.
   Business property held by business and not individually owned may be exempt subject to limitations, which generally include that the property must be used to produce income (currently or within 12 months from which property stopped producing income).
   Vacation property, second home or camp is not an exempt resource.
   For Medicaid purposes, there is a presumption that a joint bank account is considered to entirely owned by the applicant/recipient, unless facts prove otherwise. 96 ADM-8 at 13. Jointly owned stock and other non-financial institution accounts are presumed to be owned an equal shares.
9. **Community Spouse**
   a. The community spouse resource allowance is the amount of money that would have to be transferred from an institutional spouse to a community spouse in order to attain the maximum level of resources allowed. You can make the calculation by subtracting disregarded or exempt assets, such as a primary residence or an automobile, and allowed resources and dividing the couples remaining resources in half, then limiting that number so that it does not exceed the maximum allowance figure for that year.
      A greater amount of CSRA may be allowed if additional resources are required to increase the community spouses income to the MMMNA.
      After the first month that the institutionalized spouse is eligible for Medicaid, the resources in the community spouse are not considered available to the institutionalized spouse.
10. **Cure of Non-exempt Transfers -** Nonexempt transfers that do not make it through the penalty period can be cured by a return or partial return of assets in order to reduce the amount of the transfer. However, you cannot cure with different property. Generally the return of funds or property should come from the same property tracing back the same way.
11. **To Calculate the Penalty -** For a transfer that is considered an uncompensated transfer within the past five years, divide the total amount of assets transferred for less than farm fair market value by the average monthly private pay rate of a nursing home in clients area where they are Services. New York State Department of health sets the average monthly private pay rate by region:

The **penalty period for transfers** made on or after February 8, 2006, begins the first day of the first month during or after which assets have been transferred, or the date on which the individual is eligible for Medicaid and would otherwise be receiving institutional care but for the penalty, whichever is later, and which does not occur in any other period of ineligibility. Deficit Recovery Act (DRA 2005).

New York City $12,319		
Bronx	Kings (Brooklyn)	New York (Manhattan)
Queens	Richmond (Staten Island)	
Long Island $13,053		
Nassau	Suffolk	
Western $10,239		
Allegany	Cattaraugus	Chautauqua
Erie	Genesee	Niagara
Orleans	Wyoming	
Rochester $11,692		
Chemung	Livingston	Monroe
Ontario	Schuyler	Seneca
Steuben	Wayne	Yates

Central $9,722		
Broome	Jefferson	Oswego
Cayuga	Lewis	St. Lawrence
Chenango	Madison	Tioga
Cortland	Onedia	Tompkins
Herkimer	Onondaga	
Northern Metropolitan $12,428		
Dutchess	Orange	Putnam
Rockland	Sullivan	Ulster
Westchester		
Northeastern $10,719		
Albany	Fulton	Saratoga
Clinton	Greene	Schenectady
Columbia	Hamilton	Schoharie
Delaware	Montgomery	Warren
Essex	Otsego	Washington
Franklin	Rensselaer	

12. **Medicaid Liens -** a lien may be placed on the property of a Medicaid recipient prior to death for a judgment for incorrectly paid benefits, or against real property of a recipient who does not intend to return home or is not reasonably expected to be discharged from the nursing home if no protected relatives reside in the residence. Liens may also be attached to proceeds of personal injury or judgments, awards, or settlement.
13. **Estate Recovery in NY -** Currently the reachable Assets for estate recovery purposes are all real and personal property and other assets included within the individual's estate and passing under the terms of a valid will or by intestacy (the Probate Estate or Estate for Administration purposes). SSL § 369(6).
    a. Use caution with a general power of appointment in an irrevocable trust. *See Matter of Albasi*, 196 Misc. 2d 314, 765 NYS2d 213 (Sur. Ct. Bronx County 2003).
    b. Medicaid should not be able to recover if the recipient is survived by a minor, blind or disabled child. There may also be a waiver of recovery if there is undue hardship. *See* 42 USC § 1396p(b)(3); SSL § 369(5); 02 OMM/ADM-3.

PROTECTING FARM ASSETS: TRUSTS

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UTILIZATION OF TRUSTS IN FARM OPERATIONAL AND SUCCESSION PLANNING

TRUSTS OVERVIEW

Trusts come in many forms and provide many distinct advantages while at the same time, provide even more distinct challenges in determining whether one or more trusts should be incorporated into an operational plan and if so, what type or types of trusts are most beneficial for the particular family and operation.

Prior to establishing any trust, there must be a clear understanding of the advantages as well as potential disadvantages related to the particular trust being considered. The recent estate, gift and income tax law changes on both the state and federal levels have made this decision making process even more important to the present operations as well as to many generations of operators in the future.

Trusts generally fall into one or two of several categories of trusts (and one trust can have many attributes of another trust):

1. Revocable Trusts
2. Irrevocable Trusts
3. Testamentary Trusts
4. Inter Vivos or Living Trusts
5. Insurance Trusts
6. Supplemental Needs Trusts
7. Charitable Trusts
8. Income Only Trusts (or Medicaid Trusts)
9. Qualified Personal Residence Trusts (QPRTs)
10. Grantor Retained Annuity or Income Trusts (GRATs and GRITs)
11. Education Trusts
12. Dynasty Trusts
13. Intentionally Defective Grantor Trusts
14. Spousal Access Trusts
15. Etc.

The purpose of this presentation is to discuss and clarify the various forms of trusts that are available as well as their purposes, advantages and disadvantages and to address how they may be incorporated into a farm operational and succession strategy intended to not only save taxes, but to provide significant other benefits such as asset protection, ease of transfer among members of the operations etc.

A. Statutory Authority for Trusts in New York State (other states have comparable statutory provisions).

1. Overview

   a. Article 7 of Estates, Powers and Trusts Law (EPTL) - private, express trusts

   b. Article 8 of EPTL - charitable, express trusts

   c. Non-Express Trusts (implied and constructive trusts) covered by case law with limited references in Article 7 of EPTL

2. Definition of Trust

   Fiduciary relationship the creator (also known as "settlor" or "grantor") intentionally establishes where the trustee holds legal title to property (the "corpus" or "trust estate") but has an enforceable duty to administer it for the benefit of another person

3. Requirements for Lifetime Trusts

   In response to the increased use of lifetime trusts in estate planning, state legislature enacted six new statutes in 1997 which explicitly set forth the requirements for executing and revoking lifetime trusts and the lawful purposes of a trust.

   a. Lifetime Trust

      Any express trust (with some limited exceptions) created other than by Will.

      Excepted from this definition are trusts for the benefit of creditors, trusts created by judgment or court decree, deeds of trust and mortgages and resulting or constructive trusts.

      A lifetime trust can be created by any person, including a natural person over the age of 18, a corporation, partnership, association or government agency. EPTL 7-1.14.

      A trust may be funded with any property, real or personal, and may include a fee interest, estate for years or a life estate. EPTL 7-1.15.

(1) Execution

a. Trust must be in writing

b. Signed by the grantor and at least one trustee, unless the grantor is the sole trustee

c. Signature of grantor and trustee (if required) must be acknowledged in the same manner as a deed of real estate for recording (e.g. notarized) or witnessed by two individuals.

(2) Amendment or Revocation

Unless the trust agreement states otherwise, amendment or revocation must:

a. Be signed by the person named in the trust agreement who has authority to do so (usually the grantor);

b. Writing amending or revoking the lifetime trust must be acknowledged in the same manner as a deed of real estate for recording (e.g. notarized) or witnessed by two individuals.

Note that if the amendment or revocation power is given to the grantor under the trust agreement, the grantor's agent under a power of attorney cannot amend or revoke the trust. In re Goetz.

Also, if the person amending or revoking the trust and the trustee are not the same person, the person amending or revoking the trust should notify the trustee of the amendment or revocation, otherwise the trustee may continue to act on behalf of the trust under the terms of the prior trust agreement without any personal liability. EPTL 7-1.17.

c. Purpose for Establishing a Trust

An express trust may be created for any lawful purpose. A trust cannot be used to defraud creditors or to evade the law.

d. Merger Doctrine No Longer Valid

Before 1997, if the creator, trustee and income beneficiary were the same person, the trust was deemed invalid, even if the remainderman was different, on the theory that the legal title of the trustee merged with the equitable title of the income beneficiary to create a life estate and that a person with both legal and equitable title had no duty to perform for the beneficiaries. The merger doctrine created a problem for those establishing inter vivos revocable trust ("living trusts") which commonly have the creator as the sole trustee and income beneficiary.

EPTL 7-1.1 prohibits the merger doctrine from applying as long as at least one other person holds an interest in the trust, whether such interest is present or future, vested or contingent.

e. No Recognition of "Passive Trusts"

There must be a duty imposed on the trustee to act for the benefit of the beneficiaries

4. Funding of Lifetime Trusts

Property must be actually and legally transferred to the trust. EPTL 7-1.18. Actual re-titling, re-registration or delivery is required.

