2015 Annual Estate Planning & Probate Institute
Focus on Agricultural Estate Planning
March 13, 2015

Frank C. Heinisch
Patrick Sullivan
Heinisch & Lovegrove Law Office, PC LLO
Geneva, Nebraska
Frank@HLLawOffice.com

Estate Planning Issues with Farmland in C Corporation

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1. Best practice now is **NOT** to transfer farmland to a C Corporation.

   a. The main problem is the tax consequence of taking the land out of the corporation.

      i. There are corporate income taxes on liquidation or distribution in kind with no corporate capital gain tax rate relief.

         (1) The tax is on the **inside gain**: the difference between the corporate tax basis on the asset and the sale price or in kind fair market value.

         (2) Then there is a second tax on the **outside gain** I.R.C. 1001(a): the difference between stock tax basis and sale or liquidation proceeds. If the stock is held over one year the individual capital gain rates give some relief. See IRS Publication 544. The **basis of the stock** is:

            (a) the basis of asset contributed for stock at the time of contribution (do not forget the depreciation taken prior to the asset contribution and zero basis of contributed assets such as raised crop or livestock);

            (b) the cost of the purchased stock; or

            (c) the date of death inherited value.

            (d) Remember gifted stock retains the donor's basis in the stock.

      ii. A declaration of estimated tax need not be filed but quarterly estimated tax payments are required. I.R.C. §6154

      iii. The tax in full is due the fifteenth day of the third month after the close of the fiscal year.

2. Advantages of a C Corporation

a. Gifting to take advantage on the **annual gift tax exclusion** without depletion of cash. Customarily farms are land poor with little liquidity in relation to the over all worth and it is inappropriate to deplete cash to make gifts.
b. Gifting to **freeze** the value of the gift to the date of the gift.
c. Shares of stock are **recognizable**, easy to explain and may be owned under a wide variety modes as other corporate entities, trusts, partnerships, LLCs, individuals, custodians for minors under uniform transfer to minors act.
d. **Centralized control** with opportunity for voting and not voting stock and preferential stock for different classes of shareholders, such as non participating shareholders.
e. Avoids **risk of partition** liquidation forced by a single land owner.
f. Favorable income **tax rate of 15%** for the first $50,000 of income that is advantageous for paying principal on loans, but the rates quickly escalate to 39% Federal from $100k to $335k, then back down 34% to ten million dollars. Corporate tax reform is long overdue but it has been in the wings for decades.
g. **Valuation discounts**
h. **Onerous tax** consequences decreases the pressure to liquidate.
i. Well developed **retirement plan** body of law.
j. Family Farm Corporations may use the **cash accounting** rather than the accrual method unless gross receipts are more than $25 million. See IRS Pub 225 Farmer's Tax Guide, Chapter 2, I.R.C. §448
k. **Fiscal Year:** end the year in November and sell crops in December for the next year. Work individual calendar year against corporate fiscal year. Individual pay rent to corporation in December and corporation has the rent as next year's income.
l. Different **classes of stock**: voting/non-voting, preferred stock, different par value with different voting power in relation to value ($1 par = 1 vote vs. $100 par = 1 vote. [$100 of $1 par will have 100 votes]
m. **Corporate loans** to shareholders and **guarantees** of shareholder loans give interesting opportunities as long as they have reasonable business purpose and are written on customary terms.
n. **Rental** of corporate assets and use of **corporate buying power** help the operation of **non-corporate farming** and may become extremely advantageous for helping the **next generation** of farmers.
o. Mandatory annual **meetings and financial reports** keep shareholders advised of the corporate activities.
p. I.R.C. 1031 exchange is available to realign ownership of farm real estate.

3. Avenues to Take Cash Out of a C Corporation

a. Wages and bonuses, subject to Social Security and Medicare taxes
b. Director fees

c. Rent charge corporation and bargain rent charges from corporation
d. Dividends: (free to shareholder in 15% income tax bracket (Married filing joint taxable income up to $74,900)
e. High interest on loans to corporation
f. Bargain loans from corporation
g. Retirement benefits
h. Provide home and utilities with farm business purposes, such as livestock.

4. Liquidation of a C corporation

a. In General Utilities and Operating Co. v. Helvering, 296 U.S. 200 (1936), the Supreme Court held that corporations could distribute appreciated property to their shareholders tax free in dissolution of a corporation. The Tax Reform Act of 1986 repealed I.R.C. §333, the General Utilities doctrine, adding section 311(b) to the Internal Revenue Code that imposes a corporate-level tax as ordinary income on the distribution of appreciated property to shareholders as if the corporation sold such property for its fair market value. See *Eisenberg v. C.I.R.*, 155 F.3d 50, 54 (2nd Cir. 1998) for a history of the repeal of the General Utilities Doctrine. Since 1990, corporations have not had capital gain rates. I.R.C. §336(a)

b. Form 966, Corporate Dissolution or Liquidation, is required to be filed within 30 days after the resolution or plan is adopted to dissolve or liquidate stock

5. Dividends In Kind:

a. A stockholder is taxed on the FMV of a dividend in kind. However, the amount taxable as a dividend cannot exceed the earnings and profits of the distributing corporation. I.R.C. § 316(a). The excess of FMV over earnings and profits reduces the basis of the stock. If the basis doesn't absorb the excess, any remaining balance of the market value is taxed as capital gain. Cloutier, Harry, (1955) 24 T.C. 1006, acq 1958-2 CB 4; Johnson, Dorothy, (1955) TC Memo 1955-291.

The Regulations provide as an example:

> [I]f a corporation distributes to its sole stockholder (an individual) property having a basis of $6,000 and a fair market value of $16,000 and the earnings and profits amount to $10,000, the stockholder reports a dividend of only $10,000, not $16,000. Reg. § 1.316-1(a)(2); Reg. § 1.316-1(a)(3)

6. Stock Redemptions

a. A corporation that acquires it own stock in exchange for cash or property is treated as making a **taxable dividend** to its shareholders, except a qualified redemption is treated as a sale with capital gain treatment. All of a dividend is taxed, and only the gain over basis is taxed as a capital gain. Qualified dividends are taxed at capital gain rates. A redemption is not essentially equivalent to a dividend if it results in a meaningful reduction in the redeemed shareholder's proportionate interest in the distributing corporation, without regard to how it affects the distributing corporation. Reg § 1.302-2(b).

b. There are two safe harbors involving stock redemptions: (1) **substantially disproportionate stock redemptions** and (2) **complete termination** of interest. Generally funding for the redemption is **post tax cash flow**. If the taxpayer **fails** to meet either safe harbor, everything the taxpayer receives (depending on whether the redemption otherwise qualifies as not "substantially equivalent to a dividend", see Reg. §1.302-2(b)(1) (facts and circumstances test)) will be **taxed as a dividend** (at capital gains rates).

