

AG ESTATES: TOOLS, BASIS, DEPRECIATION & ENTITY OWNERSHIP

Frank C. Heinisch
frank@hllawoffice.com

Christin P. Lovegrove
christin@hllawoffice.com

MATERIALS

1. Tools

- a. Leases
 - i. Example: Cash rent based on monthly average closing price of corn
 - ii. Example: Cash rent based on the Nebraska Farm Real Estate Market Developments table for center pivot irrigation crop land in Southeast Nebraska.
 - (1) [<http://agecon.unl.edu> then tab "Research and Publications," then select "NE Ag Real Estate," then select "Farm RE Report," then select "full report"]
 - iii. Example: Crop share long term lease with marketing by Landlord
 - iv. Example: Crop share long term lease with no marketing by Landlord
 - v. Example: Cash rent with a short term roll forward termination provision
 - vi. Example: Cash rent with a long term roll forward termination provision
 - vii. 2011 Seminar Materials - Modern Farm Leases in Nebraska by Frank C. Heinisch & Christin P. Lovegrove
 - viii. "Leasing to a Family Entity: Watch the Level of Rent Closely" Volume 26, No. 16, August 14, 2015 Agricultural Law Digest
- b. Option to Purchase, example
- c. Right of First Refusal, example
- d. 2015 Seminar Materials – Entity Selection & Use of Entities in Estate Planning for Farmers & Ranchers by Timothy L. Moll
- e. "The Case for Limiting Entities in Farm and Ranch Operations" Volume 26, No. 18, September 11, 2015 Agricultural Law Digest
- f. Stock Restriction Agreement, example

2. Basis

- a. Basis Disclosure - Notes & Comments
- b. IRS Form 8971
- c. IRS Form 8971 Instructions
- d. Forbes Article - "Executors, Inheritors, Lawyers Flummoxed by New IRS Forms"
- e. "Tax Issues Associated with Unharvested Crop in a Decedent's Estate" by Roger McEowen

- f. "Valuing Ownership Interests in a Closely-held Business" Volume 26, No. 4, February 13, 2015 Agricultural Law Digest
- g. Frank C. Heinisch April 15, 2015 email to the Real Estate List Serve on valuing Nebraska land with UNL Nebraska Farm Real Estate Market Highlights publication

3. Depreciation

- a. Often ignored is the opportunity to depreciate the stepped-up value of assets in an estate under I.R.C. 1014 that are depreciable income producing assets such as a pivot irrigation system, fencing, barn, farming equipment. The hole in the ground for a well is an a non-depreciable improvement to real estate, but the column, pump, gearhead, generator and motor as well as the pivot are depreciable against the date of death value. Often over looked is the identification of value on the decedent's inventory. In order to depreciate such business items they must be identified and valued. The beneficiary will follow MACRS depreciation; no section 179 depreciation is available. An inherited item not on the inventory has a zero basis for both depreciation and sale. The bad news is the personal property tax return is based on a taxpayer's depreciation schedule and the items with new basis will be taxed as new. An interesting article on deprecation of stepped up basis is "Uniform Basis: Who Can Claim Depreciation After Death and how Much?" Volume 25, No. 24, December 12, 2014 in Agricultural Law Digest..
- b. Inventory example

4. Entity

- a. S Corp Election and late election
 - i. Form 2553
 - ii. Form 2553 Instructions
- b. Trusts permitted as shareholders of S Corporations

As originally enacted, Subchapter S limited eligible shareholders to those in a domestic corporation . . . which does not – (2) have as a shareholder a person (other than an estate) which is not an individual." Over the years, that simple rule has been amended to allow certain trusts to be permitted shareholders –

A grantor trust (technically a trust under sub-part E of Part I of subchapter J of Chapter 1 of the Internal Revenue Code) which is treated " . . . as owned by an individual who is a citizen or resident of the United States" immediately before the death of the deemed owner . . . and which continues in existence after such death, but only for the 2-year period beginning on the day of the deemed owner's death"

A testamentary trust as transferee of stock under a will, ". . . but only for the 2-year period beginning on the day on which such stock is transferred to it"

A voting trust

An electing small business trust

For Subchapter S banks and depository institutions, a trust which constitutes an individual retirement account including a Roth IRA until October 22, 2004

A qualified Subchapter S trust with only one beneficiary

Wholly owned subsidiaries

It is important to note that the first two categories – grantor trusts and testamentary trusts – are limited by the “two-year” rule – grantor trusts (for two years after death) and testamentary trusts (two years after the stock is transferred to the trust).