If the creator is the sole trustee, re-registering the assets to be held in trust (e.g. stocks, bonds, real estate) is required. If real estate is transferred to trust, the deed should be recorded. If stocks and bonds are transferred to trust, they should be re-registered in the name of the trust. If there are interests in other assets to be transferred, there should be a written assignment describing such interests with particularity.

5. Termination of Uneconomical Trusts

Trustee or beneficiary of a trust can petition the Surrogate's court to terminate any trust when the expense of administering it is uneconomical. The court will grant the petition if it finds that: a) continuation of trust is economically impractical; b) trust agreement does not prohibit termination; c) termination will not defeat the specified purpose of the trust; and d) trust termination would be in the best interests of the beneficiaries.

Court can direct the distribution of the trust assets upon termination of the trust to the current beneficiaries eligible to receive income and/or principal and to the remainder beneficiaries would be entitled to the income and/or principal if the trust terminated immediately before the court decree.

B. Trust Terms Defined

1. Creator/Settlor/Grantor.

   Creator is defined as the person who transfers legal title to property during his or her lifetime or by Will. It includes the grantor of a lifetime trust, the donor of a lifetime gift or the testator/testatrix under a Will. EPTL § 1-2.2.

   Grantor is defined under the Surrogate's Court Procedure Act as the creator of a lifetime trust. SCPA § 103.23. It is defined under the Treasury Regulations as any person to the extent such person either creates a trust, or directly or indirectly makes a gift of property, including cash, to a trust. However, if a person creates a trust but does not make any gifts to it, that person is not a grantor. Reg. §1.671-2(e)(1).

   Settlor is the person who creates the lifetime trust.

2. Trustee.

   Person who holds legal title to property for the benefit of a third person, the beneficiary.

3. Beneficiary.

   Person for whose benefit the trustee holds legal title to property in the trust and who has rights against the trustee to enforce the terms of the trust.

C. Who are the Main Parties? - Duties, Rights and Responsibilities

1. Duties of the Trustee - Generally

   a. Exercise care and skill in acting as trustee
   b. Carry out administration of the trust loyally and in good faith
   c. Comply with the terms of the trust
   d. Refrain from personal use of the property
   e. Refrain from self-dealing
   f. To be fair in any dealings with all beneficiaries (including income and remainder beneficiaries)
   g. Take possession of the trust property
   h. Not co-mingle trust property with his or her own personal property
   i. Keep trust property safe from damage or loss
   j. Deposit trust funds in a reputable financial institution
   k. Make trust estate productive and keep it prudently invested
   l. Distribute the trust property to the beneficiaries according to the trust agreement
   m. Keep accurate and detailed records of all trust transactions sufficient to provide an accounting
   n. Keep and render a full and accurate accounting to the beneficiaries

2. Rights of the Trustee - Generally

Trustee has legal title to the property held in trust. EPTL 7-2.1.

Absent specific direction in the trust agreement itself, the trustee has a broad range of powers and duties that are contained in EPTL 11-1.1 and has investment obligations under the Prudent Investor Act (EPTL 11-2.3).

The powers listed in EPTL 11-1.1 which a trustee is granted automatically (absent a contrary direction in the trust agreement) include:

a. Accept additional property into the trust
b. Invest or reinvest property
c. Maintain insurance for property
d. Sell property
e. Mortgage property
f. Collect rents on property
g. Employ bank as custodian of stock held in trust
h. Contest or settle any claim
i. Vote stock held in trust
j. Make distributions in cash or in kind

Powers that a trustee may have, but must be authorized in the trust agreement, include:

a. Abandon real estate
b. Make extraordinary repairs
c. Continue a business
d. Borrow money
e. Keep funds un-invested
f. Engage in self-dealing

If the trust agreement or the statute does not confer a specific power, the trustee can seek court approval for the exercise of that power.

Effect of Trustee Succession. If a Trustee dies, resigns, is removed or otherwise ceases to serve and there is a co-trustee or named successor trustee, legal title to the trust property vests in the remaining co-trustee or the named successor trustee. If however there is no trustee remaining, legal title to the trust property vests in the court having jurisdiction over the trust (e.g. Surrogate's Court or Supreme Court) and the court will appoint a successor trustee if the trust needs further administration. EPTL 7-2.3. In appointing a successor trustee, the court will consider the reasonable wishes of the trust beneficiaries. The appointed trustees have the same powers, duties and liabilities of the original trustees. A successor trustee is generally not liable for the acts of a predecessor trustee, but is responsible for the assets to come into his or her hands. While the successor trustee has no particular duty to seek an accounting from his or her predecessor, the successor trustee has a duty to proceed against the predecessor trustee for any breach of the trust.

Beneficiary has no legal interest in the trust property and cannot sell or otherwise dispose of the trust property. The beneficiary has an equitable interest in the trust property that allows him or her to enforce the performance of the trust. A remainder beneficiary can dispose of his or her remainder interest to a third party.

3. Prudent Investor Standard

Prudent Investor Act (EPTL 11-2.3) imposes a duty on trustees to invest and manage property in accordance with the prudent investor standard, except as otherwise provided in the trust agreement.

The prudent investor standard requires a standard of conduct, not an outcome or performance. Compliance with the prudent investor standard is determined in the light of the facts and circumstances at the time of the trustee's investment decision.

Trustee is not personally liable to the beneficiary if he or she acted in substantial compliance with the prudent investor standard or in reasonable reliance with the express terms of the trust agreement.

If the trustee has violated the prudent investor standard, the court can deny the trustee from receiving commissions and hold him or her personally liable for the legal fees incurred by the beneficiary caused by the trustee's violation.

4. Acts in contravention of trust are void. EPTL 7-2.4

Persons who buy trust property or otherwise deal with the trustee are charged with knowledge of the terms of the trust agreement.

5. Resignation, Suspension and Removal of Trustee

A trustee may resign in any way authorized under the trust agreement or by application to the Supreme Court if the Court finds it in the best interest of the trust to do so. EPTL 7-2.6.

The Supreme Court may, upon application of any person interested in the trust, suspend or remove a trustee who: (i) has violated or threatens to violate the trust; (ii) is insolvent or whose insolvency is imminent or apprehended; or (iii) for any reason, is a person unsuitable to execute the trust.

If the court approves a resignation or removal of a trustee, the court can appoint a successor trustee and, if there is no acting trustee, may cause the trust to be executed by a receiver or other officer acting under court direction.

6. Duty to Account

   The fundamental purpose of a trust is for one party, the trustee, to hold legal title to property for the benefit of another, the beneficiary, who has the right to enforce the trustee to act in accordance with the terms of the trust agreement.

   The beneficiary's right to enforce the terms of the trust against the trustee is meaningless unless the trustee has a duty to account for his or her actions.

   The trustee's duty to account to the beneficiaries cannot be waived by the terms of the trust agreement, only the timing and form of the account can be prescribed under the trust agreement.

   The accounting must show all property received, all income and expenses, all property paid out or distributed, and the balance on hand as of the closing date.

7. Transferability of Beneficiary's Interest in Trust

   a. Unless the trust agreement provides otherwise, a beneficiary may transfer or alienate his or her interest in the trust. EPTL 7-1.5(a).

   b. However, unless the trust agreement permits it, a beneficiary may not transfer or assign the right to income from the trust. EPTL 7-1.5(a)(1). There are two statutory exceptions to this rule of inalienability of an income interest. First, the beneficiary may transfer income in excess of $10,000 to a favored group of persons, which include a spouse, child, grandchild, sibling, parent, grandparent, niece or nephew. Second, a beneficiary may transfer or assign his or her right to income in any amount to a person whom he or she has a support obligation.

   Note that EPTL 7-1.5 addresses protection of a beneficiary's interest in trust income. But what about the beneficiary's interest in trust principal?

8. Protection of Beneficiary's Interest in Trust from creditors

   a. The interest of a beneficiary who is also the settlor/trust creator of the trust is available to his or her creditors, even if it is needed for his or her education or support. EPTL 7-3.1.

   b. Unless the trust agreement has directed the accumulation of trust income, the amount of trust income is excess of the sum necessary for the education and support of the beneficiary is available to the beneficiary's creditors. EPTL 7-3.4.

   c. Section 5205 of Civil Practice Law and Rules (CPLR) allows a creditor to attach against 10% of the trust income, regardless of whether the income is needed for the beneficiary's support.

d. To provide better protection for the beneficiary's interest against creditors, it is recommend that the trust agreement have a "spendthrift clause", which prohibits the beneficiary from transferring, assigning or otherwise alienating his or her interest to any creditors of his or hers.

9. Protection of Beneficiary's Welfare

   Unless the trust agreement provides otherwise, EPTL 7-1.6 authorizes the court to invade the trust principal for the benefit of any income beneficiary whose support or education is not sufficiently provided for, whether or not the beneficiary is entitled to receive any portion of the principal under the terms of the trust agreement. The beneficiary may file an application with the court for invasion of principal. An exception to this rule exists for supplemental needs trusts under EPTL 7-1.12.