i. To be a substantially disproportionate redemption, the redemption must satisfy: (1) the 80% test, I.R.C. § 302(b)(2)(C), and (2) the 50% limitation . It will meet the 80% test if:

(1) the ratio which the voting stock of the corporation owned by the shareholder immediately after the redemption bears to all the voting stock of the corporation at such time, I.R.C.. § 302(b)(2)(C)(i), is less than 80% of

(2) the ratio which the voting stock of the corporation owned by the shareholder immediately before the redemption bears to all of the voting stock of the corporation at such time. I.R.C. § 302(b)(2)(C)(ii).

ii. No distribution is treated as substantially disproportionate unless the shareholder's ownership of the common stock of the corporation (whether voting or nonvoting) after and before the redemption also meets the 80% requirement (above). I.R.C. § 302(b)(2)(C); *see* Reg. § 1.302-3(b) (example). See, also, RIA ¶¶ 242,004 to 242,007 for further elaboration.

iii. For the purpose of the 50% test, a redemption is not substantially disproportionate unless immediately after the redemption the shareholder owns less than 50% of the total combined voting power of all classes of stock entitled to vote. I.R.C. § 302(b)(2)(B); see Reg. § 1.302-3(b) (illustration).

iv. In determining whether a redemption qualifies as substantially disproportionate, the constructive ownership rules of I.R.C. § 318(a) apply in computing the ratios. For when a person will be treated as constructively owning stock actually owned by another person, see RIA ¶243,600 et seq. (Note: There are **no family attribution waivers** for substantially disproportionate redemptions, unlike complete terminations–discussed below.)

c. The more commonly used safe harbor is the **complete termination of interest** redemption test wherein the redemption distribution is treated as sale of stock; a capital gain in excess of basis, not a dividend. I.R.C. § 302(b)(3).

i. To qualify, **<u>all</u>** of a shareholder's stock in the corporation must be redeemed.

(1) In determining whether all shares have been redeemed, stock **attributed to a shareholder** under the constructive ownership rules, is taken into account. Most common are attribution rules for stock owned by "family" members: spouse (unless legally separated under a decree of divorce or separate maintenance) I.R.C. § 318(a)(1)(A)(i), children, grandchildren, and parents. I.R.C. § 318(a)(1)(A)(ii).

ii. individual shareholders or an entity may **waive the "family" attribution** rules only in a complete termination if certain conditions are met. I.R.C. § 302(c)(2); The requirements are as follows:

(1) (i) immediately after the distribution the distributee has **no interest in the corporation** (including an interest **as officer, director, or employee**), other than an interest as a creditor,
(2) (ii) the distributee does **not acquire** any such interest (other than stock acquired by bequest or inheritance) **within 10 years** from the date of such distribution, and
(3) (iii) the distributee, at such time and in such manner as the Secretary by regulations prescribes, files an agreement to notify the Secretary of any acquisition described in clause (ii) and to retain such records as may be necessary for the application of this paragraph.

d. Stock redemption to **pay death taxes** where the stock is surrendered that is in the decedents estate will be treated as a sale, a gain and not a dividend. I.R.C. 303(a). The gain may be minimal because the gain will be measured from the date of death **stepped up basis**.

7. Sell The Stock, Rather Than Assets, An Entity Sale.

a. Capital Gain treatment if the stock had been held over one year, at long-term capital gain rates. The gain is the **outside basis**, that is the basis of the stock, not the basis of the individual assets. **No step-up** in depreciable **basis** for the **inside assets**. No allocation of purchase price for the buyer to assets as permitted under I.R.C. § 754 election for partnerships.

b. The stock price would take into account the various discounts used in valuing stock, control, marketability, taxable gain on the inside assets.

c. Always possibility of unknown liabilities, dealing with tax, business or injury issues. Warranties and due diligence are the negotiation talking points.

d. If the sale is a sale of a "trade or business," it is deemed to be a sale of individual assets. I.R.C. §1060(a). See Treas. Reg. §1.1060-1(b)(1) and Form 8594 is required to reflect the allocation of consideration. "Planning Options for C Corporations," by Neil H. Harl, *Agricultural Law Digest*, Volume 22, No. 4, November 2, 2012.

8. Fair Market Value is the price property would change hands between a willing buyer and a willing seller, neither being under a compulsion to buy or sell and both having reasonable knowledge of the relevant facts. Treas Reg. § 20.2032-1(b); I.R.C. §25.2512(a); Treas. Reb. §25.2512-1; **Rev. Rul. 59-60**, 1959-1 C.B. 237 [althouth modified and amplified over the years Rev. Rul. remains the focal point for the proper method of valuing closely-held securities. See Rev. Rul. 65-192 that extends Rev. Rul. 59-60 to all types of business interests and to income taxes as well as gift and estate taxes.

a. Generally family farm corporations are valued based on the fair market value of the underlying assets determined by comparable sales. This net asset valuation is not the book value of the corporation, rather it is a liquidation model.

i. **Appraisals** are appropriate but not essential until there is a difference over the valuation.

(1) Appraisals are a best estimate. An appraisal should be considered accurate within 10% of the stated value. Until there is a public auction, the value is always an estimate that should be considered to fall within a range.

(2) An appraisal leaves little room to be creative in considering factors that may not strictly relate to value, such as basis,

relationship to other owned farmland, and sentimental value. The ball park valuation can be determined.

(3) In Nebraska, the testimony allowed in court must come either from a licensed real estate appraiser, a lawyer or from the owner of the land. The opinion of a real estate broker, a windshield appraisal, is not a solid foundation to base value, and is often no better than the lawyer's view on the value.

(a) The Nebraska Real Propertty Appraiser Act, §76-2221. Act; Exemptions, provides that Act shall not apply to:

> (6) Any owner of real estate, employee of the owner, or attorney licensed to practice law in the State of Nebraska representing the owner who renders an estimate or opinion of value of the real estate or any interest in the real estate when such estimate or opinion is offered in connection with a legal matter involving real property; ... .

(b) The Nebraska Real Property Appraiser Act, §81-885.16 Real Property Appraiser Act; Applicability; Broker's Price Opinion or Comparative Market Analysis; Requirements.

(1) The Real Property Appraiser Act shall not apply to a person licensed under the Nebraska Real Estate License Act who, in the ordinary course of his or her business, gives a **broker's price opinion or comparative market analysis**, except that such opinion or analysis shall **not** be referred to as an **appraisal**.

