Agriculture Market

Not Your Average Family Business

A transition planning guide for financial professionals
Farmers and ranchers are a breed apart. With constant uncertainties and a minimal safety net, it can be both tough and risky.

It’s much more than manually working the land. Ranchers and farmers must be scientists, meteorologists, mechanics, engineers and – most importantly – business people. They need to understand debt, negotiate contracts, make payments to employees and vendors, determine efficient pricing, keep records and prepare taxes.

_family farms accounted for 97 percent of U.S. farms in 2011._ Most farmers and ranchers see their work as more than just a job—it’s a way of life. Many want to share and pass down this way of life to the next generation. Yet despite the planning and patience they put into every other aspect of their operations, many farmers and ranchers fail to plan for their own financial future. At the Principal Financial Group®, we can help.

_family farms and ranches face problems similar to other family businesses, such as:_

- A family lifestyle personally and emotionally entwined in the business
- Little liquidity with major wealth concentrated in overhead of land, buildings, vehicles and equipment
- Often a significant amount of short- and long-term debt
- Many expenses and, factoring for depreciation of assets, a high risk of annual losses
- Often very limited participation in Social Security, pensions or other retirement accounts

Many of the positive attributes that have made agriculture an American institution also create unique challenges when an owner retires or dies unexpectedly. Estate planning – with life insurance playing a critical role – can better prepare a family for the future transfer of a farm or ranch.

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KEEPING THE FARM IN THE FAMILY

In 2010, the USDA estimated that 70 percent of U.S. farmland would change hands over the next 20 years. As studies have shown, many of the owners will fail to prepare. Some farm and ranch owners have a son or daughter ready to take over so they assume (or hope) the transition will take care of itself. Others simply can’t bear to think about the day when they no longer control the business they’ve nurtured for so many years.

The lack of planning has produced these startling statistics:

- **70%** of first-generation operations do not successfully transition to the next generation.
- **90%** of the second-generation do not make it to the third generation.
- **96%** of the third-generation do not survive to a fourth generation.

You are no doubt all too aware of the typical consequences of not planning—estate shrinkage, slow settlement, increased expenses, family discord, etc. But the agriculture market faces additional consequences because they are integral to rural communities in a way other family businesses are not. If they fail to plan, that failure may ultimately force heirs to sell assets and the property to be absorbed by larger neighboring farms. Another possibility is that the farm will be sold for development—a result that will once again have a significant impact on the community.

**CONSIDER THIS.** A 2010 survey of 1,100 farmers showed that approximately 72 percent of farmers surveyed did not have a complete succession plan. That means only 28 percent of the farmers surveyed had a succession plan in place. These numbers show that there could be a very large market of farm and ranch owners who need professional planning services throughout the country.

WHERE YOU FIT IN

As a producer, you are in a unique position to provide significant assistance to the farmers and ranchers in your community. And that’s where The Principal® can help you. This guide addresses four strategic planning concerns and the role life insurance can play in meeting these needs:

- **Supplementing retirement**
- **Equalizing inheritances**
- **Providing liquidity**
- **Covering debt**

In addition, this guide covers a number of tax and legal basics, business succession planning methods and estate planning techniques.

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2 USDA Family and Small Farms, June 18, 2010
1 Ag Web, A Successful Transition to the Next Generation, Kevin Spafford, Farm Journal Columnist, June 30, 2012
4 Farm Journal Pulse, Do you have a successful plan? July 2, 2014 (Note: the split of the 72% is 40% don’t have a succession plan and 32% somewhat have a plan.)
STARTING THE TRANSFER PROCESS

Because of the intrinsic nature of agriculture as a family business, there are often difficulties among the generations within the planning process, including:

Sharing control and income

Respecting new ideas and practices

Agreeing on a common vision for the future of the farm or ranch

Working side-by-side with children who will one day take over the business every day

Remaining fair and equitable to non-farming children

Ensuring that the farm is able to support the next generation and the farmer (and spouse) in their retirement

