Estate Planning & The Farm: Top Tips and Practice Pointers

Mid-South Agricultural and Environmental Law Conference

The primary purpose of good estate planning is to preserve family relationships.

I. Farming is Big Business

A. Price of Land – The price of farm land has increased dramatically in the United States, particularly over the last 3-4 years.

1. Partly driven by inflation.
2. Partly driven by the outbreak of the war in Ukraine.
3. Increased amounts of land came on the market at the end of 2021 due to concerns about possible tax law changes when President Biden came into office, along with the lure of higher prices.
4. Investors have also come into the market for land, seeing farmland as a safe, long-term investment and a hedge against inflation.

B. Price of Equipment

1. New equipment prices have continued to increase due to a lack of availability and general profitability of the farmer.
2. Used equipment prices have increased dramatically based on the same factors driving the price increase of new equipment.

C. Cost of Inputs

1. Crop Chemicals
2. Seed
3. Fertilizer
4. Fuel
5. Repairs
6. Custom Work
7. Labor
8. Land Rental Rates

D. Farm Programs, Crop Insurance, Commodity Marketing

E. Many Farm Clients are very savvy

1. College Education – Many farmers are college-educated, particularly the younger generation coming into farming.
2. Ongoing Education

F. May need more sophisticated estate planning techniques.

1. The days of a simple Will are over.

2. Clients are more educated about the possibilities in estate planning. Many know they want to avoid probate and know there are techniques available to reduce both their capital gains tax exposure and their estate tax exposure.
3. With the increase in the value of the farming operation, practitioners need to incorporate sophisticated estate planning techniques to help clients achieve their goals.

II. Farming is a Way of Life

A. Most farmers view their farming operation as a way of life that they would like to pass on to the next generation.
B. Many farmers have inherited land from previous generations and they see themselves as caretakers of the land for a period of time.
C. It can be heart-breaking for farmers if the next generation is not interested in farming. Therefore, they tend to do everything they can to ensure the farming operation continues.

III. The Land is Important!

A. Land may have been in the family for many generations.
B. Consolidation in Farming. Farm land is a finite resource and as farms consolidate and get bigger, the demand for farm land increases.
C. Land is always UNIQUE. Each parcel of land must be evaluated based on its particular characteristics such as:
   1. Fertility
   2. Tillable vs. Pasture vs. Timber vs. "Waste"
   3. Total Acreage
   4. Location
   5. Accessibility
   6. Need for Improvements

IV. Special Considerations when Estate Planning for Farmers:

A. Co-Ownership of Land
   1. I tend to discourage the co-ownership of land when possible during the estate planning process.
   2. In my experience, it is a rare situation where co-owners can get along and continue to operate a farm together.
   3. If the co-owners cannot get along, the land often ends up getting sold, frequently after a protracted legal battle.
   4. Planning to divide the land makes planning harder for the senior generation.
   5. However, it tends to end up with a better outcome for the estate plan and family relationships.

6. There are different ways to compute the relative value of land: cash flow versus appraised value.
7. Clients may want to do a “rough division” (with less emphasis on values) or may want to have a mechanism in the estate plan for making the values equal.

B. “FAIR is not always EQUAL”
   1. This can be a tricky discussion. Everyone involved in the discussion has different reasons to use this statement.
   2. Consider if the on-farm heir has been under-compensated for his labor and contributions.
      a. From the perspective of the senior generation
      b. From the perspective of the on-farm heir
   3. Consider giving the on-farm heir a “bonus”
      a. Equipment
      b. Specific parcel of land
      c. “Grand Central Station
      d. Livestock Facilities
      e. Grain Facilities
      f. Discount to Purchase

C. Rights of Refusal and Rights to Purchase
   1. Particularly on the real estate, I like to incorporate Rights of Refusal and/or Rights to Purchase.
   2. I prefer to base the purchase price on a current fair market value as determined by appraisal.
      a. May want to incorporate a discount
      b. If you incorporate a discount, you should also incorporate a method for recovering the premium within a certain period of time in order to avoid “flipping.”
   3. It can be problematic to include a set price.
   4. You should include a method for determining the Fair Market Value
   5. You may want to allow the purchasers to buy the real estate over a period of time (but consider a short period with specific terms).

D. Right to Rent
   1. You may want to give the on-farm heir the right to rent any real estate that will not be given to them.
   2. Could be either a crop-share arrangement or cash rent arrangement.
   3. You should include a method for determining the rental rate.