(2) **No compensation, fee**, or other consideration shall be charged for a broker's price opinion or comparative market analysis other than a real estate commission or brokerage fee charged or paid for brokerage services rendered in connection with the sale of the real estate involved **unless** the opinion or analysis is in writing, is signed by the preparer, includes the date on which it was prepared, and contains or has attached thereto the following **disclosure** in **bold** fourteen-point type: This opinion or analysis is **not an appraisal**. It is intended only for the benefit of the addressee for the purpose of assisting buyers or sellers or prospective buyers or

sellers in deciding the listing, offering, or sale price of the real property or for lending purposes in a transaction other than a federally related transaction. This opinion or analysis is not governed by the Real Property Appraiser Act.

(c) Appraisal Without Credentials, Real Property Appraiser Act, §76-2246 shall be guilty of a Class III misdemeanor.

(d) See LB 717 (2014) relating to real property appraisal.

ii. Real Estate factors for the lawyer to consider:

(1) Real estate sales between unrelated parties within one year of the valuation date.

(2) We classify sales as irrigated, dry and grass by reviewing the county assessor's records. The predominant class sales are grouped and a per acre value is determined. Such as $8,800 per acre for Fillmore County irrigate land in 2014. Common sense must prevail in weeding out unrepresentative sales.

(3) We maintain sales assessment ratios in Fillmore County, irrigated land is selling for 168% of assessed value in Fillmore County in 2014.

(4) We generally value the buildings and improvements at assessed value.

(5) We review the University of Nebraska Department of Agricultural Economics "Nebraska Farm Real Estate Market Highlights, http://agecon.unl.edu/realestate The February 1, values are published in June of each year with an update published in mid March of each year. We anticipate the values have dropped because of the decrease in crop prices.

(a) For Southeast Nebraska February 1, 2014 pivot irrigated value is $11,455 per acre High Grade value; average value is $9,760 per acre and Low Grade average value is $8,015 per acre.

9. Discount for Lack of Marketability [DLOM]

a. Closely held stock is difficult to sell. It is not like publically traded stock that has organized market places. Lack of liquidity increases the holding period

of the investment with greater exposure to changing market conditions and an increased cost to convert the stock to cash all of which has an adverse effect on value.

b. This is an arena for expert appraisal and opinion, but the middle ground is ascertainable prior to resorting the full bore court testimony of experts. There are ranges of discounts that are generally accepted without litigation.

c. Since 1934, a discount for lack of marketability was utilized for federal income tax valuation. Generally the average range of the discount was 20% to 30% until the early 1970s. Now the discount averages 34%, based on data for a specific time and specific purchasers as opinioned by experts. The discount varies from transaction to transaction depending on specific facts. BVR's Guide to Discounts for Lack of Marketability, fifth edition, 2013 John Stockdale, Sr. page 13 http://www.bvresources.com/bvstore/selectbook.asp?pid=PUB121.

d. In the world of appraisers, there are very sophisticated methodologies to determine the discount of lack of marketability. Under audit, this is a case of expert opinions to be accepted and rejected by the courts. See "Is There a "Best" Lack of Marketability Discount Model?" https://www.bvmarketdata.com /pdf/IsThereaBestDiscountModel.pdf.

e. The IRS Publication "Discount for Lack of Marketability" "Job Aid for IRS Valuation Professionals," September 25, 2009 http://www.irs.gov/pub /irs-utl/dlom.pdf is 112 pages long and reviews in detail the IRS take on a variety of studies and approaches. See page 77:

   i. Table 1, Analysis of SEC Institutional Investors Restricted Stock Study, presents detailed data from the SEC Study. According to the source reference, these data were published in the year 1971, and reflect 398 transactions over the years 1966 – 1969. In regards to Table 1, the following observations are often noted:

   "1) The data indicate that illiquid shares generally sold for less than liquid shares, suggesting an <u>average discount for lack of marketability of 26%</u>;

   "2) The **range** of variance was significant, however, with groupings ranging from a negative discount of -15% (thus, a premium for lack of marketability), to high-end groupings upwards of an 80% implied discount for lack of marketability; and

   "3) Greatest weighting of transactions occurred within the "15%" and "25%" implied discount groupings. This suggests **a most-common**

discount for lack of marketability of 20% (emphases added). Page 77.

"The courts are an excellent source of information when legal precedent is in question but can be a very questionable source when valuation guidance is desired." Page 82.

f. Where there are **shareholder dissents**, the corporations obligation is to pay "fair value" (which is not necessarily synonymous with FMV, *Lasarage Technologies Corp. v. Laserage Labroritories, Inc.*, 972 F2d 799 (7th Cir. 1992); *Bancorporation v. Lindoe, Inc.*, 62 P. 3d 353 (Colo. 2003)).

i. Numerous **dissenters rights** cases have held that either minority interest or lack of marketability discounts should **not be applied** because the minority shareholders are not willing sellers, among other rationales. *See, e.g.*, *Swope v. Siegel-Robert*, 243 F.3d 486, 492-93 (8th Cir. 2001) (citing various other cases for not allowing a marketability discount in such cI.R.C.ustances); *Rigel Corp. v. Cutchall*, 245 Neb. 118, 511 N.W.2d 519 (1994); *Kreischer v. Kerrison Dry Goods Co.*, 172 F.3d 863 (4th Cir. 1999); *Lasarage Technologies Corp*, *supra*.

10. Discount for Lack of Control [DLOC] – Minority Interest Discount

a. A controlling interest in a corporation is more valuable than a non-controlling interest because the holder can control the operation of the business, payment of dividends, compensation, investment and disposition of assets.

b. Family attribution rules related to minority corporate stock valuation is no longer an issue. DLOC will not be disallowed when the control is aggregated with interest held by family members. See Rev. Rul 93-12.

c. Generally a Minority Interest Discount ranges from 10% to 16% with a variety of exceptions and judicial interpretation of expert opinions simply finding a middle ground. I am conservative and generally used a **combined discount** for <u>Lack of marketability and for Minority Interest</u> in a range of **20% to 35%** generally relying on cases rather than appraisals. An appeal will mandate extensive appraisals. Often I am influenced by the desire to increase the stepped up tax basis by using a lower discount percentage.

d. A discount for lack of control need not reflect a minority interest in the corporation. The **super majority** requirement of a vote of two-thirds of the shareholders, Neb. Rev. Stat. § 21-20,136(5) [repealed effective January 1, 2016], for sales not in the ordinary course of business warrants a discount.

i. The Nebraska **Model Business Corporation Act** has removed the super majority requirement and only requires shareholder consent upon the recommendation of the board of directors if the corporation fails to retain a significant continuing business activity unless otherwise provided in the articles of incorporation, Neb. Rev. Stat. §21-2,170.

ii. "If a corporation retains a business activity that represented at least **twenty-five percent** of total **assets** at the end of the most recently completed fiscal year, **and twenty-five percent** of either **income** from continuing operations before taxes or revenue from continuing operations for that fiscal year, in each case of the corporation and its subsidiaries on a consolidated basis, the corporation will conclusively be deemed to have **retained a significant continuing business activity**." Neb. Rev. Stat. §21-2,170(a).

e. For entities holding real estate, the DLOC is determined by comparing the trading price of shares of a selected sample of registered real estate limited partnerships (RELPs) or real estate investment trusts (REITs) to the net asset value of the respective shares.