D. Revocable versus Irrevocable

Key difference is that a revocable trust can be revoked by the grantor and an irrevocable trust cannot be revoked.

Most common form of a revocable trust is the inter vivos revocable trust, also known as a living trust. Revocable trusts are always inter vivos trusts because the grantor must be alive to revoke the trust.

Revocable trusts may be irrevocable, for example, upon the death or incapacity of the grantor.

Irrevocable trusts can be either inter vivos trusts, established during the grantor's lifetime, or testamentary trusts, established at the death of the grantor in his or her Will.

Although it is a separate entity, a revocable trust is generally not considered a separate taxpayer for income tax purposes because it is considered a "grantor trust". All items of income and deductions in the revocable trust are reported on the grantor's personal income tax return.

An irrevocable trust is generally considered a separate taxpayer for income tax purposes and is required to file a trust income tax return.

If a revocable trust is properly drafted and funded, all of the grantor's property can pass to his or her heirs outside of probate. But keep in mind that the assets in a revocable trust are subject to estate tax at the time of the grantor's death under IRC 2038.

There are numerous kinds of irrevocable trusts which will be discussed later in detail which potentially remove the trust assets from the grantor's estate for estate tax purposes. Examples include: irrevocable life insurance trusts, qualified personal residence trusts, grantor retained annuity trusts, charitable remainder trusts, supplemental needs trusts.

E. Determining Your Client's Planning Needs

1. Discuss advantages and disadvantages of proposed trust
2. Alternative options available
3. Difference between a revocable and irrevocable trust
4. Client's purpose in requesting a trust
5. Family's needs and desires
6. Identity and qualities of proposed trustee
7. Special needs of the proposed beneficiaries
8. Tax implications of the proposed trust
9. How the trust fits in the overall estate plan scheme

Additional considerations are: cost and effort to administer the trust, personalities of the proposed trustee and beneficiaries, trustee's familiarity with the beneficiary's needs, flexibility of the trust, contingency provisions if proposed trustees and beneficiaries are not around.

REVOCABLE TRUSTS

A. Definition

A revocable trust is one created while the grantor is alive in which the grantor has retained the right to revoke the trust (either alone or in conjunction with another), or in which a power to terminate the trust is granted to someone other than the grantor.

B. Reasons to Use a Revocable Trust

- Avoid Probate.
- Protect against incapacity.
- Privacy.
- Property management.

Avoid Probate

- Probating a decedent's will involves the commencement of a legal proceeding in Surrogate's Court with notice to the decedent's distributees (those persons entitled by law to receive assets from a decedent who dies without a will).

- Decedent's distributees receive notice by means of a citation issued by court and served on the distributee. Legal process may be waived by the distributee by filing a written waiver and consent to probate with the court.

- There may be a delay in probating will. Distributees might not return waivers in a timely manner. Proponents of the will might not be able to easily locate family members, beneficiaries and heirs. Objections to the probate of the will may be filed in court. The decedent's will might not be readily available or it might be lost.

- Revocable trust avoids these delays because property is titled in the name of the trust and trustees are in place at the time of death.

- Revocable trust avoids the need to commence ancillary probate proceedings in other states in those situations where the decedent owns real property in multiple jurisdictions.

- There may be savings of fees and expenses through a reduction in executor's commission, attorney's and accounting fees incurred at the death of the grantor. However, the reduction may be offset by trustee's commission and costs incurred during the life of the grantor.

- The use of testamentary trusts involves fairly close court supervision. There is no court supervision where continuing trusts are established under a revocable trust. (However, matters dealing with inter vivos trusts are handled in the New York Supreme Court (during life of grantor) and generally in Surrogate Court after the grantor's death).

- The use of a revocable trust may reduce the chance of a contest based on arguments of lack of capacity, fraud or undue influence where the grantor has funded and used the trust during his or her lifetime. This is so because it can be shown that the grantor managed the trust competently over a lengthy period of time.

Protect Against Incapacity

- Revocable trust may be of benefit to someone under a present mental or physical disability or who may be concerned about future disabilities.

- Other techniques deal with this issue, for example powers of attorney and guardianships. However, these tools have certain limitations when compared to a revocable trust. A power of attorney terminates upon an event of disability, unless it is durable in nature. This is not the case with a revocable trust. A guardianship occurs only after there has been a court hearing, which is public in nature. The revocable trust is a private arrangement. The revocable trust can be a more flexible planning device; particularly, with respect to specific powers granted to the Trustee and the ability to direct, manage, control and distribute Trust assets.

- In the event of a disability, the co-trustee or successor trustee assumes management responsibility of the trust.

Privacy

- Assets are titled in the name of the trust, thus avoiding the need for probate and court intervention. As a result, no asset lists or property inventories are required to be filed with the court.

- Because property inventories are not filed, the public cannot learn about the amount, character and ultimate disposition of the grantor's property.

- Privacy may not be absolute, however. Some states may require the filing of copies of estate or inheritance tax returns with the court. In this regard, New York changed its law for decedents dying on or after February 1, 2000. Now, copies of estate tax returns are only filed where required by local rule.

- Families of an incompetent are sheltered from publicity where the incompetent's assets are held in a revocable trust. This is so, because there would be no need for the appointment of a guardian which entails a court hearing.

Property Management

- A revocable trust provides better continuity of ownership than a disposition by testamentary trust.

- It provides grantor with opportunity to observe and evaluate the trustee's management of the trust.

- Grantor can provide trustee with training and guidance with respect to particular assets that may become part of the trust (i.e., a business of the grantor).

- Where the revocable trust holds a business of the grantor, his or her subsequent death or incapacity is less disruptive to the daily activities of the business.

- The use of a revocable trust allows the grantor to acquaint the trustee with personal and financial concerns of the beneficiary during the grantor's life.

Costs of Creating and Operating a Revocable Trust

- Costs of creating a revocable trust may be higher than a will.
- Overall costs of operating a revocable trust depends on whether a professional trustee is chosen.
- Fees and commissions may be saved if individual or non-professional trustees are chosen.
- Certain fees are incurred regardless of the choices of trustees, e.g., accounting and custodian fees.
- Reduction in probate and other post-mortem costs may be offset by lifetime professional trustees' fees and charges.

Choice of Law

- A revocable trust provides flexibility in allowing the grantor to choose the laws that will govern the trust.
- New York Law (Estates, Powers and Trusts Law §7-1.10) provides:

  Whenever a person, not domiciled in this state, creates a trust which provides that it shall be governed by the laws of this state, such disposition shall be given effect in determining the validity, effect and interpretation of the disposition in such trust of: (1) any trust property situated in this state at the time the trust is created; (2) personal property, wherever situated, if the trustee is a person residing, incorporated or authorized to do business in this state or a national bank having an office in this state.

Tax Considerations

- With respect to income taxes, the general rule under Internal Revenue Code ("Code") §676 is that if the power to revest in the grantor the title to any portion of a trust is exercisable by the grantor, a non-adverse party, or both, the grantor is treated as the owner of that portion of the trust. As a result, the grantor is required to include in his or her taxable income those items of income, deduction and credits attributable to that portion of the trust the grantor is deemed to own.
- Adverse party is a person who has a substantial beneficial interest in the trust. This is an income beneficiary, remainderman, or both.
- Grantor's social security number may be used for the trust's taxpayer identification number where the grantor is the sole trustee.

- Income is reported on grantor's form 1040 as opposed to form 1041 where grantor is the sole trustee.

- On the death of the grantor, the revocable trust, if it does not otherwise terminate, becomes irrevocable and reports items of gain or loss on Form 1041. At that point, the general rules of income taxation of trusts apply.

- Under the gift tax laws, no gift taxes are involved with the transfer of property to a revocable living trust because the transfer does not constitute a completed gift. However, a transfer of property out of the trust to an individual other than the grantor may result in gift tax liability (see IRS Regulations §25.2511-2). Under the estate tax laws, the assets held in a revocable trust will be included in the grantor's taxable estate because of the grantor's retained right to alter, amend, revoke or terminate the trust.

- Prior to enactment of the Taxpayer Relief Act of 1997 (TRA '97), a revocable trust had numerous disadvantages for federal income tax purposes after the death of the grantor. TRA '97 added Section 645 to the Code which permits an executor and a trustee to elect that a qualified revocable trust be treated and taxed as part of a decedent's estate for income tax purposes. Making this election means that only one form 1041 need be filed rather than separate returns. As a result of this Section, a trust may now select a fiscal year rather than a calendar year. Further, amounts paid to or permanently set aside for charity may be deducted, as may amounts up to $25,000 in real estate passive losses.

  Under this section, a qualified revocable trust is any trust that was treated under Code Section 676 or owned by the grantor by reason of a power in the grantor. This means the typical revocable living trust.