S corporations and the “two-year” rule, by Neil Harl, Iowa State University, <https://www.extension.iastate.edu/agdm/articles/harl/HarlSept12.html>

If the estate is to make a Qualified Sub-chapter S Trust [QSST] election use IRS form 2553; it is due no more than two months and 15 days after the beginning of the tax year the election is to take effect, or at any time during the tax year preceding the tax year it is to take effect. If the election is not made the S Corporation status is lost. If the election is not timely made there is a procedure for relief, see Rev. Proc 2013-30. Examples of the appropriate correspondence and documents follow.

- i. Late Qualified Subchapter S Trust Election forms
 - (1) Letter for Application for termination relief under Code Sec. 1362(f) pursuant to Rev Proc 2013-30
 - (2) Affidavit of Trustee
 - (3) Affidavit of Current Income Beneficiary
 - (4) Affidavit of Shareholders
- c. Partnerships, LLCs & Corporations - Current topics & notes
 - i. Cases & Comments
 - ii. Small Partnership Exception Eliminated after 2017
 - (1) There is a trap with a Small Partnership Exception if one partner fails to report their share of the income on their tax return, then the exception is not available and the penalties for failure to file a partnership return will be assessed. Rev. Proc 84-35, 1984-1 CB 509 and Battle Flat, LLC vs US, 2015-2 U.S. Tax Case 50,490 (D. S.D. 2015). See Agricultural Law Digest Volume 26 No. 22 November 6, 2015, “The “Small Partnership” Exception: Failing to Pay Income Tax.”

- iii. Repeal of the "Small Partnership" Exception: A Devious and Highly Suspicious Congressional Move - by Neil E. Harl, Agricultural Law Digest dated March 7, 2016
- iv. IRS Form 8832 with instructions
- v. IRS Form 8893 and Form 8894
- d. 2015 Seminar Materials – Estate Planning Issues with Farmland in a C Corporation by Frank Heinisch and Patrick Sullivan
- e. "Tightening the Rules for Farm and Ranch Entities with Non-Family Members, Volume 26, No. 8, April 10, 2015 Agricultural Law Digest.

5. Trust Distributions and Terminations

- a. DHHS Notice and authorization to release information (LB 72)
 - i. Petition for Determination of Inheritance Tax (Preliminary, for Decedent over 55)
 - ii. Notice to the Nebraska DHHS of the Filing of a Stand Alone Petition
 - iii. Application for Order Regarding Notice to the NE DHHS per LB 72, §77-2018.02(6)
 - iv. Order (§77-2018.02(6))
 - v. Letter to DHHS requesting release
 - vi. Certificate of Mailing of the Notice to the NE DHHS Pursuant to §77-2018.02(6)
 - vii. Notice-No Notice to DHHS Required
 - viii. 42 U.S. Code §1396p
 - ix. DHHS will accept the above information by email at the following address: dhhs.medicaidestaterecovery@nebraska.gov
 - x. Frank C. Heinisch June 14, 2016 email to Real Estate List Serve regarding LB 72
 - xi. There will be a real estate section annual legislation discussion meeting regarding LB 72 on Thursday, August 4, 2016 beginning at 1:00 PM at the Mahoney State Park Lodge.
- b. Successor Trustee Affidavit, example
- c. Form 56 - Notice Concerning Fiduciary Relationship
 - i. Form can be downloaded at <https://www.irs.gov/>
 - ii. Form should be included in most software tax programs (ProSeries)
- d. Form 8855 - Election to Treat a Qualified Revocable Trust as Part of an Estate
- e. Trust termination in lieu of court approval
 - i. Proposal for Termination of Trust, example
 - ii. Release, example

6. Miscellaneous

- a. Listing of Original and Extended Tax Return Due Dates for taxable years starting after December 31, 2015

- b. Department of Motor Vehicles
 - i. <https://www.nebraska.gov/dmv/tlr/index.cgi> (Must be a Nebraska.gov subscriber) A \$1.00 fee is charged for each Nebraska Title, Lien and Registration Record Search and will be charged regardless of if there is a record found or not.
- c. Bank Authorization, example
- d. Bank Letter, example
- e. Investment Account Authorization, example
- f. Investment Account Letter, example
- g. Request for Federal Estate Tax Closing letter
 - i. For all estate tax returns filed on or after June 1, 2015, estate tax closing letters will be issued only upon request by the taxpayer. Please wait at least four months after filing the return to make the closing letter request to allow time for processing. To request a closing letter please call (866) 699-4083 and provide the following information:
 - (1) Name of the decedent;
 - (2) Decedent's social security number;
 - (3) Date of Death.
 - (4) The closing letter will be prepared and issued to the executor at the address of record. For any additional questions about estate tax closing letter requests or the status of the return, call (866) 699-4083.
 - ii. Account transcripts, which reflect transactions including the acceptance of Form 706 and the completion of an examination, may be an acceptable substitute for the estate tax closing letter. Account transcripts are available online to registered tax professionals using the Transcript Delivery System (TDS) or to authorized representatives making requests using Form 4506-T. NOTE: The decision to audit a Form 706 is typically made four to six months after the filing date. Please wait four to six months after filing Form 706 before submitting a request for an account transcript.
 - iii. <https://www.irs.gov/irspup/businesses/small-businesses-self-employed/transcripts-in-lieu-of-estate-tax-closing-letters#tds>
 - iv. The IRS can provide an account transcript for estate tax returns using Form 4506-T, Request for Transcript of Tax Return. You may request the transcript by fax or by mail using Form 4506-T and have it mailed to your address.
- h. Fiduciary Fees, Self-employment Tax