SAVING FOR RETIREMENT

Most Americans have difficulty saving enough for retirement; however, the agriculture market faces special hurdles. The typical farm has limited liquidity and restricted savings. Most farmers and ranchers receive Social Security in the retirement years to supplement their savings, but their benefits are typically less than the average worker’s since Social Security benefits are based on taxable income. Households operating retirement farms receive three-fifths (61%) of their off-farm income from unearned sources (such as Social Security, pensions, dividends, interest and rent). Participation by farmers and ranchers in Social Security varies greatly depending on:

TYPE OF OPERATION

For example, many smaller family farms report losses from farming due to high expenses and depreciation. No reported income means no self-employment taxes, which, in turn, means no Social Security contribution.

OFF-FARM ACTIVITIES

Many owners of smaller operations also hold jobs or own businesses separate from the farm or ranch. Income from off-farm employment frequently represents the majority of an individual farmer’s Social Security contribution.

SELLING THE FARM OR RANCH

Many family farmers and ranchers would like to pass on the family business by simply giving the business to their children when they are ready to retire. However, without money from the sale of the business, they don’t have the means to retire comfortably (or at all). This can present a problem as the younger generation typically doesn’t have the money needed to purchase the

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business outright. Installment sales are a common method for dealing with this issue. One-time payments and installment sales can be difficult for the next generation and tough on finances, but increased cash flow from the buyer now owning the farm can help them make the payments. This is just one of many examples why planning plays such an important role in the succession in the family business.

**WHY USE LIFE INSURANCE TO SUPPLEMENT RETIREMENT INCOME?**

Life insurance\(^6\) can provide:

- **TAX-DEFERRED GROWTH** — Life insurance offers one of the few opportunities outside of qualified plans for farmers and ranchers to enjoy tax-deferred growth over many years. No current income tax is due on cash value growth.\(^7\)

- **TAX-FREE WITHDRAWALS** — Income opportunities are available through partial withdrawals, which are generally not taxed until the cash value withdrawn exceeds the total amount of premiums paid. Of course, withdrawals reduce the death benefit and the cash available to pay for the costs of insurance.\(^7\)

- **TAX-FREE LOANS** — Generally, loans are not taxable. Loans are subject to interest charges, and they reduce the death benefit paid to beneficiaries.\(^7\)

- **FLEXIBILITY** — Life insurance distributions can be made prior to age 59½.\(^7\)

- **NO REQUIRED DISTRIBUTIONS** — Life insurance is not subject to required minimum distributions at age 70½.

- **INSTALLMENT INSURANCE** — If an installment sale is chosen as a way to transfer ownership and provide retirement income, the retiring farmer or rancher can protect that income by purchasing a life insurance policy on the life of the successor. This will ensure that payment is made even if something unexpected happens before the buyout is complete.

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\(^6\) All guarantees and benefits of the insurance policy are backed by the claims-paying ability of the issuing insurance company. Policy guarantees and benefits are not backed by the broker/dealer and/or insurance agency selling the policy, nor by any of their affiliates, and none of them makes any representations or guarantees regarding the claims-paying ability of the issuing insurance company.

\(^7\) Policy loans and surrenders may reduce the face amount of the policy, and surrender charges may apply. Partial surrenders of the cash value are made up to the policy’s cost basis, and then switch to loans.
Some children remain in the business, and others go in another direction. But when it comes to inheritances, these children have very different needs. Family members who decide to farm need the farm and its assets to continue operating. The last thing family members who follow other career paths need is an undivided interest in the family farm. What they could really use is cash—money to invest in their own pursuits, buy a home or put a child through college.

Succession planning presents complex choices for parents who want to divide all assets to their children fairly and equal.

**SHOULD PARENTS GIVE EACH CHILD AN EQUAL SHARE OF THE FARM OR RANCH?**

This can lead to conflicts. The children who are working the farm may resent having to buy out those who are not. This may present an extra strain on their finances as they may struggle to come up with the money to buy out their siblings’ while keeping the farm operation viable.