  The election is made by attaching a written statement to the form 1041 filed for the first year of the related estate. The statement must contain the following information:

  - Declaration that a Section 645 election is being made;

  - Name, address, date of death and taxpayer identification number of the decedent;

  - Name and address of the qualified revocable trust and its taxpayer identification number, if any;

  - Name and address of the related estate and its taxpayer identification number;

  - Representation that the trust is a qualified revocable trust;

- Representation that the personal representative elects to treat the qualified revocable trust as part of the related estate, and that he or he understands the requirements to make a timely return of income for the combined related estate and qualified revocable trust, and make timely payments of any tax due; and

- Statement from the trustee that he or she elects to treat the trust as part of the related estate and will cooperate with the personal representative for the combined related estate and qualified revocable trust and pay any tax due.

Coordination with Wills

- Revocable trusts are usually accompanied by a pour over will which ensures that the grantor's remaining assets (those assets not titled in the revocable trust prior to the death of the grantor) are added to the corpus of the trust. The use of a pour over will avoids duplicate administration: one for the trust; and, one for assets passing under the will.

- Terms of the trust agreement should include authorization for the trustee to accept the assets for the probate estate.

- Provisions of the will and the trust should provide for the appropriate method and responsibility for paying estate taxes.

- Terms of the trust may coordinate with the grantor's estate to provide liquidity for the payment of claims and administrative expenses, or will or taxes.

- Where a pour over will is used, the drafter might consider replicating the dispositive provisions of the trust agreement in the will. This will avoid an inadvertent intestacy should the trust be revoked and a new will not put in place.

IRREVOCABLE TRUSTS

A. Preliminary Thoughts

Subject to limited exceptions, irrevocable trusts cannot be changed or terminated by the trust creator at any time. Irrevocable trusts can be created by a trust agreement or under the terms of a Will. A trust created under a Will becomes irrevocable upon the death of the testator or testatrix.

The scope of this presentation and the written materials covers inter vivos irrevocable trusts.

Unless the terms of the governing instrument state that the trust is revocable, the trust is presumed to be irrevocable. EPTL 7-1.16.

EPTL 7-1.17 sets forth the requirements for the valid creation of irrevocable trusts. The trust must be in writing, signed by the trust creator and, if the trust creator is not the sole trustee, by at least one trustee, with the signatures of the trust creator and trustee either notarized or witnessed by two competent, disinterested persons.

An irrevocable trust is only effective with respect to any assets transferred to it.

There are many purposes for which irrevocable trusts can be used. A trust can be used to protect assets against future creditors of the trust beneficiary, to preserve the trust beneficiary's eligibility for government assistance benefits and to reduce or eliminate estate taxes on assets transferred by the trust creator.

B. Asset Protection

Concerns

1. Internal

    a. Beneficiary's current medical condition or disability
    b. Beneficiary's alcohol or drug addiction
    c. Beneficiary's inability to manage finances
    d. Beneficiary's whose personal judgment is questionable
    e. Beneficiary who is young or immature

2. External

    a. Lawsuits
    b. Business failures
    c. Divorce
    e. Transfer taxes (e.g., gift, estate, generation-skipping transfer taxes)

Planning Ideas

1. General

    a. How much control should trust beneficiary have over trust assets?

    b. Should beneficiary participate in trust management? Consider the beneficiary's ability to manage own finances.

    c. Should beneficiary participate in trust distribution decisions? Consider nature of beneficiary's marriage, profession.

2. Beneficiary as Trustee or Co-Trustee

   a. Beneficiary as Sole Trustee

      EPTL 10-10.1 permits a beneficiary to be the sole trustee of his or her trust as long as distribution authority is limited to beneficiary's health, education, support and maintenance. This is consistent with IRC 2041 treatment that having such authority will be considered as having a "general power of appointment".

      Disadvantage: little creditor protection, creates enforceable right to distributions

   b. Beneficiary as Co-Trustee

      Completely discretionary distribution authority provides maximum creditor protection with spendthrift provisions prevents the provisions of EPTL 7-1.5 (which authorize the beneficiary's transfer of income over $10,000 to family members or income to meet support obligations).

      CPLR 5205(c): trust principal for beneficiary who is not creator is exempt from claims of beneficiary's creditors; trust income for such beneficiary only available if there's an enforceable right to it (note: 90% of trust income is generally exempt from beneficiary's creditors unless court determines income is not needed for beneficiary's living expenses)

3. Considerations in Appointing a Beneficiary as Co-Trustee

   a. Is the beneficiary financially responsible?

   b. Age of the beneficiary

   c. Requiring consent of third party to serve

4. Removal and Replacement of Trustees

   a. <u>Treas. Reg. 20.2041-1</u>
      Beneficiary's unrestricted power to remove trustee and appoint anyone as replacement trustee is treated as having the power of the trustee (e.g. tantamount to a "general power of appointment")

   b. <u>Rev. Rul. 95-98</u>
      Beneficiary permitted to remove trustee and appoint replacement trustee without being treated as having the power of trustee as long as replacement trustee is not a "related or subordinate party" under IRC 672(c) (e.g. not a spouse, parent, sibling, descendant of beneficiary)

c. Consider appointment of trust protector (or third party) to having removal and appointment power

5. Distributions at Triggering Events

a. Occurrence at stated ages or certain number of years following a certain event

b. Exposes trust assets to trust beneficiary's creditors when distributions are scheduled to be made

c. Consider making distributions completely discretionary rather than mandatory

INTENTIONALLY DEFECTIVE GRANTOR TRUSTS

A. Making a Trust Defective

While there are many powers within the Grantor Trust rules (Code §671-679) that will make a trust "defective" for income tax purposes, be mindful of those powers will also cause estate tax inclusion under many of the various "pull back" provisions of Chapter 11 of the Code.

To be fully effective, the trust must be a Grantor Trust not only as to income but also as to principal. Grantor Trust status as to income will require the Grantor to report the trust's taxable income, but Grantor Trust status as to principal will avoid the Grantor having to recognize gain on the sale of the asset to the trust.

B. Provisions and Powers Causing Grantor Trust Status.

1. Spousal Powers or Beneficial Interests

- Under Code §672(e), the Grantor is treated as holding any power or interest held by the Grantor's spouse for purposes of Code §§672 thru 678.

- A spouse holding discretionary powers (e.g., as trustee) will cause the trust to be treated as a Grantor under Code §674(a), provided such powers are not subject to the consent or approval of an adverse party.

- A spouse who holds a beneficial interest in the trust will cause the trust to be a Grantor Trust as to that portion of the trust which the spouse may receive (see Code §§674 and 677); if only as to income, then an income interest is attributed to the Grantor; if as to principal, then the principal interest is attributed to the Grantor.

- While powers and beneficial interests in a spouse seem to be a very simple way to cause Grantor Trust status, there are several potential problems relying solely on such powers:

- If the spouse dies, or if there is a divorce or separation, Grantor Trust status will cease, and if at that time the note has not been paid in full, all future payments will be taxable to the Grantor.

- If for any reason the Grantor wants Grantor Trust status to cease and the Grantor is relying on the spouse's beneficial interest for that status, then the spouse would have to disclaim all interests which in all likelihood will be unqualified and a potential gift by the spouse).

2. Power to Substitute Property of Equal Value (IRC Section 675(4))

"The Grantor shall be treated as the owner of any portion of a trust in respect of which:

> ...(4) GENERAL POWERS OF ADMINISTRATION. - A power of administration is exercisable in a non-fiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of this paragraph, the term "power of administration" means any one or more of the following powers...
>
> (C) a power to reacquire the trust corpus by substituting other property of an equivalent value."

- The power in the Grantor or a non-adverse party, in a non-fiduciary capacity, to reacquire trust property causes Grantor Trust status and is a very useful provision.

- Since the power to reacquire property mandates only substitution at equivalent value, such a provision will not cause estate tax inclusion under most circumstances (however, such a provision will cause estate tax inclusion if found in a Qualified Personal Residence Trust; see Tres. Regs. §25.2702-5(c)(9)).

- The power to substitute property needs to be over any asset within the trust but makes the entire trust will be a Grantor Trust.

In order to cause Grantor Trust status, the power needs to be held by someone in a non-fiduciary capacity. If the power is given to the Grantor, this should not be an issue because the Grantor will in all likelihood not be a trustee (if the Grantor is a trustee, Code §2038 will cause estate inclusion).

Giving the Grantor the ability to reacquire the property also allows the Grantor to retain a "string" with which to pull back the asset should it become absolutely necessary. However, remember that while the Grantor can retrieve the property, the Grantor may only do so by substituting property of equal value. Therefore, while the Grantor's reacquiring the property is probably not a feasible solution, the option may give the Grantor some comfort and also may help keep the beneficiary from being careless with the business asset.

3. Power in Grantor to Borrow Assets Without Adequate Security - Code §675(2)

   The Grantor will be treated as the owner of any portion of a trust if the Grantor, or any non-adverse party, may borrow any portion of the trust without adequate security or the payment of adequate interest.