Generally a nonprofessional fiduciary fees are not subject to self-employment tax unless the fiduciary is conducting a trade or business or the fiduciary activities extend over an extended period of time. Fiduciary fees paid for the customary probate or distribution and winding up of a trust are not subject to self-employment tax. If there is the conduct of a trade or

business only the fiduciary that conducts the trade or business and only the portion of fees related to the trade or business are subject to self-employment tax. It may be appropriate to include in the court order closing the estate or terminating the trust to allocate fees designated as paid for the conduct of the trade or business. Generally family politics often govern no claim for fiduciary fees. If one will inherit the property it is better not to claim a fiduciary fee that is still subject to income tax even if it is not subject to self-employment tax.

Revenue Ruling 58-5, C.B. 1958-1, 322 lists the following guides in determining the question of fiduciaries subject to self employment tax:

“(1) Professional fiduciaries will always be treated as being engaged in the trade or business of being fiduciaries, regardless of the assets contained in the estate.

“(2) Generally, nonprofessional fiduciaries (that is, for example, persons who serve as executor or administrator in isolated instances, and then as personal representative for the estate of a deceased friend or relative) will not be treated as receiving income from a trade or business unless all of the following conditions are met:

- (a) There is a trade or business among the assets of the estate,
- (b) The executor actively participates in the operation of this trade or business,
- (c) The fees of the executor are related to the operation of the trade or business.

“The following examples represent applications of the above guides with respect to nonprofessional executors or administrators of decedents' estates:

“EXAMPLE (1). Executor who receives a flat fee for administering the estate. A, a nonprofessional fiduciary, receives a flat \$10,000 for administering the estate of B. B's gross estate is valued at \$150,000 and includes a trade or business which A manages for the period of time required to distribute the assets of the estate. Under the laws of the State in which b's estate is probated, an executor is entitled to a five percent commission based upon the value of the assets distributed. Since A distributed the entire estate worth \$150,000 he would have been entitled to \$7,500 executor's commissions, based upon the statutory five percent allowance. Inasmuch as A, pursuant to court order, actually received \$10,000 instead of \$7,500 in commissions, the excess, or \$2,500, is regarded as being attributable to the operation of the trade or business of the estate. A must

therefore treat this \$2,500 as earnings from self-employment. The remaining \$7,500 is regarded as being attributable to the normal fiduciary duties of marshaling the assets of the estate and should not be treated as trade or business income. On the other hand, if A's total fee for administering the estate was equal to or less than \$7,500 (the statutory executor's allowance in this case), and if nothing was said in the court order with respect to allocation of the fee, the entire fee would be regarded as being attributable to A's fiduciary activities and no part of the fee would be treated as trade or business income to A.

“EXAMPLE (2). Executrix who receives a special fee for handling the estate's business. C, the sole executrix of the estate of her husband, operates a drugstore belonging to the estate, pending dissolution of the estate. As her commission for handling the estate, C receives, pursuant to court order, \$5,125 (based upon a percentage of the value of the assets distributed) and \$500, in addition, for the operation of the drugstore. Under these circumstances, only the \$500 commission for the operation of the drugstore constitutes earnings from self-employment. The \$5,125 commission, based upon the value of the assets distributed is not related to the operation of the trade or business, and, accordingly, does not constitute earnings from self-employment.

“EXAMPLE (3). Coexecutor who does not participate in the operation of the estate's business. D and E are coexecutors of an estate which includes a trade or business. D is totally unfamiliar with the operation of the business and leaves the entire management of the business to E. Under these circumstances, D who does not participate in the operation of the business, cannot be treated as being in a trade or business. The fees received by D do not constitute net earnings from self-employment. E, however, actively participates in the operation of the business and the compensation received by him for the management of the estate's trade or business constitutes net earnings from self-employment.

“In some cases the activities of the executor of a single estate may constitute the conduct of a trade or business even though the assets of the estate do not include a trade or business as such. If, for example, an executor manages an estate which requires extensive management activities on his part over a long period of time, an examination of the facts may show that such activities are sufficient in scope and duration to constitute the carrying on of a trade or business”