**SHOULD PARENTS GIVE EACH CHILD AN EQUAL SHARE OF THE ESTATE?**

This question can also lead to conflicts when parents leave the farm to the farming children and the remaining assets to the off-farm children. It may present a situation where the farm makes up such a huge portion of the overall assets that the off-farm children could end up with less.

**A FAIR SOLUTION**

Life insurance can be a great solution to this difficult problem. With life insurance, the farmer can:

- Leave the farm or ranch to family members who have chosen to remain active in the operation.
- Purchase a life insurance policy on his or her own life and name off-farm family members as the beneficiaries of the policy. (Or let off-farm children purchase a policy that the farmer then gifts the premiums using annual gift tax exclusions.)
- Use life insurance proceeds—along with any other additional estate assets—to provide an inheritance for family members who are pursuing other careers.

Although inheritances may not be equal, they can be equitable—which can make all the difference when keeping the peace in the family.

Communication is one of the keys to making this arrangement work. Encourage your clients to discuss their plans with their children and explain the reasoning behind the choices they’ve made. This can help eliminate surprises and misunderstandings.

In some ways, the agriculture market is no different from any other family business.
Providing liquidity

There are many estate expenses that are due immediately or soon after death:

**PROBATE COSTS**  This includes court costs, attorneys’ fees, executors’ commissions, administrative costs, appraisers’ and accountants’ fees.

**FINAL EXPENSES**  Settlement of debts, end-of-life medical expenses and funeral expenses are included.

**STATE TAXES**  Inheritance and estate taxes only exist in some states but can be significant.

**FEDERAL ESTATE TAXES**  Estate taxes can vary depending on the plan in place and value of the operation at time of death.

**LONG ON ASSETS, SHORT ON CASH**

Unfortunately, most farms and ranches are long on assets but short on cash. Without enough cash to meet estate obligations, heirs may be forced to borrow money or sell assets. For the farmer or rancher who plans to keep the operation in the family, this may present the worst possible scenario. Typically, heirs who are forced to sell under these circumstances don’t have a ready buyer and can be forced to sell at sacrifice prices. This may dramatically reduce the value of the estate. Also, farm and ranch sales typically take some time—time that heirs may not have before expenses become due.

**SPECIAL USE VALUATION**

One provision enacted to ease the estate tax burden on farmers and ranchers is Section 2032A, part of the federal tax code allowing “special use valuation.” This means that heirs can value the land based on its farming or ranching use rather than its “highest and best use.” There are conditions associated with this election, including the continuation of the agricultural business for 10 years following the estate transfer.

Another federal tax provision, IRC Section 6166, allows for installment payments to be based on a 15-year payment schedule. This is a deferral of estate taxes through an installment note arrangement between the estate and the government. If qualifications are met, estate taxes attributed to the presence of a closely-held business interest may be deferred over a period of up to 14 years. Only interest is due for the first four years, then interest and principal payments are due for the next 10 years.

There are conditions and qualifications associated with this election.

**A WELL-TIMED INFUSION OF CASH**

A life insurance policy helps to ensure that the estate has immediate cash to help pay debts, taxes and other estate expenses without forcing the sale of assets or land. The proceeds paid to the beneficiaries may prevent an unnecessary reduction in wealth and possibly save a farm or ranch from extinction.
For decades now, farm expenses (fertilizers, seed, fuel, pesticides, feed, etc.) have consistently risen. According to the USDA, 62 percent of all U.S. farms reported a negative margin in 2011.\textsuperscript{8} The majority of overall debt is held by young farmers and larger farms, but almost all farmers carry debt. Some is paid off the same year, after crops or livestock are sold, but debt from buying more land or equipment or starting a new enterprise is much larger and is held for a longer term.

While absolute debt has increased steadily, relative debt (compared to assets) has actually fallen. Farmland represents a large portion of a farm’s assets, so higher land prices reduce the farmer’s relative debt position. Of course, land prices are in constant flux, as are the prices farmers can obtain for goods and what they must pay for all other expenses.