   - Estate Tax Problems With No Adequate Interest

     Code §675(2) states, "without adequate interest **or** without adequate security" (emphasis added). Therefore, if the Grantor has the ability to borrow upon demand any portion of the trust without either adequate interest or adequate security, then the trust will be a Grantor Trust as to that portion of the trust. However, allowing the Grantor to borrow without adequate interest could potentially cause inclusion in the Grantor's estate under Code §§2036 or 2038. While a similar inclusion argument could be made for adequate security, it is less likely.

   - Non-Adverse Party

     The power to borrow may be given to a non-adverse party (such as an Independent Trustee). Granting such a power to the Independent Trustee, to be used in his or her discretion in a fiduciary capacity should still make the trust a non-Grantor Trust. Remember that Code §675(2) does not prohibit such powers to be held in non-fiduciary capacities, but only Code §675 (4) powers are to be held in a non-fiduciary capacity.

   - Not a Grantor Trust if Power is General Lending Power

     Code §675(2) will not apply to a trustee who is authorized to make loans to any person under a general lending power.

   - Power to Borrow (Code §675 (2)) v. Borrowing Code §675 (3)

     It is important to make the distinction between the power by the Grantor to borrow trust assets without adequate security or interest (Code §675(2)), and were the Grantor has actually borrowed trust funds without adequate security or adequate interest. Code §675(2) is the ability to borrow, which will always apply so long as the ability to borrow with adequate security or interest is real. IRC §675(3) only applies when the loan is in existence.

Therefore, IRC §675(3) is not a provision which is useful in causing Grantor Trust status.

4. Power in Person to Add Beneficiaries

Code §674(a) and (c) provides that a trust will be a Grantor Trust as to any portion of the trust if a person (other than an adverse party) has the power to add beneficiaries (other than by will). The power to add beneficiaries is probably the most common Grantor Trust power used by the estate planner to make a trust a Grantor Trust.

- Grantor Can Not Participate

  In order no to include the property in the taxable estate of the Grantor under Code §§2036 or 2038, be sure the Grantor is not involved in the decision to add to the class of beneficiaries.

- Non-Adverse Party

  This power is effective if held by a non-adverse party.

- Survival of Power

  Be careful not to fall into the common trap of giving the power to an individual who may die or become incapacitated effectively at such time making the trust a non-Grantor Trust. Therefore, the power should be given to a position, like Independent Trustee or Trust Protector, and not a specific person, so that the power to add beneficiaries will continue to the successor Trustee or Trust Protector.

- Adding After-Born Children

  If the power is limited to only being able to add children born after the creation of the trust, then such a power will not cause Grantor Trust status.

- Limiting the Power (but not too much)

  Most Grantors will not be thrilled at the concept of granting to a trustee or anyone the ability to just carte-blanche add beneficiaries to a trust (especially one which contains the family business), therefore, the power to add beneficiaries should be limited. As seen above, if it is only limited to adding children born after the creation of the trust, then the power will not cause it to be a Grantor Trust. Thus, most practitioners will suggest that the power to add beneficiaries is limited to adding charitable beneficiaries or adding spouses of beneficiaries. However, the practitioner must be careful not to limit the power too much, because if the power is so limited that the person has no discretion to add beneficiaries, then the power is not real and the power may be found to not cause Grantor Trust status.

- Using Multiple Provisions

  While only one of the above provisions will be necessary to cause Grantor Trust status, adding more than one such power is prudent.

- Reimbursement Provisions

- Mandatory Reimbursement of Taxes

  The trust may require or allow the Trustee to reimburse to the Grantor for any income taxes paid by the Grantor by reason of inclusion of trust income on the Grantor's tax return.

- Discretionary Reimbursement

  Alternatively, the trust may give an Independent Trustee the discretion to reimburse the Grantor for such taxes. However, caution should be exercised when using such a provisions so as to not result in inclusion of the Trust assets in the Grantor's estate.

SUPPLEMENTAL NEEDS TRUSTS

A. Purpose

Avoid trust assets from being considered a resource of beneficiary's for eligibility for government assistance benefits.

B. Third-Party vs. Self-Settled

Third-party funded with assets of someone other than beneficiary. Self-settled funded with assets of beneficiary.

C. Third-Party Supplemental Needs Trusts (EPTL 7-1.12)

Requirements

1. Discretionary income and principal distributions
2. Beneficiary has a "persistent and chronic disability"
3. Funded with assets of someone other than beneficiary, beneficiary's spouse or a person with legal obligation of support to beneficiary
4. Intent to supplement government assistance benefits
5. Prohibit trust distributions that supplant government assistance benefits
6. Prohibit beneficiary from transferring his or her interest in trust

D. Self-Settled (First Party) Supplemental Needs Trusts (a/k/a "Special Needs Trusts")

Two types:

1. Payback Trusts. 42 USC 1396p(d)(4)(a); NY Soc. Serv. Law 366(2)(b)(2)(iii)

   Requirements

   a. Discretionary income and principal distributions
   b. Beneficiary is "disabled" within the meaning of Social Security Act and under age 65
   c. Established by beneficiary's parent, grandparent, guardian or by court order
   d. Funded with assets of beneficiary
   e. "Payback provision" - governmental program must be reimbursed by trust at beneficiary's death for any benefits paid to the beneficiary

   Must notify Department of Social Services of trust creation and give advance notice to DSS of trust distributions directly to beneficiary and "substantial depletions" from trust and notify DSS of beneficiary's death

2. Pooled Trusts. 42 USC 1396p(d)(4)(C); NY Soc. Serv. Law 366(2)(b)(2)(iii)

   Requirements

   a. Beneficiary is "disabled" within the meaning of Social Security Act
   b. Established and maintained by a "nonprofit association"
   c. Pool the assets contributed by each beneficiary for purposes of investment and management
   d. Have a separate account for each beneficiary
   e. "Payback provision" - governmental program must be reimbursed by trust at beneficiary's death for any benefits paid to the beneficiary, but only to the extent the balance is not retained by the pooled trust

E. Transfers of Assets/Income and Impact on Medicaid Eligibility

1. Brief introduction to financial eligibility standards for Medicaid

   Asset-based eligibility, excess income (over personal needs allowance) must be spent-down on medical expenses

2. Transfer of Income to Self-Supplemental Needs Trust Not Subject to Transfer Penalty Period if Beneficiary is under 65 at transfer. 96 ADM-8.

3. Transfer of Income to Third-Party Supplemental Needs Trust Subject to Transfer Penalty Period unless trust agreement provides that assets be spent over beneficiary's actuarially-based life expectancy and the distribution of

4. Assets in Trust are Included in applicant/settlor's estate under IRC 2036(a)(1)

IRREVOCABLE LIFE INSURANCE TRUST

1. IRC 2042

   Life Insurance on Decedent's Life owned by decedent or life insurance payable to decedent's estate is includible in decedent's estate.

2. Life Insurance Owned by and Payable to an Irrevocable Trust is generally not subject to estate taxes.

3. Requirements for Avoiding Estate Taxation

   a. Irrevocable
   b. Policy either purchased by trust or transferred more than 3 years prior to trust creator-insured's death
   c. Trust creator-insured has no rights of ownership over the policy (cannot borrow, pledge, surrender policy or change policy beneficiary)
   d. Trust creator-insured is not a trustee
   e. Identifiable trust beneficiaries living at trust creator-insured's death

4. Optional Provisions

   a. Estate-Tax Deferral Provisions if transfer occurs within 3 years of trust creator-insured's death (e.g. marital trust for spouse)

   b. Crummey Withdrawal Rights considered "present interests" for gift tax purposes and thus qualify for $14,000 gift tax annual exclusion can be structured as 5 x 5 hanging power to avoid it being considered a taxable gift by Crummey beneficiary to trust

QUALIFIED SUBCHAPTER S TRUST/ ELECTING SMALL BUSINESS TRUST

A. Overview

These types of trusts are available for clients with S corporation stock. The purpose of these trusts is to ensure that the trusts are eligible shareholders of the S corporation so that the S corporation maintains its "pass-through" income tax treatment.

B.. Qualified Subchapter S Trusts - IRC 1361(d)(3)

1. Requirements

   a. Only one beneficiary during that beneficiary's life who is a US citizen or resident

   b. Trust principal may only be distributed to one beneficiary

   c. All trust income must be distributed to one beneficiary for that beneficiary's life or until trust termination, whichever is earlier

   d. If trust terminates during beneficiary's lifetime, trust assets must be distributed to that beneficiary

   e. Election to treat trust as "qualified subchapter S trust" (made by beneficiary or his/her representative)

   f. Separate Elections required for each S corporation stock held in "qualified subchapter S trust"

   g. Election must be made within 2 months and 16 days after the S corporation stock is transferred to the trust

2. Prohibitions

   a. Trust distributions cannot be made to satisfy trust creator's support obligation because in that situation the trust creator (rather than the beneficiary) would be the owner of the trust for income tax purposes

   b. Charitable remainder trust is not eligible to be a "qualified subchapter S trust"

C. Electing Small Business Trust - IRC 1361(e)

1. Requirements

   a. Only individuals, estates, charities or local governments can be beneficiaries

   b. Discretionary distributions of income and principal are permitted

   c. No interests in trust are acquired by purchase (must be gifted)

   d. Election to treat trust as "electing small business trust" (made by trustee)

   e. One election is made to the trust, as a whole (not made with respect to each S corporation's stock held in trust)

f. Election must be made within 2 months and 16 days after the S corporation stock is transferred to the trust

2. Prohibitions

a. Charitable remainder trust and any other tax-exempt trusts are not eligible to be "electing small business trust"

D. QSST vs. ESBT

1. ESBT can have multiple income beneficiaries
2. ESBT may accumulate trust income
3. Income in ESBT taxed at highest marginal rate for individual
4. Income in QSST taxed at beneficiary's marginal rate

MINOR'S TRUSTS

A. Overview

1. Trusts are excellent vehicle through which a parent or grandparent can provide for children or grandchildren while they are minors and until they are mature enough to manage their own assets.