"Citing mere averages or using generic samples of data is not sufficient. As with the DLOM, the **appraiser's skill** in relating the sample of closed-end funds used to not only the asset type but also the size and other attributes of the assets of the entity being valued is critical." "Valuation Discounts for Estate and Gift Taxes, "Recent Court Decisions Offer Guidance on Interests in Closely Held Businesses" by Justin P. Ransome and Vinu Satchit July 1, 2009

11. Discount for Income Taxes on Built-in Gains [BIG]

a. Often farmland owned by a C Corporation was contributed with a low basis with a substantial capital gain. Such an adverse income tax consequence will influence the value. Corporate federal income tax rates are 39% from $100 thousand to $335 thousand and 34% to $10 million with increasing rates thereafter.

b. The courts have clearly established that with the Net Asset valuation approach the tax value of a closely held corporation stock can be reduced by the built-in tax on the potential capital gain even though no liquidation is imminent.

i. *Estate of Jelke v. C.I.R.*, 507 F.3d 1317 (11th Cir. 2007), [U.S. Supreme Court denied certiorari] reviews in depth the case history of

BIG discounts and applied a 100% discount of the built-in capital gains tax liability [$51million], a 20% discount for lack of control and a 35% discount for lack of marketability were also claimed. The dissent wanted a time use of money reduction of the BIG discount arguing that the majority opinion advocating a simple 100% discount computation violated Teddy Roosevelt strenuous life maxim.

ii. *See, also, Finney v. Finney*, 2003 A-01-770 (expert valued stock using discount for built-in gain, relying in part on ***Buche v. Buche,*** **228 Neb. 624, 428 N.W.2d 448 (1988)** (where the court held in a divorce case that income tax consequences associated with an IRA was a proper consideration in determining the present value of the account, since income tax would have to be paid eventually).

iii. The Nebraska courts have carved out what appears to be an exception to *Buche* in the arena of divorce cases, while leaving open the application of *Buche* other purposes.

(1) Built in gain discount of corporation valuation disallowed in asset based value in divorce case, as speculative when sale of business is not reasonable certain, but permitted in a capitalization of income approach. Discounts allowed for lack of marketability and minority interest. *Shuck v. Shuck*, 18 Neb. App. 867, 806 N.W.2d 580 (Neb. App. 2011):

(a) "Even if it is theoretically true that a potential purchaser would consider " embedded" income tax consequences as a result of capital gains in arriving at a purchase price to offer for any of the businesses, discounting for such in the course of business valuation in the context of a marriage dissolution is appropriate only in limited circumstances,... ."

(2) BIG tax discount disallowed in valuation of closely held family corporation in divorce case if **no sale is imminent** or **no sale is necessary to meet obligation imposed by the court.** *Schuman v. Schuman*, 265 Neb. 459, 658 N.W.2d 30 (Neb. 2003):

(a) "Natalie argues that Buche is distinguishable because we also determined it was improper to consider a penalty which would have had to be paid if the respondent withdrew the IRA. We concluded that since the IRA was not going to be withdrawn, the penalty was to be disregarded. However, since it was certain that

income tax would eventually have to be paid on the IRA, we considered the future tax consequences in our valuation. Natalie argues in the instant case that there is no evidence that Hruska-Schuman is going to be sold and that, therefore, we should not consider the tax consequences of the sale for the same reasons we did not consider the penalty consequences in Buche."

12. Election to Pay Estate Tax Over Ten Years

a. When a substantial part of a decedent's estate consists of closely held business interests, an election can be made to pay the portion of the estate tax incurred by reason of the inclusion of the business in the gross estate in equal installments at very favorable interest rates over a period of time not to exceed 10 years, with the first installment being deferred for up to 5 years after the due date for the tax. Code §6166(a). Thus, full payment of the estate tax attributable to the closely held business may be deferred for up to 14 years (5 years for interests in qualified lending and financing businesses). Code §6166(b)(1)(B).

b. The decedent's estate must include an interest in a closely held business with a value exceeding 35 percent of the decedent's adjusted gross estate. Internal Revenue Code §6166(a)(1).

c. "Interest in a closely held business" includes indirect ownership through "stock in a corporation carrying on a trade or business if (a) 20 percent or more in value of the voting stock of the corporation is included in determining the gross estate of the decedent or (b) the corporation had 45 or fewer shareholders. Code §6166(b)(1)." [Attribution rules apply.]

   Handling Closely Held Business Interests and Other Special Assets, Gregg M. Simon of Much Shelist Denenberg Ament & Rubenstein, P.C. Chicago [paragraph 5.51]
   http://www.iicle.com/Links/EstatePlanningBasicsandBeyond-Ch5-Simon.pdf

13. Special Use Value

a. [5.13] Indirect-Ownership, Special-use valuation may be elected with respect to real property held indirectly through a **corporation**, LLC, partnership, or trust if the decedent's interest in the entity is an interest in a closely held business as defined by Internal Revenue Code §6166(b)(1) (discussed above). Code §2032A(g). See Treas.Reg. §§20.2032A-3(b)(1), 20.2032A-3(d), 20.2032A-3(f). Handling Closely Held Business Interests and Other Special Assets, Gregg M. Simon of Much Shelist Denenberg Ament

& Rubenstein, P.C. Chicago
http://www.iicle.com/Links/EstatePlanningBasicsandBeyond-Ch5-Simon.pdf

b. 20.2032A-3(f) Special rules for corporations, partnerships, and trusts.

i. (1) **Required arrangement.** With **indirectly** owned property, as with property that is directly owned, there must be an arrangement calling for material participation in the business by the decedent owner or a family member.

ii. Where the real property is indirectly owned, however, even full-time involvement must be pursuant to an arrangement between the entity and the decedent or family member specifying the services to be performed. Holding an office in which certain material functions are inherent may constitute the necessary arrangement for material participation....

iii. (2) **Required activities.** The same participation standards apply under section 2032A where property is owned by a qualified closely-held business as where the property is directly owned. In the case of a corporation, a partnership, or a trust where the participating decedent and/or family members are employees and thereby not subject to self-employment income taxes, they are to be viewed as if they were self-employed, and their activities must be activities that would subject them to self-employment income taxes were they so.

