USING TRUSTS IN FARM TRANSITION PLANNING

Maybe you've asked the question, "should I have a trust?" It's a common question for farm families who are planning for the future of the farm. Trusts have become quite popular, with good reason. Trusts can be useful tools for keeping farmland in the family, avoiding probate, holding assets for minors, and more. But while a trust may have many applications and benefits, it may not always be the right solution for your farm transition goals. A careful analysis with your attorney and professional advisors is the best way to determine whether you need a trust. This bulletin offers explanations of trusts and illustrates roles they can play in farm transition planning.

WHAT EXACTLY IS A TRUST?

A trust is one of several tools that holds and transfers assets. Think of a trust as a container. You can place your assets in the container at any time—during life, immediately upon death, and after death. You can create terms and conditions in the trust. Then the assets are distributed out of the trust by the trustee according to the terms and conditions.

To help understand how a trust works**, consider the following example:**

> Andy establishes a trust for his land and includes the following provision: "Upon my death, my son Bill shall have the option to purchase the land. The purchase price shall be 75% of the land's appraised value. My trustee shall provide Bill written notice of his option to purchase the land within 60 days of my death. The purchase proceeds shall be distributed to all my children equally."

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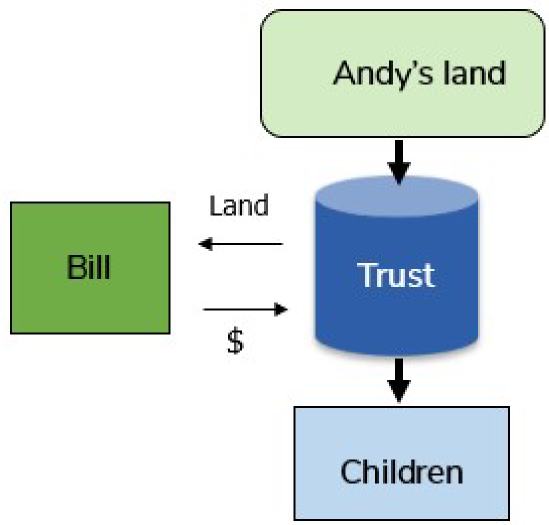
In this example, after Andy's death, his assets will be held in his trust and eventually distributed to out to his beneficiaries. While the assets are in the trust, the trustee will administer the terms and conditions of the trust as established by Andy prior to his death. Here's how the trust could play out:

1. The land goes into Andy's trust upon his death.
2. The Trustee provides Bill written notice that he has the option to purchase the land at 75% of appraised value.
3. Bill elects to buy the land and pays the purchase price to the trust.
4. The trustee distributes the purchase proceeds to all of Andy's children.



As the example shows, the trust is the container that holds Andy's assets. While the assets are in the trust, conditions can be placed on the assets which the trustee must enforce. Ultimately, after the conditions of the trust have been met, the assets flow out of the trust to the trust beneficiaries.

There are essentially no limits to the type and number of conditions that can be placed on assets as they flow through a trust. The conditions in the trust can be very simple, such as giving a beneficiary the right to buy an asset, to very complex, such as holding assets in the trust for multiple generations with restrictions on how the assets can be used. One of the key benefits of a trust is the flexibility it provides for planning because conditions can vary so widely.

HOW LONG ARE ASSETS HELD IN TRUST?

How long it takes from the time assets go into a trust until they leave the trust depends on a trust's conditions and purposes. Sometimes assets transfer through the trust within a few days, weeks, or months. Other times, assets may remain in a trust many years before being distributed.

Assets held in the trust only a short period of time may be assets needed by the next generation to continue farming. Holding assets such as machinery and livestock in trust may impede the ability of the next generation farmer to effectively operate the farm. **Consider the example on the following page:**

> George is a farmer who owns farm machinery. Mary is George's daughter and the successor to the farming operation. George's trust provides that all farm machinery is to be distributed outright to Mary. George dies just as planting season is starting and Mary needs to use the machinery. The trustee distributes the machinery to Mary immediately so that Mary's farming operation is not interrupted.

As this example shows, it is possible for some assets to be held in trust only a few days. Because the machinery is to go directly to Mary with no additional conditions, the trustee is free to distribute out the machinery very quickly.

We pointed out above that assets can also stay in a trust for many years. Often, real estate is the most common asset to be held in trust for a long period. Farmers will sometimes require their land be held in a trust for an entire generation to keep the farmland available to future generations. **Consider the following example:**

> George's land has been in his family for five generations. He does not want the land sold until his grandchildren have a chance to farm it. He establishes a trust with the following provision: "All of my farmland shall be held in trust for the benefit of my children. While the farmland is held in trust, my daughter Mary shall have the option to lease the land. Upon the death of all my children, the farmland shall be distributed to my grandchildren. At the time of distribution, any of my grandchildren who are actively farming shall have the option to lease the land."
>
> In this example, the farmland will be held in trust for the lifetimes of George's children. Perhaps the land is held in trust for as long as 50 years. This is a perfectly acceptable way to use a trust.

