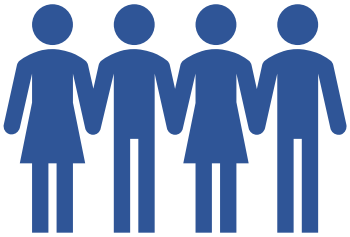
Farmers First Trust
Preserving Value



Selling Mom & Dad's Farm

Preserving Memories and Value

A Family's Decision to Preserve the Value and Heritage of the Family Farm.

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Introduction

This white paper was written for the families that have decided to sell the family farm i.e. 'Mom & Dad's Farm.' To some siblings the farm sale is a way to 'cash out' because they couldn't even find the location of the farm if they had a map. To other siblings it is deeply emotional as memories and the relationships formed by hard work and effort on the farm, as a family, are etched deep into their memory.

To make the situation even more complex, some farms are not only owned by siblings, but several groups of siblings because of the structure of wills and trusts. This situation can be prevalent especially if 'Mom & Dad' were really 'Grandma and Grandpa.' In this case, there may be two (2) or more sets of children with their children as the current heirs to the property.

While it could be interesting to eaves drop into the discussion on whether to sell the farm amongst all these heirs (engineers, doctors, lawyers, store owners, truck drivers, nurses, etc.) we can assume that one point that will be raised is capital gains taxes.

Each of the heirs has their own personal financial situation, but each understands the significance and impact capital gains taxes will have on their portion of the proceeds.

Hypothetical Scenario

The farm was formed as a Family Limited Partnership (FLP) with shares distributed as desired by the owners… 'Mom & Dad' or in this case 'Grandma and Grandpa.' At this point, Grandma and Grandpa had three (3) children who each had 33.33% of the shares of the FLP. Those three children had ten (10) children but now, the shares aren't equal. In this case one family had two (2) children, another had three (3) children and another had five (5) children and since the FLP did not designate a 'last survivor' clause, the share distribution was now very different: (for our example, we will assume that only the grandchildren are alive at this time)

- Two (2) children from adult #1: each have 16.665% ownership of the farm
- Three (3) children from adult #2: each have 11.11% ownership of the farm
- Five (5) children from adult #3: each have 6.666% ownership of the farm

While the conversations might be passionate from all perspectives, the final decision was to sell the farm. Final proceeds would be split based on the percent ownership of each of the heirs.

Farm Location: Any state in the United States, but for our example we will select Illinois.

Farm Operation Scenario: The current farmer renter is the second-generation farmer renting this farm. His father farmed this land and now he can buy the ground he has farmed for so long.

Owned acres: 640 acres
Price/acre: $7,150/acre
Total Gross Sale $'s: $4,576,000

Row crop: Corn and soybean rotation
Livestock: Decades since any livestock lived on the farm.
Buildings: House and 40' x 60' metal shed

- House is valued at $85,000
- Metal shed is valued at $21,000

Decision Criteria

The ten (10) owners have agreed to the purchase price

Owned acres: 640 acres
Price/acre: $7,150/acre
Total Gross Sale $'s: $4,576,000
Contract #1, Net Sale $'s on Land: $ 4,470,000
Contract #2, Net Sale $'s on House and Metal Shed: $106,000
Closing costs *(est.)*: $250K (including broker fees)

Basis per acre: $1,115/acre (second generation did not receive stepped-up basis)
Basis: $ 713,600

Exposure to capital gains taxes: $1,016,557

Tax Type	Marginal Tax Rate	Effective Tax Rate	Tax Amount
Federal	23.80%	23.19%	$837,743
State	4.95%	4.95%	$178,814
Local	0.00%	0.00%	$0
Total Capital Gains Taxes			$1,016,557

Randolph County Illinois location used for taxes shown. Numbers shown are for example only and does not represent your tax situation or an actual transaction.
Tax example used for multi-family siblings is example only and is simplified for representation purposes. Taxes for each sibling would require significantly more analysis based upon tax bracket and other financial requirements.

Note: FLP shareholders will pay capital gains taxes based upon their individual taxable income bracket and revenues attained from the land sale. The table above represents the total capital gains taxes if each shareholder had the same annual income of $90,000.

Deferring the Capital Gains Tax

First thing to remember, the capital gains tax using MDPT can be deferred for up to 30 years, but it will be due at the term end, in 30 years! The taxes will require payment.

Each of the heirs can make their decision if they will use MDPT (Monetized Deferred Payment Transaction) from the sale dollars they receive. The table below will calculate the entire farm sale.