iv. Where property is owned by a corporation, a partnership or a trust, participation in the management and operation of the real property itself as a component of the closely held business is the determinative factor. Nominally holding positions as a corporate officer or director and receiving a salary therefrom or merely being listed as a partner and sharing in profits and losses will not alone support a finding of material participation. This is so even though, as partners, the participants pay self-employment income taxes on their distributive shares of partnership earnings under §1.1402(a)-2.

v. Further, it is especially true for corporate directors in states where the board of directors need not be an actively functioning entity or need only act informally. Corporate offices held by an owner are, however, factors to be considered with all other relevant facts in judging the degree of participation. When real property is directly owned and is leased to a corporation or partnership in which the decedent owns an interest which qualified as an interest in a trade or business within the meaning of section 6166(b)(1), the presence of material participation is determined by looking at the activities of the participant with regard to the property in whatever capacity rendered... .

vi. (g) Examples. The rules for determining material participation may be illustrated by the following examples. Additional illustrations may be found in examples (1) through (6) in §1.1402(a)-4.

c. Caution, use of special use value decreases income tax basis. *Alen v. Commissioner*,, T.C. Memo. 2013-235. "Consequences of a Lower Basis for Special Use Valuation Property," Neil H. Harl, *Agricultural Law Digest*, Volume 24, No. 22, November 15, 2013.

14. Stock Restriction Agreements [Buy-Sell Agreements] were an accepted mode of determining value of a Corporation if the following conditions were met:

a. There is a fixed stock price or a formula establishing the stock price;

b. The estate is under an obligation to sell or under an option to sell;

c. The obligation to sell must be binding in life as well as after death; and

d. The agreement had to be for bona fide business reasons.

e. The multiple triggers for the sale are often used to deal with controlling stock that may be acquired by reason of divorce, employment termination, debt foreclosure, inheritance, or undesirable shareholders.

f. Such **valuations** were **controlling** for estate tax valuation until the **1990** Omnibus Budget Reconciliation Act, Pub L. No. 101-508, Section 11602(a), 104 Stat. 1388 (1990), I.R.C. Section 2703(a) which supplemented the pre-1990 rules providing that property is to be valued without regard to any option, agreement, restriction "or other right" which set a price at less than fair market value of the property unless

i. The arrangement is a bona fide business arrangement, valid and enforceable under state law;

ii. Not a device to transfer value for less than full consideration; and

iii. The terms are comparable to similar arrangements entered into in an arms length transaction (I.R.C. section 2703(b)).

iv. See Estate of *Amlie v. Commissioner* T.C. Memo. 2006-76 that upheld a bank stock valuation at death pursuant to a pre-death agreement. ["Valuing Ownership Interests in a Closely-held Business," Agricultural Law Digest Volume 24, No. 4 page 25 - 27; February 13, 2015.]

v. See Nebraska **Model Business Corporation** Act §21-248 Restriction On Transfer Of Shares And Other Securities [effective January 1, 2016] (emphasis added) [Nebraska **Business Corporation** Act §21-2046 repealed January 1, 2016] :

(a) The articles of incorporation, bylaws, an agreement among shareholders, or an agreement between shareholders and the corporation may impose restrictions on the transfer or registration of transfer of shares of the corporation. A restriction does not affect shares issued before the restriction was adopted unless the holders of the shares are **parties to the restriction** agreement or **voted in favor** of the restriction.

(b) A restriction on the transfer of shares is valid and enforceable against the holder or a transferee of the holder if the **restriction is authorized** by this section and its existence is **noted conspicuously** on the front or back of the **certificate** or is contained in the information statement required by subsection (b) of section Neb. Rev. Stat. §21-247. Unless so noted or contained, a restriction is **not enforceable against a person without knowledge** of the restriction.

(c) A restriction on the transfer or registration of transfer of shares is authorized:

(1) To maintain the corporation's status when it is dependent on the number or identity of its shareholders;

(2) To preserve exemptions under federal or state securities law or under the Internal Revenue Code; or

(3) For any other reasonable purpose.

(d) A **restriction on the transfer** or registration of transfer of shares may:

(1) Obligate the **shareholder** first to offer the corporation or other persons, separately, consecutively, or simultaneously, an opportunity to **acquire** the restricted shares;

(2) Obligate the **corporation** or other persons, separately, consecutively, or simultaneously, to **acquire** the restricted shares;

(3) Require the corporation, the holders of any class of its

shares, or another person to **approve** the **transfer** of the restricted shares, if the requirement is not manifestly unreasonable; or

(4) **Prohibit** the transfer of the restricted shares to **designated persons** or classes of persons, if the prohibition is not manifestly unreasonable.

(e) For purposes of this section, shares includes a security convertible into or carrying a right to subscribe for or acquire shares.

g. The most workable and fair method of valuation that has widespread use is a periodically renegotiated fixed price, a required annual determination of value by the governing board or owners. A back-up valuation is prudent, such an appraisal by a qualified appraiser or a formula adjustment from the prior fixed price. Also the buy-out should be over a term of ten or twenty years with interest. *Estate of Amlie v. Commissioner*, T.C. Memo. 2006-76 upheld a periodically renegotiated fixed price. See "Valuing Ownership Interests in a Closely-held Business, by Neil E. Harl, *Agricultural Law Digest*, Volume 26, No. 4, February 13, 2015

15. Shareholder Rights -- a Minority Shareholder Who Wants Cash

a. Often the minority shareholder is unable to sell his or her shares and the shareholder's only recourse may be to attempt to **dissolve the corporation** and **liquidate** the assets.

b. The following two subsections of Neb. Rev. Stat. § 21-20,162 (repealed effective January 1, 2016; replaced by the Nebraska Model Business Corporation Act effective January 1, 2016 § 21-2,197 containing the same language) allow a court to dissolve a corporation:

i. (2)(a) In a proceeding by a shareholder if it is established that:

(1) The directors or those in control of the corporation have acted, are acting, or will act in a manner that is illegal, oppressive, or fraudulent; [or]

(2) The corporate assets are being misapplied or wasted.

c. In Baker v. Baker, 080911 NECA, A-10-901 (2010), the minority shareholder claimed illegality and oppressive conduct by those in control of the corporation

i. by their **failure to provide** financial statements as required by Neb. Rev. Stat. § 21-20,186 (repealed effective January 1, 2016, to be replaced with Neb. Rev. Stat. § 21-2,227 effective January 1, 2016) requiring a corporation to provide its shareholders with **annual financial statements** that include a **balance sheet** as of the end of the fiscal year, and **income statement** for that year, and a statement of changes in shareholders' equity for that year unless such information appears elsewhere in the financial statements.

