

The “small partnership” exception: a way to escape partnership tax complexity, continued from page 3

Judicial response

To date, there have been 18 litigated cases on the “small partnership” exception. In McKnight v. Commissioner, the “small partnership” exception was upheld, the regulations were deemed valid and there was no conflict found with other pertinent regulations. In Davis v. Commissioner, the court held that no final partnership administrative adjustment was made because the partnership was excepted from partnership audit. The same conclusion was reached in Harrell v. Commissioner.

Importance of the provision

A significant proportion of all partnerships and a substantial fraction of farm and ranch partner-

ships appear eligible to meet the requirements to be within the “small partnership” exception. The availability of the exception generally means a lower annual cost for income tax return preparation and freedom from the onerous penalties for failure to file a timely or complete Form 1065, not to mention the advantage of sidestepping the complex rules that apply to partnerships generally such as the depreciation rules applicable to partnerships after transfer of depreciable assets to the partnership.

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Retirement planning for farm families

by Tim Eggers, extension field economist, 712-542-5171, teggers@iastate.edu

Farm families face challenges related to retirement planning and implementation similar to other small businesses. This article briefly addresses two primary challenges. They are the visualization of a retirement lifestyle and confidence in funding that lifestyle.

Farmers are uniquely situated to implement subtle variations of retirement allowing for individualized alternatives. There isn't a “turning in the keys” moment. Changes in enterprises, increased use of off farm labor sources, custom operations, custom farming, crop share and cash rent leasing of land allow for a transition from 100 percent of operations and management being provided by the farm family to simple ownership of the limiting resource in agriculture – land.

Visualization

The identity of a farmer is often closely tied to their occupation. This may be due to several factors including the percentage of time devoted to operation and management of the operation, the high level of interaction between the farm business

and family activities. The length of time engaged in the business is another dominant factor for operators who were raised on a farm and became operators at a young age.

A first step in retirement planning is to visualize what retirement will be. An exercise to follow is:

1. Draw a sketch of your retirement fantasy without financial, geographical, health or other limitations.
2. On another sheet of paper, write the words to describe your retirement. Then write the words you do not want to use to describe your retirement.
3. Write a paragraph each for the things you want to do, be, have and contribute to in retirement. These four paragraphs can help to provide the positive expectations regarding the retirement phase of an individual's life.

To be practical, the next step is to outline the things you need to be doing now to make your future years dreams a reality. While there's mental work necessary to prepare, there's also financial groundwork to do.

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Costs of retirement for farm families

Farm families may be perceived as having a lower cost of living than non-farm families. There are some family living costs that may bear this out. The farm home may be mortgaged through a land note that is paid by the farm business. Rent or purchase of a new home needs to be built into the budget if the farm family plans to purchase a second home in a different climate or move off the farm in retirement.

If home utilities expenses were heavily mingled with farm utility expenses, then making certain that they are accurately estimated could be a challenge. Health insurance might have been covered by the farm business. Retirement healthcare costs are only partially borne at no cost by Medicare. The costs of Medicare components and supplemental insurance would need to go into budgets as the farm family transitions to retirement healthcare needs. Long Term Care Insurance is a product that will need to be carefully considered based on its capacity to offset what may be a major cost for a family.

A primary consideration of farm families when calculating the costs of retirement is to recognize that a simple monthly or annual ballpark estimate of costs of living allocated across a 25-30 year period is too simplistic. Months and years in retirement are not equally active, healthy or opportunity filled. R.C. Atchley outlined six stages of retirement; pre-retirement, retirement (honeymoon, immediate retirement routine or rest and relaxation), disenchantment, reorientation, retirement routine and termination of retirement.

Coming up with a monthly cost of living is a start. A second step is to budget the costs that are not monthly like trips, workshops and the other things developed in your retirement fantasy.

A third step is allocating those costs across different stages of retirement. For some this may result in financial gaps. As you attempt to fill in those gaps, consider the variations of income production

from different sources. Some streams, like Social Security, have incentives to delay the beginning of the income. Others, like withdrawals from a 401K have penalties related to early withdrawal. Then there are assets that can result in rental income like land, while others like stocks, have valuation risk which may be unwelcome in retirement. One area that is difficult to estimate is the impact that inflation will have on retirement living expenses and retirement incomes. Some spreadsheets take this into consideration. As life expectancies have increased the impact of inflation has been greater.

Financial preparation for retirement

There is a default financial preparation built into many farm operations. Farming is a capital intensive business. For operations that have purchased land and equipment, there are financial returns expected as land is leased or sold and equipment is sold. Depreciation recapture and capital gains taxes can act to diminish the returns from outright sale of assets to fund retirement. Returns from the leasing of farmland may be a primary expected source of retirement income.

There are options unique to small businesses, IRS Publication 560 (<http://www.irs.gov/pub/irs-pdf/p560.pdf>) provides an explanation of the plans available for farm families. Each farm operation will have a different level of ability to access the tools at any given time, and each vehicle is unique, making it important to find the right one for your individual situation.

Farming, Investment Planning (<http://www.extension.iastate.edu/Publications/PM1167i.pdf>) is a good starter source of information about the tax treatment of off-farm investments. The online course Investing for Farm Families (<http://www.extension.org/pages/23204/investing-forfarm-families>) provides additional resources to compare on and off farm investments. Social Security is another source of retirement income that requires preparation by farm families. For tax purposes, taxable income may have been mini-

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mized. That can have a significant and negative impact on social security benefits. A good starter source of information on issues farmers should consider about social security is "Farming: Social Security Issues" (<http://www.extension.iastate.edu/Publications/PM1167h.pdf>).

The complete "Retirement Planning for Farm Families" publication is Ag Decision Maker Information File C4-56. Visit the Transition and Estate Planning section on Ag Decision Maker at: <http://www.extension.iastate.edu/agdm/wdbusiness.html> for more retirement planning related materials.

Updates, continued from page 1

2012 Iowa Farm Custom Rate Survey – A3-10 (2 pages)

Feeder Cattle Basis – B2-43 (1 page)

Feeder Steer-Heifer Price Spread – B2-45 (1 page)

Wages and Benefits of Farm Employees - 2011 Iowa Survey – C1-60 (8 pages)

Please add these files to your handbook and remove the out-of-date material.

Internet Updates

The following information files and tools have been added or updated on www.extension.iastate.edu/agdm.

Bonus Plans for Farm Employees - 2011 Iowa Survey – C1-61 (3 pages)

Federal Gift Tax – C4-23 (2 pages)

Federal Estate Tax – C2-24 (4 pages)

Iowa Inheritance Tax – C2-25 (4 pages)

Retirement Planning for Farm Families – C4-56 (4 pages)

Estate Planning Questionnaire – C4-57 (15 pages)

Estate Planning Goals – C4-58 (2 pages)

Trusts as an Estate Planning Tool – C4-59 (4 pages)

Current Profitability

The following tools have been updated on www.extension.iastate.edu/agdm/info/outlook.html.

Corn Profitability – A1-85

Soybean Profitability – A1-86

Season Average Price Calculator – A2-15

Ethanol Profitability – D1-10

Biodiesel Profitability – D1-15

Returns for Farrow-to-Finish – B1-30

Returns for Weaned Pigs – B1-33

Returns for Steer Calves – B1-35

Returns for Yearling Steers – B1-35

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