

**SPECIAL ISSUES IN ESTATE PLANNING  
FOR  
PERSONS WHO OWN AGRICULTURAL LAND  
OR  
CONDUCT FARMING OPERATIONS**

**By Robert Serio**

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**I. PLANNING TO PROTECT A WAY OF LIFE**

Our clients in agriculture assume the risks of weather, commodity pricing, the impact of government policies, as well as the impact of income and capital gains taxes. These are factors that are entirely beyond our clients' control but these risks have a huge impact on their livelihood. We also know that farming is much more than a means of livelihood—it is a way of life. For many of our clients, their farm land represents a legacy that has been carefully assembled and nurtured over several generations. Preserving agriculture as a viable economic enterprise for our clients and preserving it as a lifestyle option for younger generations is important work, and the subject of this presentation.

**II. INTRODUCTION TO FARM SERVICE AGENCY AND NATURAL RESOURCE CONSERVATION SERVICE PROGRAMS**

It is likely that persons who own or lease agricultural lands will have those lands enrolled in programs administered by the Farm Service Agency (FSA) or the Natural Resource Conservation Service (NRCS), agencies of the United States Department of Agriculture. Such programs generally have payments that may be earned by landowner or tenant. For those landowners or tenants participating in the Conservation Security Program administered by NRCS, the landowners or tenants must conduct an agricultural operation as defined by 7 CFR 1469.3. Landowners or tenants participating in Price Loss Coverage and Agricultural Risk Coverage must be "actively engaged in farming".

A landowner who receives a crop share rent is considered "actively engaged in farming". A tenant producer must make a significant contribution of capital, equipment or land or a combination thereof. In FSA vernacular, these contributions are termed "left hand contributions". If the tenant producer is a general partnership, each partner must make a significant contribution commensurate with the partner's ownership interest of labor or management or a combination of both.

If the partner is an entity, then each individual in the entity must make a contribution of labor or management or a combination of both. This type of contribution is called the "right hand contribution". If the tenant producer is a corporation, limited liability company, limited partnership, trust or some other such entity, then said entity must make the "left hand contribution", but the individuals in those entities must make the "right hand contribution".

There are many nuances in the regulations covering eligibility to participate in farm programs and receive farm program payments from the FSA. The regulations can be found at 7 CFR 1400 et seq. It is not my intent to touch on all of the “actively engaged in farming” regulations, but only to address those regulations that might have an impact on estate planning.

In addition to conducting an agricultural operation or being “actively engaged in farming”, a landowner or tenant must also be in compliance with the adjusted gross income rule, which can be found at 7 CFR 1400.500 et seq. In short, a landowner or tenant is not eligible to receive farm program payments if the person’s average adjusted gross income for the three years prior to the year preceding the program year exceeds \$900,000.00.

### **III. PAYMENT LIMITS:**

Lands enrolled in FSA farm programs for production agriculture will have cropland acres, most of which will be base acres. Base acres are those acres which have a history of growing program crops, such as corn, soybeans, and rice. Those acres have a production yield assigned to them and are eligible to possibly receive a farm program payment (ARC or PLC) based upon an assigned commodity value.

Lands may be enrolled in CRP, which is land that is taken out of production agriculture by a landowner and placed into a recognized conservation program for which the federal government will pay what is essentially a per acre rent. The CRP contract can be from 10 to 15 years.

Farm land can also be enrolled in the Conservation Security Program administered by the NRCS. The federal government will then pay the tenant or landowner certain amounts of money for the types of conserving practices applied by the tenant or landlord.

In some years the USDA may declare certain counties to be disaster areas allowing the landowners or tenants to apply for disaster payments.

All of the payments under the above cited programs are subject to payment limitations. No one person or entity can receive payments that exceed the payment limitation for the particular program. For ARC or PLC program the limit is \$125,000.00 per person. For Conservation Reserve Program the limit is \$50,000.00 per person. For Conservation Security Program the limit is \$40,000.00 per person. In some years there are disaster programs and those programs have payment limits per person, generally between \$70,000.00 to \$100,000.00 per person. It would not be unusual for the normal farming operation to be eligible for payments far in excess of the limitation.