(1) It is mandatory that the corporation **actually deliver** the annual financial statements to each shareholder within **120 days** after the close of each fiscal year.

ii. by improperly **using the resources** of Bur-Mil Farms to provide financial support to a certain shareholder and his family without adequate consideration. Questioning **rent** paid for corporate farmland and use of **corporate equipment** on shareholder land.

iii. claiming unreasonable **wages and benefits**.

iv. by **failure to pay dividends** or otherwise making distributions from the corporation to the plantiffs.

v. The Baker case was remanded and eventually settled in a type D split-off reorganization transferring to plaintiffs a quarter section of irrigated farmland in exchange for their stock.

d. An action for the judicial dissolution of a corporation is equitable. *Woodward v. Andersen*, 261 Neb. 980, 627 N.W.2d 742 (Neb. 2001). There are a plethora of fact situations where a shareholder may claim oppression, illegality, fraud, or that assets are being misapplied or wasted. However, the statutory remedy of dissolution and liquidation is so drastic that it must be invoked with extreme caution. *Id., Hockenberger v. Curry*, 191 Neb. 404, 215 N.W.2d 627 (1974).

e. However, where the a **shareholder dissents**, the corporation's obligation is to pay "**fair value**" (which is not necessarily synonymous with FMV. *Lasarage Technologies Corp. V. Laserage Labroritories, Inc.*, 972 F2d 799 (7th Cir. 1992); *Bancorporation v. Lindoe, Inc.*, 62 P. 3d 353 (Colo. 2003). See Neb. Rev. Stat. §21-20,138 repealed effective January 1, 2016; Nebraska Model Business Corporation Act §21-2,201 and §21-2,181 effective January 1, 2016.

f. “The Iowa Supreme Court, after a review of authorities held that ‘ ... majority shareholders act oppressively when, having the corporate financial resources to do so, they fail to satisfy the reasonable expectations of a minority shareholder by **paying no return on shareholder equity** while declining the minority shareholder’s repeated offers to sell shares for fair value.’ ” *Baur v. Baur Family Farms, Inc.,* No. 11-0601 (Iowa Sup. Ct., June 14, 2013). “Ignoring Reality: Iowa Supreme Court Decides Case Involving ‘Oppression’ by Majority Shareholder in Farm Corporation,” by Neil H. Harl, *Agricultural Law Digest*, Volume 24, No. 15, July 26, 2013.

g. Numerous dissenters rights cases have held that either **minority interest or lack of marketability discounts should not be applied** because the minority shareholders are not willing sellers, among other rationales. *See, e.g.*, *Swope v. Siegel-Robert*, 243 F.3d 486, 492-93 (8th Cir. 2001) (citing various other cases for not allowing a marketability discount in such cI.R.C.ustances); *Rigel Corp. v. Cutchall*, 245 Neb. 118, 511 N.W.2d 519 (1994) (“In the event of a merger, **neither a minority discount nor a deduction for lack of marketability is to be given in determining the fair value of a dissenter's shares of stock** under the provisions of Neb.Rev.Stat. § 21-2080.”) [Nebraska Model Business Corporation Act §21-2,201 and §21-2,181 effective January 1, 2016]; *Kreischer v. Kerrison Dry Goods Co.*, 172 F.3d 863 (4th Cir. 1999); *Lasarage Technologies Corp*, *supra*.

16. Sub S Recognition Period for Prior C Corporation Retained Earnings:

a. If delay in liquidating a C corporation is not a factor, or in anticipation of liquidating a C corporation an election IRS Form 2553 under IRS I.R.C. §1362 as an S corporation is the best alternative to avoid the double taxation, the gain on the sale on the outside stock basis that adjusts with undistributed income previously subject to income tax against the shareholder.

i. Remember the shareholders of an S corporation are taxed as a partnership on their pro rata share of the corporate earnings regardless of the earnings distribution.

(1) If the S corporation **sells assets** and distributes the cash to a shareholder, the corporation is taxed on the sale, the same as a C corporation but the tax consequences of the sale pass to the shareholder on the schedule K-1 IRS tax form 1120S. I.R.C.. §1366(a). The shareholder basis in the stock is adjusted to reflect the income and off-set the income from being taxed a second time, I.R.C.. §1367(a). I.R.C. §334. .

(2) an **in kind** C corporation or **in kind** S corporation **distribution** is treated as a sale to the shareholder by the corporation, I.R.C. §336.

ii. The S corporation liquidation is taxed on the inside basis, to the extent the S corporation has income. Outside basis is adjusted by such income and the distribution of the liquidation proceeds is taxes on the outside basis of the stock that has been increased by the inside basis sale.

b. if the S corporation was **formerly a C corporation with retained earnings**, the taxable gain that relates to the retained earnings is separately taxed as if the S corporation was a C corporation as to such retained earnings.

c. The potential tax liability associated with the net unrealized built-in gains of S corporations not only applies to the corporation as a whole, but all assets held by the corporation as well.

i. Based on §1374 of the Code, if an S corporation sells or distributes assets after an S election is made, that corporation will be subject to a corporate level tax (at the highest corporate income tax rate) on any asset appreciation that arose prior to the S election (i.e., asset appreciation while the corporation was a C corporation).

ii. This tax treatment is applicable for a 10-year period beginning with the first day of the first taxable year for which the corporation was an S corporation and is also known as the "recognition period".I.R.C §1374 was enacted to prevent C corporations with highly appreciated assets from electing S corporation status for tax purposes and immediately thereafter distributing assets to avoid built in gain taxes.

iii. If statutory time has elapsed, there is no double taxation on the built-in gains of an S corporation. I.R.C. § 1374(d)(7) controls recognition periods following Sub-S election. I.R.C. § 1374(d)(7)(a) defines the term "recognition period" to mean the "10-year period beginning with the 1st day of the 1st taxable year for which the corporation was an S corporation." This is, however subject to special rules laid out in (7)(B) & (C):

(1) (i) in the case of any taxable year beginning in 2009 or 2010, if the 7th taxable year in the recognition period preceded such taxable year, or

(2) (ii) in the case of any taxable year beginning in 2011, if the 5th year in which the recognition period preceded such taxable year.