No matter what the debt-to-asset ratio is, the fact is there is often significant debt that must be settled when a farmer dies unexpectedly.

All valid creditor claims, including bank loans, must be paid out of the estate. If there is not enough money available, the estate must sell assets—or even the land itself—to pay the debt. This is a very real scenario for many farms and ranches. Even when money is available, savings may be depleted to pay farm debt, which can again create significant problems where some heirs are inheriting the farm while others were supposed to inherit savings or other liquid assets.

Without proper planning, inheritances can be greatly reduced, equitable divisions can become lopsided, or the family legacy can come to an end. \textit{Luckily, life insurance can help by providing sufficient liquidity to cover existing debt.} The immediate influx of cash from a life insurance policy allows the estate to pay off (or substantially reduce) loans while leaving farm assets and savings intact for the heirs.

Legal and tax basics

Estate planning is a broad and complicated subject. There are no one-size-fits-all solutions. In addition to the specific estate needs we’ve discussed, each farmer and rancher has a unique situation that affects almost every area of estate planning.

Take a look at this brief overview of some important estate planning issues, and examine the best ways to approach them in the agricultural community.

ESTATE PLANNING

Estate planning is the process through which individuals prepare to transfer their assets after death. It also includes preparation for incapacity. This type of planning is important for everyone, but it is vital for farmers and ranchers, whose jobs inherently contain many dangers—chemicals, machinery and tools, grain bins, livestock, trucks and tractors, even ladders. Farming injuries are common and tend to increase in severity as a farmer ages. Increased likelihood of an accident, coupled with the lack of liquidity we’ve been discussing, equals potential disaster for families who have not properly planned for such contingencies. An estate is comprised of all of the assets and liabilities at death. The typical estate plan includes the following:

- **WILL** This is a legal document authorized under state law to direct the distribution of assets and payment of liabilities.

- **POWER OF ATTORNEY** This document authorizes another individual to handle the farmer’s affairs if he or she becomes incapacitated and cannot act for himself or herself.

- **LIVING WILL** It allows the rancher to state his or her preferences regarding end-of-life care and extraordinary medical measures to extend life.

- **HEALTH CARE POWER OF ATTORNEY** A document authorizing an individual to speak for the farmer or rancher if he or she is incapacitated.

- **LIVING TRUST** A revocable trust that a farmer or rancher (the “grantor”) creates during life. The grantor may alter, amend or revoke the trust and retains full control of all the assets in the trust. After the grantor’s death, the trust becomes irrevocable, and the assets in the trust avoid probate.

- **TYPES OF BUSINESSES**

  A farm or ranch can be set up many different ways. Determining the type of business set-up is critical when helping a farmer or rancher plan for the future transfer of the operation. It will determine the legal and tax requirements that must be met when planning.

  - **SOLE PROPRIETORSHIP** A sole proprietorship is owned by one person and has no separate legal existence from the owner, meaning the owner and the business are one and the same.

    The major concern with a sole proprietorship is the unlimited liability of the owner. So, the owner’s personal assets may be taken to satisfy a business debt. This type of ownership can often be found in startup operations or those that are small and simple.
PARTNERSHIP

A partnership is an association of two or more persons (often a parent and a child or siblings) to carry on a business as co-owners. There are two basic types of partnerships: general and limited.

In a general partnership, each partner is an owner, shares in profits and management and is subject to unlimited personal liability for the partnership’s debts. A general partnership can encourage heirs to stay on the farm and may also allow parents to gradually withdraw from the business as they near retirement.

In a limited partnership, there are both general and limited partners. Limited partners contribute capital and share in profits, but they have no voice in management, and their liability is limited to the amount of their capital contribution. A limited partnership allows off-farm family members to share in the farm business as investing partners without participating in management decisions.

There are also more complex forms of partnership called limited liability companies and limited liability limited partnerships.