As this discussion demonstrates, trusts can be used to hold assets just long enough to transfer them to a beneficiary or to hold assets for many years to meet the goals of the grantor. When considering the use of a trust, the amount of time that the assets will be required to be held in trust is an important consideration.

TRUSTS AND PROBATE AVOIDANCE

A primary characteristic of a trust is probate avoidance. Probate is a time-consuming process. It can take months or longer to administer an estate through probate, but a trust continues to operate without having to wait on probate. Probate can also be expensive.

As we discuss in our other bulletin in this series, Legal Tools for Avoiding Probate, we can avoid probate of titled assets without the use of a trust with payable-on-death or transfer-on-death designations. These assets include financial accounts, life insurance, vehicles, and real estate. But non-titled assets such as equipment, crops, grain, and livestock can only avoid probate by using a trust. Farms with substantial amounts of these non-titled assets can keep those assets out of probate by using a trust. **Consider the two scenarios in the following example**:

Scenario 1. Jane owns a large inventory of farm machinery. For her estate plan, she has a simple will leaving the farm machinery to her children. When she dies, the machinery will be subject to probate. It will likely take several months, at a minimum, to complete the probate process to transfer the machinery to the children. Additionally, considerable legal fees will be required to file the appropriate forms with the probate court.

Scenario 2. Jane elects to have a trust for her estate plan. When Jane dies, the machinery will be in her trust. Jane's trustee can distribute the machinery to Jane's children at any time after Jane's death. Other than perhaps a simple document recognizing the children's receipt of the machinery, the machinery can pass to the children with little effort and in a short amount of time.

This example highlights the probate-avoiding benefits of a trust. For farm operations with large inventories of machinery, livestock, grain, crops and other non-titled assets, trusts will usually save significant time and legal fees by avoiding the probate process.

DO YOU NEED A TRUST?

A trust is not necessary for every situation; sometimes a simple will is adequate. Several factors can help with deciding if the benefits of a trust outweigh the extra costs and complexities of a trust. The following are a few of the more important factors to consider when making this decision.

1. Complexity of plan

Generally, the more complicated the plan the more likely a trust is the better option. Remember that assets that are subject to a will are also subject to probate court oversight. While probate courts provide an important service and do a good job of administering many estates, the probate process is also well known for being laborious and time consuming. Administering a complicated plan through a will and probate can get bogged down very quickly.

A trust is not subject to probate oversight. The trustee administers the trust with the oversight of only the beneficiaries. The administration of assets through a trust can often be done much more efficiently and quickly than probate. Trust administration does not have all the constraints and formality of probate. **Consider the following examples**:

Example 1. Mike's goal is to have his farmland go to his three children equally with no additional conditions. A trust is likely not needed as the distribution plan is simple and straightforward.

Example 2. Mike would like all three of his children to benefit from his farmland. However, he wants his son Nick to have the option to purchase the other children's ownership interests. He also wants to set the purchase price at 80% of the appraised value and give Nick 10 years to pay for the land at the lowest allowable interest rate. A trust is likely the better option for this scenario because of the complexity involved with Nick's option to purchase. While this scenario could be done through probate, it would take much longer and likely incur significant legal fees. Instead, by using the trust, the trustee obtains an appraisal, makes the offer to Nick and collects the sale proceeds – all without the need to involve the probate court.

The more complex the estate plan becomes, the more likely a trust is the better option. Wills are the better option for people with simple plans, but most farmers do not have simple plans. Farmers often include options to purchase, leases, rights of first refusals, and many other complicated components in their plans. For many farmers, a trust will be the better option for their estate plan.

1. Transition of operation

One of the primary concerns of many farmers is the transition of the farming operation to the next generation. Trusts can allow the farming operation to flow to the next generation farmer quickly and efficiently. This quick and efficient transition can help ensure that the farming operation remains viable and profitable for the successor farmer. **Consider the following example:**

Linda owns a herd of beef cattle. Her intention is for her two children to inherit the cattle. Linda knows the cattle should be sold upon her death since her children have no interest in the cattle and have never helped with the cattle. Linda dies unexpectedly a week before her cows are to start calving.

Scenario 1. Linda dies with only a simple will that leaves everything to her children. Before the cattle can be sold, Linda's estate must be opened in probate court and an executor must be appointed by the court. Then, the executor must receive permission from the court to sell the cows. This process could take several weeks and in the meantime, the cattle have likely started to calve and there is no one to take care of the cattle or the new calves.