(3) 7(C) Special rules for 2012, 2013, and 2014. For purposes of determining the net recognized built-in gain for taxable years beginning in 2012, 2013, or 2014 subparagraphs (A) and (D) shall apply by substituting “5-year” for “10-year”.

iv. In summary, the non-recognition period is 10 years, except:
(1) 7th year for 2009 & 2010
(2) 5th year for 2011
(3) 5th year for 2012-2014

v. Thus for 2015 the recognition period tax on retained earnings is 10 years unless there is a change in the law; H.R. 4453 (https://www.congress.gov/bill/113th-congress/house-bill/4453) would reduce recognition period from 10 to 5 years and make such reduction permanent.

d. An S corporation can lose its S status if it has prior accumulated earnings and profits at the close of three consecutive tax years and when passive investment income exceeds 25% of gross receipts [see I.R.C. §1362(d)(3)(A)(I). The term “passive investment income” means gross receipts derived from royalties, rents, dividends, interest, and annuities.§1362(d)(3)(C)(I). Crop-share rental is a safe haven. Consider paying out the accumulated earnings.

e. Ownership of S Corporation stock in a trust is limited:
i. Grantor Trust, I.R.C. §1361(c)(2)(A)(i).
ii. Estate for two years after death.
iii. Testamentary Trust for two years after death, I.R.C. Sec 1361(C)(2)(A)(iii).
iv. Qualified Sub-chapter S Trust [QSST], I.R.C. §1361(d)(3)
(1) one income beneficiary, or multiple beneficiaries each have a separate and independent share of the trust that is treated as a separate trust for federal income tax purposes. Regs. §1.1361-1(j)(3).
(2) principal distributions may only be made to the one income beneficiary as long as the income beneficiary is alive.
(3) income beneficiary’s interest in the trust terminates upon the death of the income beneficiary or the termination of the trust.
(4) If trust terminates while income beneficiary is alive all trust assets must be distributed to the current income beneficiary.
(5) trust income must be required to be distributed or be actually distributed. I.R.C. §1361(d)(3)(B) and Reg. 1.1361-1(j)(1)(I).
v. Electing Small Business Trust [ESBT] may have multiple beneficiaries, and trust income can be accumulated and/or sprinkled upon the multiple beneficiaries. The S corporation portion is subject to the highest income tax rate, 39.6%.

vi. Ltr. Rul 201102046, Sept. 28, 2010 addresses the problems involved, including potential built-in gains tax liability of a reorganization involving an S corporation. "Consequences of Divisive, Type D, Reorganizations for S Corporations," by Neil H. Harl, *Agricultural Law Digest*, Volume 22, No. 4 March 4, 2011.

17. Type D Reorganization With A Split Off

a. When future generations of family stockholders can no longer continue operating the corporation together, a Type D Split-off reorganization is the answer. Tax free, the corporation is split into two or more corporations and each of the shareholders who want to carveout their share will have their own corporation.

b. To accomplish a Type D reorganization, a I.R.C. §355 transaction under I.R.C. §368(a)(1)(D).
   i. The corporation will create a subsidiary corporation,
   ii. transfer assets to the subsidiary of a value equal to the value of the stock owned by the departing shareholders,
   iii. adopt a plan of reorganization, and
   iv. exchange their stock for the subsidiary's stock.

c. B. Tax Consequences of a Section 355 Transaction

   1. No Shareholder-level Gain
      A distribution qualifying under section 355 will not result in the imposition of tax at the shareholder level. Section 355(a)(1).

   2. No Corporate-level Gain
      A distribution qualifying under section 355 will also not result in the imposition of any corporate-level tax, unless section 355(d), (e), or (f) applies. Section 355(c)(1).

   3. Gain on the Distribution of Boot
      Boot distributed as part of a section 355 transaction will, however, be subject to both corporate- and shareholder-level tax. Section 355(c)(2)."

   Practicing Law Institute Tax Strategies for Corporate Acquisitions, Dispositions, Spin-offs, Joint Ventures, Financings, Reorganizations and Restructurings 2010 Corporate Divisions under Section 355 , II. Section 355 -- Overview

d. The stock basis of the departing shareholder in his new corporation is the same as his basis is the stock in the original corporation. §358(a)(1); §358(b)(2), but see §358(g).

e. The tax attributes of the assets transferred to the new corporation will remain the same as in the old corporation. §381(a) The profit and loss will be allocated in proportion to the value of the retained and transferred assets. Reg. §1.312-10(a).

f. Formal Statutory Requirements
   i. Control: the old corporation must be in control of the subsidiary corporation immediately before the distribution.
   ii. Not a device to distribute earnings and profits.
   iii. Business Purpose.
   iv. Active Trade or Business
      (1) **Currently engaged** in the active conduct of a trade or business §355(b)(2)(A)
      (2) The trade or business must have been actively conducted throughout the **five-year period** ending on the date of the distribution §355(b)(2)(B)
      (3) The trade or business must not have been acquired during the five-year period in a transaction in which any gain or loss was recognized §355(b)(2)(C)
      (4) Control of the business conducting the trade or business must not have been acquired within the five-year period preceding the distribution in which any gain or loss was recognized §355(b)(2)(D)
      (5) Departing shareholder must **transfer all** or substantially all of his stock in the old corporation.
   v. Continuity of Interest Reg §1.355-2(c)(1) **for five years** Rev. Rul 66-23, 1966-1 C.B. 67; Rev. Rul. 78-142, 1978-1 C.B. 111. *Penrod v. Comm.*, 88 T.C. 1415 nine months was ok; *McDonald's Restaurants of Illinois v. Comm.*, 688 F.2d 520 (7th Cir 1982) seven months not ok.

g. The active trade or business requirement is not met where corporation cash rented farm land. Rev. Rul 86-126. 1986-2 C.B. 58. Share lease is an active trade or business Rev. Rul 73-234. 1973-2 2C.B. 180.

Basics of U.S. tax-free spin-offs under section 355, Gregory N. Kidder November 2011; http://www.steptoe.com/assets/attachments/4358.pdf

Corporate Divisions Under Section 355 June 2013 by Mark J. Silverman Steptoe & Johnson LLP Washington, D.C,. Practicing Law Institute, Tax Strategies for Corporate Acquisitions, Dispositions, Spin-offs, Joint Ventures, Financings, Reorganizations and Restructuring
http://www.americanbar.org/content/dam/aba/events/taxation/taxiq-fall11-harris-section355.pdf

18. Brother-Sister Control Group and Income Tax Rate Bracketing 021815:

a. Component members of a controlled group of corporations are limited to share
   i. a total of only one of each of the three taxable **income brackets** below the top corporate bracket (I.R.C. § 1561(a)(1)) ;
   ii. one $250,000 minimum **accumulated earnings credit** ($150,000 if the group includes a service corporation) (I.R.C. § 1561(a)(2)); and
   iii. one **$40,000 exemption** amount (less the 25% reduction amount) for purposes of computing the **alternative minimum tax** (I.R.C. § 1561(a)(3); I.R.C. § 55(d)(2); & 55(d)(3)(D)). *See* RIA Tax Desk Analysis ¶607,201.