CORPORATION

A corporation has an existence that is separate and distinct from its owners. The corporation itself owns the corporate assets, and this provides the shareholders with limited liability (up to the amount of their shares in the corporation). Incorporating the family farm allows parents to gift part of the business to their children during life—through shares of stock—without destroying the efficiency of the operation. It also allows the owner to offer benefits to employees (often family members).

GIFTING ASSETS

Gifts can play an important role in transition planning for farmers and ranchers, especially in an operation that is concerned about the impact of the estate tax. Farmers and ranchers can reduce their gross estates during life through use of the gift tax annual exclusion and gift splitting.

Every year, the farmer or rancher can make gifts to each child up to the amount of the annual exclusion (in 2015, $14,000 for an individual or $28,000 for a married couple). In addition to reducing the taxable estate, these gifts may provide a good method for slowly transitioning the business when the farm or ranch is operating as an LLC, limited partnership or corporation. The farmer or rancher can give fractional ownership to interested children up to the annual exclusion amount each year while retaining control with a majority ownership percentage.

CHARITABLE GIFTS

Farmers and ranchers are often very involved in their communities and may wish to make charitable gifts a part of their estate planning. Listed below are two types of charitable giving that allow the owner to give back while also supplementing their retirement income.

CHARITABLE GIFT ANNUITY (CGA)

A CGA is a contractual agreement between the donor and the charity, in which the donor agrees to make a charitable gift, and the charity agrees to pay a fixed amount periodically to the person designated by the donor. The income stream is backed by the full assets and endowment of the charity. The charitable donation made by the donor is larger than would be necessary to achieve the same return on a commercial annuity. Generally, the amount over and above the annuity return amount is the charitable contribution.

CHARITABLE REMAINDER TRUST (CRT)

A CRT requires the donor to irrevocably transfer money or property to a trust. The trust agreement (drafted by an attorney) directs that the trust will pay a specified income each year to the donor and/or other individuals named in the agreement for as long as the donor or other designated beneficiaries may live or for a specific term of up to 20 years. Once the trust term ends, the remaining assets in the trust are paid to the designated charitable beneficiary.
Business succession planning

When working with farmers and ranchers, you’ll find that many of their deals and negotiations are based on personal relationships and sealed with a simple handshake.

Without the formality of legal paperwork and documentation – and without a succession plan – the death of a farm or ranch owner can leave many issues, such as:

- Problems with product suppliers
- Customer concerns about the quality of the product under the new ownership
- Issues with banks and other financial institutions regarding ongoing credit lines for annual expenditures for livestock or crop production
- Employee questions about the direction and future of the business

Heirs may be concerned with:

- Long-term financial security
- Retention of the business interest (or a timely sale at an attractive price)
- Quick settlement of the deceased’s estate

A succession plan can help to eliminate some of these worries. And, if there isn’t a family member ready to serve as successor, a formal, written buy-sell agreement can serve as the first step in ensuring an orderly and successful transition following an owner’s death, incapacity or retirement.

A properly funded buy-sell agreement can:

- Set a fair price for the business interest and specifies terms of sale.
- Provide assurances to employees, customers, suppliers and creditors that the business will remain strong through ownership transitions.
- Help owners use their business as a source of retirement income.

Here’s a quick look at four types of buy-sell agreements:

1. **Cross-Purchase Agreement**
   This is a commonly used agreement for farm or ranch operations with multiple owners. It provides that individual owners will buy and the deceased owner’s heirs will sell the business interest at an agreed-upon price.

2. **Entity-Purchase Agreement**
   This agreement provides for the purchase of an owner’s interest by the business entity itself. It is unsuitable for sole proprietorships and is probably the least likely option for many agricultural businesses.

3. **One-Way Buy-Sell Agreement**
   This type of agreement allows a farmer or rancher to identify a potential buyer who agrees to purchase the owner’s interest. In a business with a sole owner and no obvious heir, this is the most likely choice of business succession plans. It is usable by all business entity types.