You may have noticed that I did not list a general partnership as an entity subject to limitations. General partnerships are not recognized as entities for farm program payments. Each partner in a partnership, whether an individual or an entity, may be recognized as a separate person or entity for payment purposes. For instance, a general partnership consisting of five partners, all of whom are at risk and are “actively engaged in farming” may qualify for 5 payment limitations.

#### **IV. ESTATE PLANNING WITHOUT INTERFERING WITH PAYMENT LIMITATIONS:**

Estate planning is done to preserve assets in the future. It is not usually good estate practice to preserve assets in the future while costing the client income in the present. The following scenarios are very common in the farming sector.

The simplest example is that of a husband and wife who are farmland owners or farm tenant. If the husband and wife are partners in a general partnership then each will be eligible for a full payment limit for whatever program in which they are participating. If the husband and wife are simply joint landowners, each is eligible for a payment. If, however, the estate planner does away with the general partnership and in its place creates an LLC, corporation or trust in which both the husband and wife have an interest, he has reduced the eligibility of the husband and wife to one payment limit. If he takes land either jointly owned by the spouses, or owned separately by the spouses and places that land in a joint trust or LLC or corporation he has reduced the eligibility of the spouses to one payment limit.

Another common example is family members who jointly own land that is eligible to be enrolled in a Conservation Reserve Program. There is enough land to draw \$150,000.00 annually from the program and we assume there are at least three joint owners. If the family members maintain their joint ownership or transfer the land to a general partnership in which each owns an equal share, they will each be able to draw \$50,000.00. If, however, this land is placed in an LLC, corporation or trust, the eligibility will be reduced to \$50,000.00.

A third example is two brothers farming in a general partnership. They decide to enroll the land they are farming in CSP. There is enough land enrolled to qualify for an \$80,000.00 CSP payment. If they maintain the general partnership, the partnership will receive \$80,000.00, if, however this partnership is replaced with an LLC, corporation or trust, the farming operation will only qualify for \$40,000.00.

A fourth example involves “actively engaged in farming” rules. Particular attention must be paid if the landowner is also leasing the land from himself under a separate farming operation. This is the case with many of my clients. Farmer A owns the land but leases same for cash to Farmer A partnership, composed of he, his wife, and two corporations in which Farmer A owns 1% of each. This is done to enhance the number of farm program entities that are eligible to draw \$125,000.00 program payments. If, however, if Farmer A must use his land as collateral for his farming operation he must not violate a capital contribution rule which does not allow a landlord to co-sign, secure or guarantee the note of his or its tenant, unless the landowner is a partner. If the individual farmer is a partner, but the land is owned by a trust, LLC, or corporation, which is not a partner, the leased land can not be used as collateral for the operating funds to be obtained by the tenant. Transferring land into one of these entities could have a substantial impact on the cash flow of the tenant partnership and jeopardize the viability of the farming operation.

As mentioned above there is income eligibility requirement. An individual remains eligible for farm program payments until his adjusted gross income exceeds the \$900,000.00 average. This limit is applied to each person, so that a husband and wife each have a \$900,000

limit. It is, therefore, important to keep the income earned by each spouse as equal as possible so that the farmer can effectively have a \$1,800,000.00 AGI limitation.

The eligibility issues raised by the examples above can usually be resolved by an attorney who is familiar with payment limitation rules. It is imperative that an estate planner be aware of payment limitation issues and work closely with the payment limitation specialist.

It would be good practice for the estate planning attorney facing situations like the examples above to think in terms of who can I make members of the general partnership. Many situations can be resolved by placing each person into a separate trust, LLC, or corporation, and then have the separate entities form a general partnership.