E. Trustees
   1. Consider a Special Farming Trustee
   2. Family Members
   3. Corporate Trustee
      a. Give ability to hire a farm manager
      b. Farm manager may be one of the beneficiaries

F. Lifetime Trusts
   1. PURPOSE: Protection of Beneficiaries
   2. Protect from Creditors
   3. Protect from Ex-Spouses
   4. Reduce or Eliminate Estate Tax for Beneficiaries
   5. Flexibility vs. Control
   6. Also called: Heritage Trusts, Dynasty Trusts, GST Trusts

G. Planning with Life Insurance
   1. Consider Irrevocable Life Insurance Trust
   2. Can provide liquidity
   3. Unlikely to be an equalizer

V. Taxes: Where are We and Where are We Going?

A. Federal Estate and Gift Tax
   1. The current exemption for each person is $13.61 Million.
   2. This number is actually based on a $10 Million exemption, increased by inflation.
   3. The combined exemption for a husband and wife is more than $27 Million.
   4. The estate tax rate above exemption is phased in for the first $1 Million and then is 40%.

Taxable Amount	Estate Tax Rate	What Your Estate Would Pay
$0–$10,000	18%	—$0 base tax —18% on taxable amount
$10,001–$20,000	20%	—$1,800 base tax —20% on taxable amount
$20,001–$40,000	22%	—$3,800 base tax —22% on taxable amount
$40,001–$60,000	24%	—$8,200 base tax —24% on taxable amount

$60,001–$80,000	26%	—$13,000 base tax —26% on taxable amount
$80,001–$100,000	28%	—$18,200 base tax —28% on taxable amount
$100,001—$150,000	30%	—$23,800 base tax —30% on taxable amount
$150,001–$250,000	32%	—$38,800 base tax —32% on taxable amount
$250,001–$500,000	34%	—$70,800 base tax —34% on taxable amount
$500,001–$750,000	37%	—$155,800 base tax —37% on taxable amount
$750,001–$1,000,000	39%	—$248,300 base tax —39% on taxable amount
$1,000,000+	40%	—$345,800 base tax —40% on taxable amount

5. The gifts can be given during life, at death, or a combination of both.
6. **The current estate tax exemption sunsets on January 1, 2026.**

B. Where is the Federal Estate and Gift Tax Headed?
- The direction of the Federal Estate and Gift Tax depends on the 2024 Elections.
- Congress may extend the current exemption levels. We have never had a decrease in the exemption amount during the history of the estate tax regime.
- Congress may also allow the current high exemption to sunset at the end of 2025 and fall back to half of the amount of the current exemption.
- When President Biden first came into office, there were concerns that any changes would be made retroactive. This is still a concern.
- You must also factor in the impact of inflation on the increase or decrease in the estate tax exemption.

C. Large Gift Opportunity
1. There may be an opportunity to make a large lifetime gift before the estate tax exemption goes down.
2. In order to take advantage of this opportunity, the gift must be larger than the potentially lower estate tax exemption. Otherwise, you have not accomplished anything with the large gift.
3. You should consider only using one spouses' exemption.
4. Because we don't yet know what will happen with the election, it may be wise to put clients in a position to make a large gift very quickly.
5. Utilizing entities to make the gift will allow you to take advantage of discounts for lack of marketability and lack of control.
6. You should also consider incorporating "Dynasty Trusts into the plan to make a large gift.
7. The downside of making a large gift is the lack of a stepped-up basis if you make a gift during the lifetime of the client.

D. Capital Gains Tax
1. **Basis:** the value of the asset at the time you bought it or received it by inheritance.
2. **Appreciation**: rise in value of an asset from receipt to disposition
3. **Stepped-up Basis**: if asset is transferred at death, recipients receive a basis of the value of the asset at the date of death.
4. **Transferred Basis**: if asset is transferred during life, recipients receive the previous owner's basis in the asset.
5. **It matters because you pay capital gains tax on the difference between the basis and sales price of an asset**.

BASIS: Example
- Buy a farm in 1980 for $100,000. The farm is now worth $500,000.
- If I **SELL** the farm during my lifetime: I owe capital gains tax on $400,000
- If I **GIFT** the farm to my children during my **lifetime**: I do not owe capital gains tax, but my children will owe capital gains tax on the difference between $100,000 and what they sell it for if/when they sell farm
- If I **GIVE** the farm to my children at my **death**: my children will have a basis of $500,000 in the farm. If children sell the farm, will not owe capital gains tax

E. Where is the Capital Gains Tax Headed?
1. The capital gains tax rate will most likely increase in the near future.
2. There was some discussion when President Biden took office that they would either eliminate stepped-up basis or tax unrealized capital gains at death.
   a. Proposed Exemptions: $1M plus primary residence (up to $500,000)
   b. Exemption for Farms that Stay in the Family

VI. Government Programs

A. Administered by the FSA (Farm Service Agency) or NRCS (Natural Resource Conservation Service) - both are agencies of the United States Department of Agriculture

B. Types of Government Programs
   1. ARC – Agricultural Risk Coverage
   2. PLC – Price Loss Coverage
      a. Both ARC and PLC will have “base acres” – acres which have a history of growing certain crops (corn, soybeans)
      b. Will also have a certain yield assigned to them
   3. Disaster Relief - USDA may declare certain counties “disaster areas” and farmers may apply for payments.
   4. CRP – Conservation Reserve Program
      a. Government pays the farmer “rent” to take the land out of production.
      b. Contract usually between 10-15 years
   5. Conservation Security Program
      a. Administered by NRCS
      b. Government pays the farmer a certain amount of money to conduct certain conservation practices.