What are the steps the farm operation can review to determine if they should defer their capital gains taxes? Let's take a look:

Activity	Standard Tax Approach	MDPT - Deferring Capital Gains Taxes
Farmland acres sold	640	639*
Net Sale (after closing costs)	$4,326,000	N/A
Depreciated assets on separate sales agreement for MDPT*	N/A	$106,000
MDPT Net Sale amount*	N/A	$4,198,898
Capital Gains Tax Paid (current year)	$1,016,557	N/A
Cash available after transaction	$3,309,443	$3,988,953
Additional cash available with MDPT	N/A	$679,510

See https://www.farmersfirsttrust.com for calculation methodology.

Tax calculation shown assumes all residents live in the same county and in the same tax bracket. In actual life this is unlikely but is used here for example only. State, county and local taxes differ and would affect the calculation shown.

The heirs (altogether in this hypothetical example) would have almost $680K more in cash on hand after using the MDPT process and deferring the capital gains tax.

The MDPT process provides up to 95% of the net sale as cash. The cash received will have interest only payments over the life of the deferred contract. (See https://www.farmersfirsttrust.com for MDPT details.) The net loan interest spread, as a percentage, could range from 1.4% - 1.6% on an annual basis.

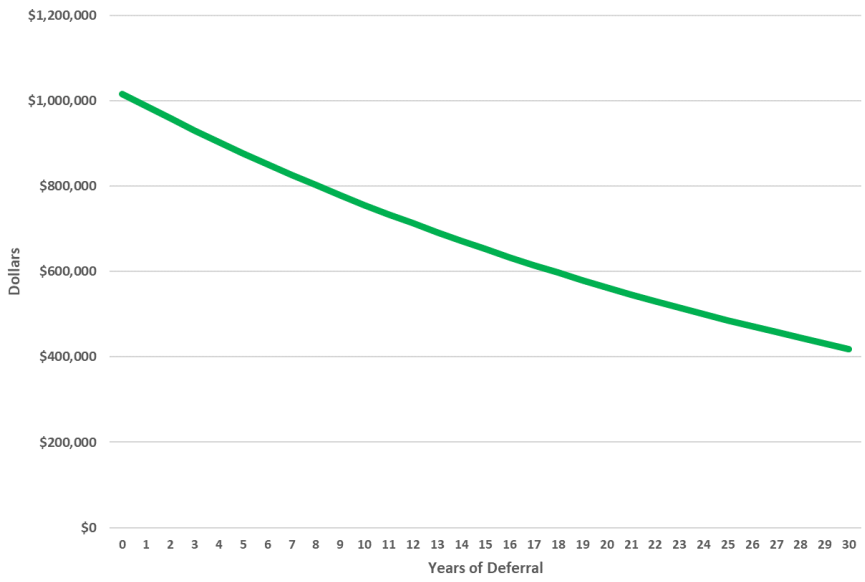
Monetized Deferred Payment Transaction MDPT, utilizes Section 453 of the US tax code and is therefore not encumbered by the restrictions placed on 1031-Exchange transactions.

* In this hypothetical example, the farmhouse and metal shed are placed in a separate sales agreement as Section 453 does not allow depreciated assets to be involved in an installment sale. MDPT Net Sale amount also includes one-time setup fee cost from Farmers First Trust.

The Power of Present Value

Present value accounts for the time value of money. Over time, even 3% inflation erodes the power of the dollar so paying in the future is paying with cheaper dollars. Delaying payment of taxes allows you to pay with comparably inexpensive dollars in the future!

When the deferral timeframe has arrived, the capital gains taxes will be due. However, compared to today's dollars, they will be significantly reduced. If we calculate a 3% inflation rate (realistically it will go up and down over 30 years and what that fluctuation will be is anyone's guess.) on $1,016,557 we see how the power of present value works in the favor of the farm operation:



Because of time and inflation, $1,016,557 is reduced (comparable to today's $'s) to a little over $418K which is about 59% less than if the taxes were paid in the standard fashion!

The key is to grow the deferred dollars, allow inflation and time to work on the real dollar payment due in 30 years and get your farm operation cash flowing positively.

Financial institutions establish their strategic plans and future investments based upon present value. MDPT allows farmers to leverage the power of present value for the benefit of their farm operations.

Conclusion

The Monetized Deferred Payment Transaction MDPT is a powerful approach for farm operations seeking ways to preserve the value of their farm. Receiving cash (in the form of a loan) will provide a financial improvement that can be utilized in a way that is most beneficial to the heirs.

The hypothetical example shown in this white paper displays the power of preserving the heritage of the family farm. The second-generation heirs have the opportunity to retain the maximum dollars from the farm sale and invest to their own plans. The taxes will be due in the future but with the power of present value, their impact will be reduced as compared to today's dollars.

Monetized Deferred Payment Transaction MDPT, see **farmers**firsttrust.com for details and background information.

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