2. Gifts in trust are subject to gift taxes, unless the gift is subject to an exclusion provided under the Internal Revenue Code. Gifts made directly to an educational institution or a medical facility are excluded from the definition of a gift. IRC 2503(e). Also excluded are gifts of "present interests" in property up to a maximum of $15,000 per year per donee.

3. The Internal Revenue Code expressly authorizes two types of trusts that can be utilized for the benefit of minors in which the minor beneficiary's interest is considered a "present interest" and therefore not subject to gift tax. Except as provided in IRC 2503(c), a present interest is the immediate right to receive substantial economic benefits from the property.

B. Section 2503(c) Trusts

1. Requirements

a. All trust income and principal can be distributed to the minor beneficiary.

b. Remaining trust assets distributed to the minor beneficiary at age 21, however, the trust may permit continuation beyond age 21 if the minor beneficiary is deemed as trust owner for income tax purposes or minor beneficiary has the right to compel distribution after age 21 for a limited time.

c. If the minor beneficiary dies before age 21, the remaining trust assets are distributed to the minor beneficiary's estate or pursuant to a minor beneficiary's exercise of a general power of appointment.

2. Avoid:

   Donor or donor's spouse serving as trustee to avoid estate taxation at donor's or donor spouse's death

C. Section 2503(b) Trusts

IRC 2503(b) allows for an exclusion for gifts of "present interests" in property up to a maximum of $15,000 per year per donee.

In order for the income interest in the Section 2503(b) trust to qualify as a "present interest" and thus the $15,000 annual exclusion, trust income must be required to be distributed to the minor beneficiary. Please note that a spendthrift provision can still be in the trust agreement.

D. Crummey Trusts

These types of trusts give the minor beneficiary what is called a "Crummey" power, which is the right to withdraw the minor beneficiary's share of the property contributed to the trust. Usually, this right of withdrawal is limited to a reasonable period of time such as 30 days following the date notice of the withdrawal right is provided to the minor beneficiary. The property subject to a minor beneficiary's Crummey withdrawal power is considered a gift of a "present interest" for gift tax purposes and thus qualifies for the gift tax annual exclusion. These trusts originated from the landmark 1968 case of *Crummey vs. Commissioner.*

1. Notice Requirement is Critical

   Minor beneficiary must have actual knowledge of the Crummey power.

2. Withdrawal Period

   Minor beneficiary must have a reasonable time to exercise the Crummey power. IRS has approved trust agreements giving withdrawal periods ranging from 30 days to 90 days.

3. Gift Tax Impact of Unexercised Withdrawal Right

   Crummey power is considered a "general power of appointment". If it's a 5 x 5 power, the nonexercise of it is not considered a gift.

QUALIFIED PERSONAL RESIDENCE TRUSTS

A. Overview

1. What Is It?

   Irrevocable trust that holds one personal residence for the benefit of the trust creator/grantor and the trust creator's/grantor's family members in which the trust creator/grantor reserves the right to use the personal residence for a fixed term of years or until his or her earlier death and the remainder interest is distributed to the trust creator's/grantor's family members (whether outright or in further trust). It is specifically authorized by IRC 2702(a).

2. Purpose

   Designed to remove future appreciation of residence from trust creator/homeowner's estate for estate tax purposes and to reduce the value of the gift of residence to the trust by the value of the trust creator/homeowner's retained interest in the trust.

3. Special Valuation Rule: Chapter 14 of IRC

   Generally, the value of any interest in property transferred into a trust that is retained by the trust creator/grantor is zero if one of the remainder beneficiaries is either the trust creator/grantor's spouse, ancestor (of either spouse), descendant (of either spouse), sibling, spouse of any descendant (of either spouse) or sibling.

   The interest retained by the trust grantor/grantor in a qualified personal residence trust is an exception to this rule.

B. Requirements (IRS Sample QPRT in Rev. Proc. 2003-42)

1. During the reserved term of years, all trust income must be paid to trust creator/grantor.

2. During the reserved term of years, no principal can be distributed to anyone other than the trust creator/grantor.

3. During the reserved term of years, the QPRT can only hold one personal residence.

4. The QPRT cannot be sold to trust creator, trust creator's spouse or any entity controlled by trust creator or trust creator's spouse.

5. The trust creator's retained interest cannot be commuted prior to the expiration of the reserved term of years (trust cannot pay trust creator for value of retained interest to accelerate it).

6. During the reserved term, trust creator must use residence as his or her personal residence.

7. If the residence is sold during the reserved term, the trust will cease to be a qualified personal trust with respect to the sale proceeds no later than (i) 2 years from sale date, (ii) expiration of reserved term of years, or (iii) when a new residence is acquired by the trust.

8. If the trust ceases to be a qualified personal residence trust, the trust assets must be either distributed to the trust creator or converted into a "grantor retained annuity trust".

C. Optional Provisions

1. Trust may accept cash as long it's held in a separate account and does not exceed 6 months of trust expenses.

2. Trust can hold cash for 3 months to acquire the initial or replacement residence as long as the purchase contract was signed before the cash was transferred.

3. Trust may accept improvements to the personal residence as an addition.

4. Trust may allow for the sale of the residence and the proceeds to be retained in trust for up to 2 years after the sale.

5. Trust may own homeowner's insurance policy on residence itself (not on personal effects inside residence) and hold any insurance proceeds received from any damage or destruction to the residence.

D. Advantages

1. Potential estate and gift tax savings

2. The value of the gift is reduced by the value of the trust creator's retained interest in the trust (as computed using Table B in IRS Publication 1457).

3. If the trust creator survives the reserved term of years, the appreciation in the residence between the time of gift and the time of the trust creator's death will not be subject to estate taxes at the trust creator's death.

4. Control over distribution of personal residence at death.

E. Disadvantages

1. Trust creator required to pay rent equal to fair market rental value after the expiration of reserved term of years if he or she wishes to continue to live in the residence.

2. Trust creator must survive the reserved term of years to achieve transfer tax savings.

3. Carryover basis in the personal residence if sold.

GRANTOR RETAINED ANNUITY TRUSTS

A. Overview

1. What Is It?

   Similar to the qualified personal residence trust, a grantor retained annuity interest is a split-interest irrevocable trust for the benefit of the trust creator/grantor and the trust creator's/grantor's family members in which the trust creator/grantor reserves the right to receive an annuity (fixed payment) for a fixed term of years or until his or her earlier death and the remainder interest is distributed to the trust creator's/grantor's family members (whether outright or in further trust). It is specifically authorized by IRC 2702(b).

2. Purpose

   Designed to remove future appreciation of the underlying trust asset from trust creator's estate for estate tax purposes and to reduce the value of the gift of asset to the trust by the value of the trust creator's retained interest in the trust.

3. GRAT is Exception to the Special Valuation Rule

4. When Is It Used?

   If the trust creator has reasonable expectation that the growth/appreciation on the asset being transferred into the GRAT during the trust creator's reserved term will exceed the IRC Section 7520 rate that the IRS uses to value the trust creator's retained interest, the GRAT could be used to remove the excess "return" on the assets from additional estate and gift taxes.

B. Requirements

1. Pay a Fixed Amount (expressed as a dollar amount or a percentage of initial fair market value) to the trust creator/grantor.

   Note that if it's stated as a dollar amount, the amount can increase by as much as 20% each year (does not necessarily have to be the same amount every year), remain constant or the amount can decrease each year.

Note that if it's stated as a fixed percentage, trust must provide for adjustments in the case of an overvaluation or undervaluation of the initial fair market value of the trust assets.

2. At Least Annually (can be more frequent than that) Start Date: must begin either with 105 days after 1st year anniversary of trust's creation or on the date the first trust tax return is required to be filed.

3. Either for a Term of Years or for the Trust Creator/Grantor's Life, whichever is earlier.

4. Prohibit Commutation (Prepayment) of the trust creator/grantor's interest.

5. Prohibit Additional Contributions to the trust.

C. Advantages

1. Potential Transfer Tax Savings

   a. The Value of the Gift is reduced by the value of the trust creator's retained interest in the trust (as computed using Table B in IRS Publication 1457).

   b. If the Trust Creator Survives the Reserved Term of Years, the appreciation in assets between the time of gift and the time of the trust creator's death will not be subject to estate taxes at the trust creator's death.