b. After a Type D corporate divisive reorganization split off a brother-sister controlled group may have been created. Under I.R.C. § 1561, a brother-sister **controlled group of corporations** is a group of two or more corporations if five or fewer persons who are individuals, estates, or trusts own (directly, or constructively **under the attribution** rules contained in I.R.C. § 1563(e)) stock possessing more than 50% of the total combined voting power of all classes of stock entitled to vote and more than 50% of the total value of shares of all classes of stock of each corporation, taking into account the stock of each shareholder only to the extent that the **ownership is identical with respect to each corporation in the group**. I.R.C. § 1563(a)(2).

c. Attribution rules I.R.C. § 1563(e) link family ownership of
   i. spouse,
   ii. minor children under age 21 to parents,
   iii. parents to minor children, under age 21,
   iv. adult children and grandchildren to a parent or grandparent who owns over 50% of the stock value or voting power of the corporation, and
   v. parents and grandparents to adult children, or grandchildren if child or grandchild owns more than 50% of the stock value or voting power of the corporation.

   vi. The **solution** to a controlled group problem is to either to
      (1) have the family owner of the split-off corporation **no longer own** the initial corporation, or
      (2) elect **Sub S corporation** status of one of the corporations.

19. Accumulated Earnings Tax

a. A farm corporation can accumulate $250,000 of its earnings for a possible expansion or other bona fide business reason (service company limit is $150,000).

b. **Corporate minutes** should specifically identify the need to accumulate earnings, such as expanding farmland holdings, installing and replacing irrigation wells and pivots, replace equipment such as a $350,000 combine. With appropriate planning, the Accumulated Earnings Tax should not be a problem. Pay a reasonable salaries and dividends but, most important, have plans in the minutes that will require retention of future accumulated capital.

c. An annual **penalty** tax of **20%** [15% for 2012, 2011 & 2010] of a corporations "accumulated taxable income", I.R.C. § 531, is imposed on corporations that accumulate earnings an profits in the form of liquid assets to avoid income tax to shareholders. Such assets are valued at liquidation value not cost.

d. Internal Revenue Manual 4.10.13.2 has interesting insight on Accumulated Earnings Tax audit issues. The IRS position is that liability for the accumulated earnings tax is based on two conditions:

    i. The corporation must have **retained** more earnings and profits than it can justify for the reasonable needs of the business.

    ii. There must be an **intent** on the part of the corporation to avoid the income tax on its stockholders by accumulating earnings and profits instead of distributing them. Indicative of such intent is:
        (1) Corporate loans to shareholders.
        (2) Investments that have no reasonable connection to the corporation's business.
        (3) Dividend history.

20. Personal Holding Company Tax

a. Personal holding companies are subject to an additional tax at 20% (15% in 2012, 2011 and 2010) on any undistributed personal holding company income. (Code Sec. 541)

b. A personal holding company means any corporation where the following are both true:

    1. At least 60 percent of its adjusted ordinary gross income (defined in I.R.C. § 543(b)(2)) for the taxable year is personal holding company income (as defined in I.R.C. § 543(a).

2. At any time during the last half of the taxable year more than 50 percent of the value of its outstanding stock is owned, directly or indirectly, by or for not more than 5 individuals.

c. **Personal holding company income** includes items thought of as passive income items, such as dividends, **cash rents**, etc. I.R.C. § 543. The fact that any corporation is a "mere" holding or investment company is prima facia evidence of the purpose to avoid income tax with respect to shareholders. I.R.C. § 533(b)

d. A mere holding company is entitled to an accumulated earnings credit for the amount, if any, by which (a) $250,000 plus dividends paid during the first 2½ months of the tax year exceeds (b) accumulated earnings and profits at the close of the preceding tax year. I.R.C. § 535(c); Reg § 1.535-3(b); Rev Rul 73-139, 1973-1 CB 295.

21. Obamacare, the Affordable Care Act, (ACA)

a. Plain speak: Corporations must have a qualified integrated group health plan for any type of health reimbursement plan. Group health plans appear to be unrealistic for farm corporations with under 50 employees; therefore we see **no health reimbursement plans are feasible** for family farm corporations.

i. Group health plans within the meaning of I.R.C. § 9832(a); § 733(a) of the Employee Retirement Income Security Act of 1974 (ERISA), and § 2791(a) of the Public Health Service Act (PHS Act), include:

(1) health reimbursement arrangements (HRAs), I.R.S. Notice 2013-54,

(2) group health plans (or employer payment plans) for reimbursement of premium expenses, *id.*, and "certain" health flexible spending arrangements (health FSAs). *Id*.

(3) Under the Affordable Care Act (ACA), *id*., such plans cannot be integrated with individual market coverage for the purpose of the annual dollar limit prohibition, DOL Techinical Release 2013-03, A-1, p. 6, or for purposes of the preventive service requirements. *Id*. A-3, p. 6, unless one of the two integration methods set forth in id. A-4, p.7, are followed, which is virtually impossible.

b. A **one-hundred dollar per day** [**$36,500** per year] per employee excise tax or **penalty** is assessed under I.R.C. § 4980D against corporations in violation of the ARA commencing January 1, 2014. This forces the employer to make the reimbursed benefits fully taxable to employee and subject employer and employee FICA tax contributions.

i. On **February 18, 2015, Notice 2015-17** was issued to supplement and clarify Notice 2013-54, and provides **temporary relief from** the I.R.C. § 4980 D **penalties**:

(1) Until such guidance is issued, and in any event through the end of 2015, the excise tax under Code § 4980D will **not be asserted** for any **failure to satisfy the market reforms** by a **2-percent shareholder-employee healthcare arrangement**.

(2) Further, unless and until additional guidance provides otherwise, an S corporation with a 2-percent shareholder-employee healthcare arrangement will **not be required to file IRS Form 8928** (regarding failures to satisfy requirements for group health plans under chapter 100 of the Code, including the market reforms) solely as a result of having a 2-percent shareholder-employee healthcare arrangement.

(3) However, unless and until additional guidance provides otherwise, taxpayers **may continue to rely** on Notice 2008-1 with regard to the tax treatment of arrangements described therein **for all federal income and employment tax purposes**.

(4) If an S corporation maintains **more than one such arrangement** for different employees (whether or not 2-percent shareholder employees), however, all such arrangements are treated as a single arrangement covering more than one employee so that the exception in Code § 9831(a)(2) **does not apply**

c. Single employee businesses are **not subject to market reforms**. I.R.C. § 9831(a)(2).

d. Also, allowed are group insurance plans that cover only **non-essential health** (excepted) benefits, [dental, cancer etc plans] as described in I.R.C. § 9832(c), ERISA § 732(c), and PHS Act §§ 2722(b) and §2763. See Notice 2013-54; DOD Technical Release 2013-03.