## **V. FAIR IS NOT NECESSARILY EQUAL—STRATEGIES TO TRANSITION THE FARM LAND AND FARMING OPERATION EQUITABLY TO THE YOUNGER GENERATION**

Farmers assets are generally the tools of their trade, land and farm equipment. Those assets are dear to the farmer and he would like those to stay intact for successive generations. On the other hand, he is fortunate to have one child who wants to remain on the farm. That child has probably worked with his (or her) father and subordinated his interests in favor of his father with the expectation that he will inherit the farming operation. The father wants to treat all of his children fairly, but would like to leave his land and equipment to the child who has remained on the farm. What are some of the strategies that the estate planner may use?

Here are some my thoughts:

### Equipment:

Farmer leaves equipment to on-farm child and offsets value with cash, life-insurance, or some other asset of near value.

Farmer directs that his equipment be appraised by a person knowledgeable in the values of farm equipment (might be specific as to person or business) and that his on-farm child is to pay a certain percentage of the appraised value to his other children within a certain period after his death. This may be in the way of an installment sale with the other children taking a security interest in the equipment.

Farmer directs that his equipment may be rented by his on-farm child at a percentage of fair market value for a certain amount of years then at the end of that period the equipment is distributed to the on-farm child. If the equipment needs to be traded in prior to the expiration of the lease term, then the on-farm child is to pay a percentage of the trade-in value to the other children.

### Land:

Farmer sets out rent to be paid by on-farm child (preferably a crop share rent) and the number of years the rent will be paid. At the end of that period he sets the value of the land that the on-farm child can pay the other siblings, with a provision that if the on-farm child sells land

within a certain number of years after the purchase from other siblings, then he must share the overage on the sale price with the other child equally. Of course, if all children agree to sell during rent period then land price is shared equally.

The farmer directs that his land be appraised by a person knowledgeable in the value of farm land in that particular area (might be specific as to person or business) and that his on-farm child is to pay a certain percentage of the appraised value to his other children within a certain period after his death.

The farmer conveys land to a trust, LLC, or corporation, sets out how rent is to be determined, provides for on-farm child to be manager, places restrictions on sale of interest, provides for restrictions on pledging land as collateral, and provides for some distribution of rent to each child.

The above are examples that may be used in attempting to save the farm operation but leave all of the children feeling that they have been treated fairly. I would suggest meeting with all of the family to ascertain the thoughts and concerns they have about the family assets.

## **VI. FOUNDATION PLANNING**

Up to this point we have focused on issues that are unique to farmers and farm land owners. We also must remember that farm families also share many of the same planning issues that are issues for other families. Frequently, we find concerns such as these:

- A desire to keep the family business out of the court system upon disability or death
- Clarity in making health care decisions and end of life decisions
- A desire to protect the surviving spouse and the children in the event the surviving spouse remarries after the death of the first spouse
- A desire to protect the children's inheritance from the possibility of a future divorce or lawsuit.
- Children or grandchildren who have not (and may never) possess the financial skill or maturity to responsibly manage an inheritance
- A desire to provide asset protection for IRA accounts and other tax qualified retirement accounts while also allowing for long term "stretch-out" of required minimum distributions.

These issues are major planning drivers. When these issues are thoughtfully explored, clients frequently implement plans that include the creation of revocable living trusts, general durable powers of attorney (to provide for financial decision making for non-trust assets), testamentary trusts for surviving spouses and for children or other heirs as well as stand-alone retirement trusts as IRA beneficiaries.

## VII. PLANNING TO PROTECT BASIS STEP-UP

With the signing of the American Taxpayer Relief Act of 2012 (ATRA) in the early hours of the morning of January 1, 2013, the tax issues in estate planning shifted significantly. The focus now for most farm families (and most families) is not the estate tax but rather the capital gains tax. Because assets that are included in a deceased person's estate receive a step-up in basis to their fair market value on the date of death (even though no estate tax is incurred as a result of that inclusion), planners are now compelled to revisit existing plans clients have created over the years.

Most plans for clients with even modest wealth included what we refer to as A/B will or A/B living trusts. These plans allocate the deceased spouse's assets to a trust that is referred to as a "Credit Shelter Trust" or a "B Trust." Those assets receive a basis step-up at the first spouse's death; however, if those assets continued to appreciate, they did not receive a second basis step up when the surviving spouse passed.