D. Disadvantages

Estate tax inclusion if trust creator does not survive reserved term

CHARITABLE REMAINDER TRUSTS

A. Overview

A form of split-interest trust in which trust creator transfers property into a trust that pays a fixed percentage of the trust assets valued annually (unitrust) or a fixed amount of money (annuity) to one or more noncharitable beneficiaries either for the live or lives of the noncharitable beneficiaries or for a fixed term of years and distributes the remainder interest to one or more charitable beneficiaries. IRC 664(d).

Gifts made to inter vivos, charitable remainder trust are eligible for income and gift tax charitable deduction.

Bequests made to testamentary, charitable remainder trust are eligible for the estate tax charitable deduction.

B. Types

1. Charitable Remainder Annuity Trusts

2. Charitable Remainder Unitrusts

C. Requirements

1. Pay a sum certain (annuity trust) or a fixed percentage of trust assets valued annually (unitrust)

2. Between 5% and 50% of the initial net fair market value of the trust assets

3. To one or more noncharitable beneficiaries

4. Either for a term of years not exceeding 20 years or for the lives of the noncharitable beneficiaries

5. Distribute the remainder interest to one or more charitable beneficiaries

6. Value of charity's remainder interest must be at least 10% of the initial net fair market value of the trust assets

D. Prohibitions

1. No self-dealing as defined in IRC 4941

2. Trustee cannot buy or sell assets from trust for less than fair market value

3. No taxable expenditures as defined in IRC 4945(d)

4. In the case of the charitable remainder annuity trust, no additional contributions after the initial contribution is permitted.

E. Variations of charitable remainder unitrust permitted under IRC

1. NIM CRUT

   Trust pays lesser of net income and the fixed percentage amount to the noncharitable beneficiary as long as the trust requires any net income in excess of the fixed percentage to be paid to the noncharitable beneficiaries to the extent that the total distributions made in prior years was less than the amount the noncharitable beneficiary would have received under a traditional fixed percentage payout

   Advantage: not forcing a sale of the underlying trust assets to meet payout requirements

2. FLIP Unitrust

   Trust pays net income to the noncharitable beneficiary for an initial period and then, upon a triggering event or a specific date, pays a fixed percentage of the trust assets as long as:

   - Triggering event cannot be within trustee or other person's control;
   - Change in payout method occurs at beginning of year in which triggering event occurs; and
   - Each year after the triggering event, a fixed percentage payout will be used.

3. Designating CRTs as Beneficiary of IRAs/Qualified Retirement Plans

CHARITABLE LEAD TRUSTS

They are the reverse of the charitable remainder trusts. The charitable beneficiary receives a unitrust or annuity interest and the noncharitable beneficiary receives the remainder interest.

SALES TO DEFECTIVE TRUSTS

A. The Concept/Definitions

Grantor. The person who contributes property to a trust. The Grantor is often the creator ("settlor") of a trust but does not need to be.

Grantor Trust. A trust which for income tax purposes is the same as the Grantor. Therefore, any income associated with a wholly owned Grantor Trust will be attributed to the Grantor and, therefore appear on his or her personal tax return. However, a Grantor Trust is more than simply a "pass through entity". It is considered the same taxpayer as the Grantor for income tax purposes.

Different Tax Systems. In understanding a sale to a Grantor Trust, it is important to understand that there are multiple tax systems at work and that these tax systems are mutually exclusive of each other.

Income Tax System. The most "familiar" tax system to the average person. However, the income tax system with respect to trusts (Subchapter J) is a complicated system, which includes the "grantor trust rules" (IRC §§671-679).

Estate and Gift Tax Systems. The estate and gift tax systems are a tax regime based not on income but on transfer of wealth.

Note: It is the fact that these two systems are NOT related that allows a sale to an Intentionally Defective Grantor Trust provide tax benefits to the family.

B. Why is a Trust "Intentionally Defective"?

"Defective" is a term of art with respect to income tax consequences of an irrevocable trust. If a trust is "defective" for income tax purposes, that trust does not accomplish the creation of a separate entity for income tax purposes. The term gained popularity when the Grantor Trust rules were put into place to stop abuses by taxpayers who placed large amounts of assets in trust in order to avoid the potentially high personal income tax brackets. The term is still used today, however, the use of the term "defective" many times confuses the issue.

1. How to Walk the Tightrope Between the Income Tax Systems and the Estate Tax Systems.

   A properly structured Intentionally Defective Grantor Trust ("IDGT") for the purposes of purchasing assets will be "defective" for income tax purposes but will be "effective" for estate tax purposes in that the Grantor will not have any incidents of ownership or control over the trust which would cause inclusion of the trust property in the taxable estate of the Grantor. The key is knowing where the median ground is between control and powers enough to cause Grantor Trust status but not enough to cause inclusion in the taxable estate.

2. How is the Sale Accomplished?

   The sale is accomplished much like any other sale of an asset with an exchange of consideration. Usually, the steps to follow in a sale to an IDGT are as follows:

   a. Creating the Trust. Make sure the trust is properly structured from both a tax and dispositive standpoint.

   b. "Seeding" the Trust. Requires the trust to be funded prior to the sale in order for the sale to be commercially reasonable. See Section IV, A, below.

   c. Selling the Asset. The asset needs to be sold for full value; and if the seller is going to take back a note for installment payments, the terms of the note must be commercially reasonable. See Section IV, A, below.

3. What Are the Benefits of a Sale to an IDGT?

   a. Valuation Freeze. Since the asset is being sold for its fair market value by the Grantor, there is no inclusion in the Grantor's estate of the asset upon his or her death. The only item that will possibly be included in the Grantor's estate is the date of death value of the unpaid portion of the note. Therefore, the value of the asset, for estate tax purposes, is frozen at the date of sale, and regardless of the growth of the asset from the time of sale until the time of death, the value of the asset will not be included in the Grantor's estate.

b. Leveraging. With a sale, as with a gift or any other type of valuation freezing technique, do not underestimate the ability to use discounting in the sale or gift. Especially in the case of a sale to an IDGT, if the sale is of only a part of the asset, it may be possible for the sale to be for a reasonable discounted value. However, make sure any value that is determined for the sale (whether or not discounted) is backed by an appraisal that can withstand scrutiny.

c. Is the Family Business Right for a Sale to an IDGT? Many family businesses are ideal assets for the sale to the Grantor Trust however, several aspects of a business should be analyzed prior to proceeding with a sale to an IDGT.

d. Cash Flow of Business. What is the expected cash flow of the business over the next few years, or at least during the term of the note? The reason why the sale to an IDGT will work is because the business should be able to generate enough money to cover the installment payments of the note.

e. Appreciation of Business. The sale of an asset to an IDGT is a freezing technique. Therefore, if the asset which you are selling is not going to appreciate in value, then what is the purpose of freezing its value?

4. Who Should be the Trustees of the Trust?

The trustee not the beneficiary will control the asset, therefore, give some consideration as to who the trustee should be.

5. Who Should the Trust Benefit?

The IDGT will be irrevocable, so thought needs to be given to whom the beneficiaries of the trust should be, not only for the immediate future, but for the entire term of the trust.

6. What Should Be the Terms of the Note?

As discussed below, the note needs to be commercially reasonable, however, there should be a discussion with the Grantor as to what is reasonable based on the cash flows of the business and expectations of the Grantor.

7. Is the Grantor Ready?

While the trust offers some control over the beneficiary, the Grantor needs to be both mentally and emotionally ready to "give up" control of the business, or at least a portion of it. This does not mean the Grantor can no longer be involved in the business as an employee, but he or she must be ready to give up ownership of what probably has always been "theirs".

8. Advantages and Disadvantages Over Outright Sale.

a. Advantages Over Outright Sale.

<u>No Taxable Gain</u>. Since the trust is not recognized as a separate tax entity for income tax purposes, the sale will not trigger any gain, regardless of the Grantor's basis in such business interests (Rev. Rul. 85-13; PLR 9535026).

<u>No Income Taxes Due on Interest</u>. For the same reason given in (a) above, the interest paid to the Grantor on the note will not be taxable income to the Grantor, because payments to oneself are not considered income for tax purposes (Rev. Rul. 85-13).

<u>Rev. Rul. 85-13</u>. Actually, this ruling was "anti-taxpayer". The facts showed that the trust sold its assets back to the Grantor for an unsecured note. The Grantor attempted to get a step-up in basis in those assets equal to the principal of the note. The IRS ruled that while the trust was not a Grantor Trust by any of its terms, the sale of the assets back to the Grantor for an unsecured promissory note constituted an indirect borrowing of trust corpus by the Grantor, therefore making the trust a Grantor Trust under IRC §675(3). Since the trust is a Grantor Trust, the Grantor and the trust are the same taxpayer for income tax purposes. Therefore, although the Grantor paid full price for the assets of the trust, he did not receive a step-up in basis in the trust, and by the same terms the trust could not recognize any gain because for income tax purposes, there was no sale.