C. General Rules
   1. Can be for landowners or tenants
   2. Must be “actively engaged in farming”
      a. Crop-Share – for landowners
      b. Significant contribution of labor, management, capital, equipment and/or land
   3. Left-hand contributions: capital, equipment and/or land
   4. Right-hand contributions: labor and/or management
   5. Adjusted Gross Income Rule
      a. Not eligible if average adjusted gross income for previous 3 years is more than $900,000
      b. Husband and Wife each get $900,000
      c. Put in place by the 2018 Farm Bill

D. Payment Limits
   1. ARC and PLC - $125,000/person
   2. CRP - $50,000/person
   3. CSP - $40,000/person
   4. Disaster Payments - $70,000 - $100,000/person

5. An ENTITY is 1 person except for a **General Partnership**

E. Planning for Government Programs
1. **You don't want to reduce eligibility for farm payments by placing them in an entity – Corporation, LLC, joint trust, etc.**
2. Exception: General Partnership

Example 1
- Husband and Wife own farmland jointly
- If they own jointly in their individual names or in a general partnership, husband and wife are each considered 1 person
- If they transfer the land to a joint trust – the trust qualifies as ***1 person***
- If they transfer the land to an LLC or corporation – the entity qualifies as ***1 person***

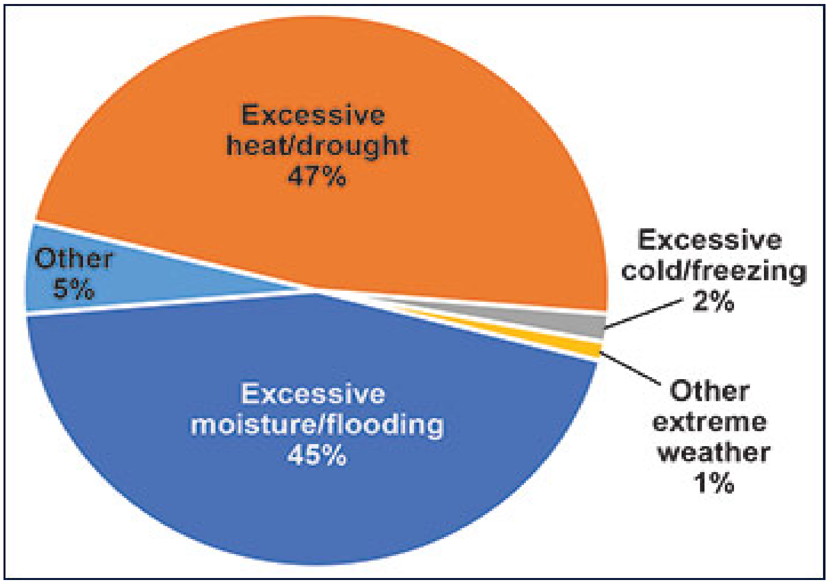
Example 2
- 2 Brothers and 1 Sister own farmland jointly that they want to enroll in CRP
- Each have a $50,000 payment limitation = $150,000 total
- If they transfer the land to an LLC or corporation – the entity qualifies as ***1 person***
    - ***Only qualify for $50,000***

Example 3
- 2 Brothers farm together and want to enroll in CSP
- If have general partnership – each qualify for up to $40,000 payment ($80,000 total)
- If have a corporation or LLC – only qualify for one payment of $40,000

3. **Layer entities under a general partnership -** Each spouse or partner has a separate trust or LLC that is a partner in a general partnership

VII. Crop Insurance

A. What is Crop Insurance?
1. Protects Farmers Against:
    a. Natural Disasters – Drought, Flood, Tornado
    b. Poor Harvests
    c. Crop Loss
2. Different Events
3. Different Crops (Corn, Soybeans, Wheat, etc.)
4. Revenue Policy - pays out based on the amount of revenue that the farmer loses because of a certain event
    a. Based on Previous Yields



*Source: University of Missouri Extension

5. The Risk Management Agency of the USDA administers the Federal Crop Insurance Corporation
6. Private companies sell and service all federal crop insurance products.
7. RMA develops and approves the premium rates, administers subsidies, approves and supports products, and reinsures these private companies.

B. Planning for Crop Insurance
1. May want to segregate high-risk land from other land to reduce the overall cost of crop insurance
2. Create multiple LLCs to lease the land
3. This can adjust from year-to-year

C. Increase in Crop Insurance

1. The percentage of Missouri cropland insured has steadily increased since the mid-1990s