That structure made sense and was necessary in order to preserve the deceased spouse's estate tax exemption. If the deceased spouse's assets passed to the surviving spouse, the exemption was wasted. At the surviving spouse's death, there was only one exemption. However, after ATRA which incorporated the concept of "portability" allowed the deceased spouse's exemption to pass to the surviving spouse with the fairly simple filing of an estate tax return making the portability election.

With this change in the law, families frequently find that their overall tax position would actually be better had they done no planning. Had the deceased spouse's assets passed to the surviving spouse, they would have received a "second step-up" and no estate tax would have been incurred in any event because the combined exemptions exceeded the value of the assets passing to the children. This shift in thinking prompts three potential changes:

- First, and most commonly, a revision to the plan to eliminate the A/B provisions of the will or trust, to be replaced by an "all to spouse" provision; or
- If second marriage protection is an issue (and it is an issue more than you might think), replacing the "B Trust" with a QTIP trust for the surviving spouse which provides the next marriage protection but also provides for estate tax inclusion of the QTIP assets at the surviving spouse's death; or
- A more elegant drafting solution which grants a special independent trustee or trust protector the power to grant powers of appointment in the B trust on specific assets—thus causing those assets to be included in the surviving spouse's estate and receiving a basis step-up.

## **VIII. PLANNING FOR THE ESTATE TAX**

With ATRA, the number of clients who are potentially impacted by the estate tax was dramatically reduced. However, if our client has an estate that is (or potentially could be) more than the inflation-adjusted \$5 million exemption, estate tax planning still matters. The 40% estate tax rate on the value of assets above the exemption is clearly enough to motivate clients to take action. But what action do they take? The number of strategies are extensive and require considerable discussion to explain properly. Given the limitations of time for this presentation, I will offer three of the most common solutions:

- Remove any life insurance death benefit the client currently owns by selling the policy to an irrevocable life insurance trust.
- Transfer the farm land to entities such as a limited partnership or LLC. If this transfer is done for significant and legitimate non-tax business reasons, the value of the interest in entity for transfer tax purposes will be considerably less than the value of the underlying asset. And in the case of farm land, the non-tax reasons are compelling and worth doing if there was no transfer tax benefit
- A part gift/part sale of the LP or LLC interest to a grantor trust in exchange for a simple promissory note, a self-cancelling installment note or a private annuity.

Generally, through the use of this combination of tools, the estate tax can be eliminated on estates of \$40M or less while continuing to allow the senior generation family member to continue to control the operation and continue to benefit during lifetime from the asset base.

## **IX. PLANNING TO PROTECT THE FARM FROM THE COST OF NURSING HOME CARE**

We know that 70% of us will spend some time in a nursing home. In the South, one month in a nursing home costs about \$5000 or \$60,000 for a year. In other parts of the United States, that cost is far higher. For a married couple, we have to consider the likelihood that one spouse will be in the nursing home and the other spouse will remain at home and will continue to need the resources to maintain their lifestyle. If both are institutionalized, the monthly cost is even more. And if the income generated is not sufficient to cover these costs, assets have to be sold to generate the cash until the client has exhausted their assets and qualify for Medicaid benefits. For farm families, the asset that must be sold is the family farm.

There are three solutions that should be considered here:

- First, the purchase of a long term care insurance benefit sufficient to cover the shortfall between the clients' secure income sources (farm cash rent, Social Security, income from other investments) and the predicted cost of long term care;
- Second, an investment in a specially designed life insurance policy with a long term care rider that, if used, reduces the death benefit under the policy. For many, this

is more attractive than long term care insurance because it allows the entire death benefit to pass to beneficiaries if the long term care benefit is not used.

- Third—and only if the other solutions are not workable—is the implementation of a Five Year Medicaid Asset Protection Trust. If the farm or other assets are transferred to this trust, these assets will not be countable as an available resource for Medicaid qualification purposes after five years. The client may retain the income from the assets. With this solution, thought must be given to how to cover the payment for nursing home care after the transfer is made and before the look-back period has elapsed.

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