4. **Wait-and-See Buy-Sell Agreement**
   A hybrid of entity-purchase and cross-purchase agreements, this buy-sell agreement is usable by all business entities with multiple owners. A wait-and-see agreement lets owners defer the choice of a buyout arrangement.
BUSINESS VALUATIONS

Farmers and ranchers typically operate using a high-asset, low-cash philosophy. This can make it particularly difficult when determining the true value of their business. Many assets have a logical basis for valuation, such as equipment, buildings, inventory, etc. While other assets, like real estate or the owner’s specialized knowledge, may have less obvious market value. It’s very important that farmers and ranchers make sure that they are not undervalued for their insurance and retirement planning purposes.

PROPERTY OWNERSHIP AND PROPERTY RIGHTS

There are many forms of ownership (both outright and limited) when it comes to farms and ranches. Let’s take a look at a few:

**SOLE OWNERSHIP**  This is the most traditional type of property ownership. One person owns the whole property, enjoys full use of the land and holds all its rights. When a sole owner dies, the property passes to the owner’s heirs.

**JOINT TENANCY**  Many couples who own property together own the real estate in joint tenancy, where the entire property is owned jointly by both parties. In general, when one owner dies, the property passes to the surviving owner, who then becomes the sole owner of the property.

**TENANCY BY THE ENTIRETY**  In some states, married couples can own the entire property as one entity. Neither spouse may transfer or restrict any part of the property without the consent of the other spouse. State laws vary on this form of ownership.

**TENANCY IN COMMON**  This is land ownership by multiple owners that, unlike a joint tenancy, allows for unequal ownership percentages. At death, an owner’s interest in the property passes to the owner’s heirs and not to the surviving owner(s).

**LIFE ESTATE/REMAINDER INTEREST**  A life estate is a limited property interest that gives an individual the right to possess and enjoy the property for life. However, another individual will hold a remainder interest in the same property, which gives that person the right to possess and enjoy the property after the life estate terminates at the life tenant’s death. For example, a farmer may arrange for his wife to retain ownership of the farm for her lifetime while granting a remainder interest to their children. This type of interest does not qualify for the unlimited estate tax.

**LEASEHOLD INTERESTS**  Another limited property interest is the right of a person leasing or renting the land. Modern farming and ranching relies extensively on leased land—both land leased by the farm (e.g., for additional crops or for raising livestock) and excess land the farm leases to others. It is important to determine how the lease is held. For example, if it is in the farmer’s name as an individual, the farm may be faced with the loss of the lease if the farmer dies. When creating this kind of agreement, needs for the land, as well as the required liquidity to pay for the land, must be considered.
ESTATE PLANNING TECHNIQUES

Federal estate tax law changes regularly. For farm and ranch owners, a key issue is ensuring that their estate will be subject to as little estate tax as possible. There are a number of options and techniques an estate can use to minimize taxes, thereby passing more assets to the next generation.

CREDIT SHELTER TRUST

For those estates above the estate tax exemption amount, one of the most basic methods of minimizing taxes is the credit shelter trust, or bypass trust.

A credit shelter trust estate plan uses the unlimited spousal deduction, combined with the estate tax exemption amount, to minimize estate taxes and maximize assets distributed to family members. At the death of the first spouse, the will divides the estate into two parts. A part of the estate equal to the exemption amount is placed in a credit shelter trust. The estate tax exemption shelters this portion of the estate from the estate tax. The surviving spouse has full rights to the income from this trust and limited access to the trust principal. When the surviving spouse dies, the property in the trust is distributed to family beneficiaries.

The second part of the estate is sheltered by the unlimited marital deduction, so what remains either passes outright to the surviving spouse or is placed in a marital trust for the spouse’s benefit. However, for very large agricultural enterprises—or even smaller ones, if additional changes to federal estate tax do come about—the credit shelter trust can be a valuable tool to minimize federal estate taxes.