The circular logic of the IRS in Rev. Rul. 85-13 is hard to ignore; the fact of the sale caused there to be no sale for income tax purposes. However, the importance of this ruling is not how the trust became a Grantor Trust, but that because it was a Grantor Trust, the sale will not be recognized for income tax purposes.

Note that the IRS decided not to follow *Rothstein v. United States*, 735 F. 2d 704 (2d Cir. 1984), a Second Circuit Court of Appeals case in which the facts were almost identical to Rev. Rul. 85-13, and the court held that there was a sale for income tax purposes.

PLR 9535026. This ruling was IRS's first approval of a "sale" to a Grantor Trust with the intended tax result that the sale is ignored for income tax purposes. There is no imputed gift provided the appropriate interest rate is used (see section IV, B, 1, below), and no Chapter 14 problems. However, PLR 9535026 was conditioned on the fact that the note is a debt instrument and not equity. PLR 9535026 does not refer to any security for the installment obligation, although it is well known that in discussing this plan with the IRS, the applicants and the IRS agreed that the trust would consist of assets valued at least 10% of the purchase price prior to the purchase.

b. Disadvantages Over Outright Sale

No Step-Up in Basis. In most sales, the buyer will have a basis in the property equal to the purchase price of the property (Code §1012). However, as described in (1) above, since the Grantor of the trust and the trust are the same person for income tax purposes, the flip side of no recognition of gain is that the trust does not receive a stepped-up basis in the property equal to the purchase price (Rev. Rul. 85-13).

Complicated. A sale of a business to an IDGT is not doubt more complicated than the outright sale. The trust instrument must be drafted, and administered, and trustees will need to be compensated.

Unhappy Beneficiary. The beneficiary of the IDGT may not like the idea of a trust owning something that he or she is "paying" for out of the profits of the business. This is why it is absolutely necessary to make sure the beneficiary (and not just the client) understands the concept and the advantages of the sale to an IDGT.

c. Advantages and Disadvantages over Outright Gift

(1) Advantage - No (or very little) Erosion of Unified Credit and GST Exemptions.

(A) Since the asset is being purchased by the trust for its current fair market value, there is no use of the applicable exemption amount (unified credit) or gift tax associated with the sale. However, there may be some use of the Unified Credit or some gift tax due in connection with the initial "seeding" of the trust, (see Section IV, A, below.)

(B) With the multi-generation trust as the purchaser for very little use of generation skipping transfer tax (GSTT) exemption, the trust can hold the asset for the benefit of generations beyond the children of the Grantor, and without being subject to estate tax at the Grantor's children's deaths and possibly for generations beyond.

(2) Advantage - "Tax Free Gifts to Trust"

Under the grantor trust rules, because the Grantor is obligated to pay the income taxes on the income earned by the trust, the trust may accumulate more income for ultimate distribution to the beneficiaries. Since this is an obligation of the Grantor, the payment of taxes is not a taxable gift to the trust, therefore, no gift tax return needs to be filed, no annual exclusions need to be used up, and no GSTT exemption needs to be allocated. In effect, the Grantor is able to make a tax free gift to the trust of the amount of the trust's tax liability.

Example: Grantor creates Grantor Trust GT. GT is a Grantor Trust for both income and principal. The beneficiaries of the trust are his three children A, B and C. The trust owns an LLC membership and gets a K-1 at the end of the year for $25,000 of income. If the trust was a non-grantor trust the tax liability would be approximately $7,636. But because the $25,000 is taxed to the Grantor, who is only in a 24% tax bracket, the 25,000 of income only generates a tax liability of $6,000 at a flat 24% tax.

Since GT is a Grantor Trust, not only is the tax liability less because Grantor is in a lower 24% tax bracket (a non-Grantor Trust reaches the 24% tax bracket at $2,550 of income), but since the Grantor is liable for the taxes, the trust does not have to deplete its cash reserves in order to pay the taxes and therefore, GT has $6,000 more to reinvest for the benefit of the children. This can be a very useful way to "spend down" the estate of the Grantor without using annual exclusions or unified credit.

d. Fair Treatment of Children with a Business

With the sale, the child involved in a business must "pay" for the business using the cash flows from the trust asset (the business) itself.

(1) The only gratuitous transfer is the initial funding by the Grantor in order to seed the trust (see Section IV, A, below).

(2) Another inequity to the child beneficiary is that the Grantor is responsible for the income taxes on the income and payment by the trust. However, this may be overcome by a reimbursement for taxes clause (see Section III, D, below).

NOTE: Be careful that the child who is the beneficiary of the trust does not feel that he or she is being treated unfairly by having to "pay" for the business. This is where it is important to have both the parent and the child comfortable with the idea of the sale. It may be necessary to explain to the child (with the client's consent) that he or she will (in all likelihood) receive some of those payments back in the form of an equal share of mom and dad's inheritance.

e. Control

As with traditional trusts, a Grantor Trust will offer the Grantor some control over the assets in the trust. However, it is very important that the Grantor not be the Trustee (but as with a traditional ILIT or other irrevocable trust, the spouse may be a trustee). In addition, an independent trustee or a Trust Protector may also be recommended.

f. Advantages and Disadvantages Over Owning Property at Death.

(1) No Ability to Use Code IRC §2032A. Special Use Valuation. Code §2032A allows for certain property to receive special valuation based on a particular use, usually associated with farming property that may have a higher value as developed real estate.

(2) No Ability to Use Code §6166. Installment Payments of Estate Tax. Under Code §6166, if more than 35% of the adjusted gross estate consists of closely held business interests, the executor may elect to defer payment of the tax for up to 14 years.

(3) No Ability to Use Code §303. Redemption of Stock not Treated as Dividend Code §303 allows under special circumstances for stock to be redeemed by an estate and have such redemption treated as an exchange for the stock, and not as a dividend. Thus, Code §303 allows money to be distributed out of the corporation tax-free. However, like most sections offering special treatment, the circumstances which §303 may be used are few and far between.

(4) No Use of Code §1202. Small Business Stock Gain Exclusion. A business owner may exclude from capital gains tax up to 50% of the gain, provided it was held more than 5 years prior to sale. This provision is relatively new to the Code and is limited to domestic C corporations with assets less than $50,000,000. Also, the stock must be original issue and issued after August 10, 1993. In addition, any gain over the 50% will be recognized at the maximum capital gains rate. Be aware of the potential benefits of this provision (exclusion from gain, stepped-up basis to fair market value), however, since it is limited to C corporations, it has limited value in today's traditional tax planning.

UTILIZATION OF DYNASTY TRUST FOR PRESENT AND FUTURE OWNERSHIP

A. The Concept

With holdings of significant magnitude or assets that are based on family or closely held businesses, it may not be practical to set up an estate plan in the traditional manner of having assets divided among family members at the time of death and distributed outright to them (in whole or in part).

With the creation of an irrevocable trust that is a "Dynasty Trust" we take the steps now to ensure that assets will stay together rather than having distributions outright. Outright distributions can result in fractional ownership of entities such as corporations, LLCs, and even more problematic real estate.

The problem that is faced, however, is how to fairly treat those who have been managers and owners of the operations and who have built up additional value over the years through their efforts. These certainly should be recognized, but in a manner that does not lead to multiple levels of buyouts at different generations or even within the same generation. For example, assuming there are two children in the operations, if one child has passed away, is the other child going to want to be burdened with the purchase of the interest or if a child has decided to go in a different direction in his life? Or, if one child passes away and leaves family members, is it fair for the other child to have to fund a full buy out of his brother's interest.

B. Forms and Variations

A dynasty trust can have several forms and variations. However, it is intended to provide a vehicle for holding family business (and other) assets for as long a time as possible under the law. However, it may be the case that at appropriate times assets or the proceeds from sales of assets can be distributed out to the family members because of a sale of the family business, sale of individual assets, etc. Each of these situations can be considered, but we want to do so in a tax efficient manner and in a manner that will provide as much creditor protection as possible.

Regardless of whether we create a lifetime (inter vivos) or testamentary trusts (trusts created under your wills), each of these types of trusts can contain the creditor protection and tax protection that can be considered a "dynasty trust". The purpose is that it continues on for a lengthy period of time based on the law and/or family intentions.

C. Advantages

1. Creates terms of succession plan for present and future generations

2. Avoids having to have buy outs for each family member who dies or terminates his or her relationship with the farming operation

Benefits to deceased, retired, disabled family members may be established through compensation plans such as deferred compensation, life insurance policies, etc.

3. Provides mechanism to retain all farm interests under one form of title ownership rather than having multiple owners of lands, operating entities, etc.

4. Creditor Protection

   Additional creditor protection is provided to members of the family because the assets are not subject to the creditors of a family member, a spouse of a family member in the event of a matrimonial proceeding and/or plaintiffs in legal actions.

5. Third-Party Lenders

   Lenders and other third parties may prefer having assets in a trust for purposes of lending and to ensure that there are fewer attacks by creditors.