IRREVOCABLE LIFE INSURANCE TRUST (ILIT) AND CRUMMEY POWERS

An ILIT is created to hold an insurance policy. This allows the farm or ranch owner to purchase life insurance that will usually remain outside of the estate. Typically, farmers and ranchers would use ILITs to:

Provide estate liquidity.

Protect the estate from shrinkage due to estate taxes.

Avoid estate taxation of the policy’s death proceeds.

Provide for the income needs of survivors after liquidity costs have been satisfied.

Shelter trust property from creditors at death.

Every year, the grantor can make contributions to the trust, and those contributions may be used to pay the premiums on the life insurance policy. The amount of the contribution up to the annual exclusion amount is transferred free from gift taxes.

However, the annual gift tax exclusion only applies to gifts of a present interest. A Crummey power makes such a contribution a gift of a present interest by granting the trust beneficiaries the “right” to immediately withdraw the contributions (hopefully, the beneficiaries won’t exercise this right). But without the protection of the Crummey power, the entire contribution would be considered a taxable gift.

GRANTOR RETAINED ANNUITY TRUST (GRAT)

The GRAT is a wealth-transfer tool in which the grantor moves property into a trust for one or more beneficiaries for a set term and then receives an annuity from the trust. The taxable gift is equal to the amount of the assets transferred minus the amount of the annuity plus the amount of growth on the assets calculated using the rate (called the 7520 rate) required by the IRS.
In general, a GRAT is a good tool to transfer property during periods with low 7520 rates for property that will experience appreciation over time. For example, a horse breeder with a potential prize-winning, yearling colt with impressive bloodlines may use a GRAT to transfer the horse to his children. The value of the unproven horse with potential is much less at the time of transfer than it will be once the horse is a proven winner or breeder.

Often, a grantor will attempt to fund the trust in a way that creates a zeroed-out GRAT, which means the amount of the annuity the grantor retains is equal to the appreciable assets plus the anticipated growth return. This would allow a truly tax-free transfer of trust assets to the remainder beneficiary.

**FAMILY LIMITED PARTNERSHIP (FLP) AND FAMILY LIMITED LIABILITY COMPANY (FLLC)**

An FLP and an FLLC are business and financial planning devices that combine business operational planning, personal tax planning, transfer of family wealth, and business succession planning all under one flexible arrangement. These business entities are created by an agreement between an individual and certain family members for the purpose of estate planning and asset protection. It is typically used when an individual owns real estate, a business, or a farm and wants to:

- **Centralize and consolidate management.**
- **Reduce estate transfer costs by shifting future increases in value to younger generations through gifting.**

There are several benefits of using a family business entity in estate planning:

- **Limited liability protects assets from creditors.**
- **The asset does not need to be broken up to give it to multiple people.**
- **The transfer of interests in the FLP or FLLC to other family members also may allow the agricultural business owner to take advantage of discounts on the transfer allowed by the IRS for gift and estate tax purposes.**
- **Each child can receive an interest in the farm while the owner still retains majority control.**
- **The FLLC provides options for distribution of the owner’s share upon death.**

**DYNASTY TRUST**

In recent years, the dynasty trust—also known as a perpetual trust or generation skipping trust—has become much more widely used after state law changes began allowing long-term trusts. The dynasty trust lets an individual with significant wealth create a trust that will benefit future generations.

The assets placed in the trust are owned by the trust, and the trust agreement provides for distributions to the beneficiaries. A dynasty trust is typically used with gifts up to the lifetime exemption cap, which also qualifies for the generation skipping transfer tax exemption. Dynasty trusts can be good vehicles for life insurance policies.
The time is now

Encourage your clients to pay attention to important transition and succession planning issues now. No one knows what the next day holds. But at The Principal, we can help you prepare your clients for whatever lies ahead. Use your skill and expertise, along with your knowledge of the issues surrounding the agriculture market, to help guide clients through what might be the single most important task of running a successful agricultural business—planning for the successful transfer of the farm or ranch to the next generation.
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