Scenario 2. Linda had set up a trust before her death which holds the cattle. Upon Linda's death, the trustee is able to immediately find a buyer and sell the cattle. All the cattle are sold to another beef operation before they begin calving.

This example shows how a trust can provide a better transition of the farming operation. In the first scenario the probate court was required to be involved, which could hold up the transition. In the second scenario the trustee had the authority to sell the cattle immediately upon Linda's death. The independence enjoyed by the trustee allows decisions to be made faster and actions to be taken quicker–both important to a smooth transition of the farming operation.

3. Concerns about heirs

Most people want to leave an inheritance to their heirs to help improve their lives and the lives of future generations. But sometimes, there may be concerns that the heir may not be able to manage the inheritance left to them or that it may be lost to frivolous spending or creditors. A trust can help ensure that an inheritance will be protected from mismanagement or loss.

A trust strategy uses a trustee to manage an heir's funds. The trustee can provide the heir with income and/or principal from the trust and can also limit the resources available to the heir to be sure it is not wasted. The assets can be held in trust until certain conditions are met, for a certain period, or for the life of the heir. **Consider the following example:**

Nancy wants to leave her farmland to her two children, Paul and Oscar. Paul has never been able to manage his finances and spends every dollar that is available to him. Nancy is concerned that if Paul inherits the land he will immediately sell it to get money to spend on things he does not need. Nancy wants Paul's children to be able to enjoy and benefit from the land someday.

Nancy establishes a trust. Upon her death, Paul's share of the land will be held in trust for the remainder of his life. Oscar, who is responsible and good with money, will be the trustee of Paul's trust. Oscar will manage the land on behalf of Paul and will release only the income generated from the land annually to Paul. The trust instructs Oscar not to sell the land and upon Paul's death, to distribute the land to Paul's children.

When facing a scenario in which the heir should not receive the assets directly, a trust is an excellent means to protect the assets. This strategy can be used to protect assets from issues that heirs may have such as drug/alcohol abuse, gambling, creditors, lawsuits, bankruptcies, spending problems, and marriage problems. Wills, conversely, provide limited options to protect assets for heirs.

4. Estate taxes

In the last decade, federal estate taxes have become less of a problem for farmers because the federal estate tax exemption has steadily increased. And many states, like Ohio, no longer have estate taxes. This means only a small fraction of farm families face the prospect of paying estate taxes. However, for those farm families who do face estate taxes, trusts are a near necessity.

A discussion on the intricacies and complexities of estate taxes and trusts is beyond the scope of this publication. However, it can safely be said that trusts provide opportunities to reduce estate taxes that cannot be accomplished by a will alone. This estate tax savings benefit is mostly applicable to married people because assets can be held in trust at the death of the first spouse. For unmarried people, trusts do little to reduce estate tax liability and thus a will may be an adequate solution.

5. Privacy

The process of probate is overseen by a probate court and all filings and information are open to public access. For some people, the idea of having information about their will, assets, and heirs be publicly available is not a big concern. For others, privacy is a priority.

Trusts can maintain privacy. Because a trust is a private document and only the trustee and beneficiaries are entitled to see it, a person's assets, beneficiaries, and distribution plan remains completely private. For individuals who wish their estate information to be private, a trust is a better option than a will.

6. **Legal fees**

Generally, trusts are more complex legal documents than wills and usually cost more in legal fees, although costs vary greatly from one attorney to another. However, the attorney and probate fees for implementing a will-based plan can be several times more than the costs to administer a trustbased plan. Before engaging an attorney to draft a will or a trust, be sure to understand what the total costs will be as this is an important factor in deciding between a will or trust.

OTHER BENEFICIAL CHARACTERISTICS OF A TRUST

There can be other benefits of incorporating a trust into your farm transition plan. We explain these additional benefits and considerations below. If any of these are important to your goals for the future of your farm, consider using a trust to accomplish those goals.

Control after death. A trust allows you to continue to control the assets after your death through the terms of the trust. For example, the trust could hold farmland after death and not allow that farmland to be sold for 50 years or more.

Planning for second marriages. In a blended family involving a second marriage after the loss of a first spouse, a trust can provide income and support for your second spouse if you pass away while keeping farm assets in your family. If your second spouse later remarries after your death, the trust could direct the assets to go to your children, whether from the first or second marriage, and the assets won't end up in your second spouse's new family. This strategy can keep farmland and other farm assets in your family in a second marriage situation.

Restrictions for minors. A trust can include provisions requiring your children to meet certain age requirements before they receive income from an asset or the asset itself.

Provide for heirs with special needs. Much like a trust can provide for a surviving spouse, a trust can manage funds and assets for loved ones with special needs like a handicap or disability who might not be able to care for themselves after you pass away. Appointing a trustee to manage the assets and income for your beneficiary gives you the assurance that your loved one will have the funds and care needed to live a comfortable life.

Giving to charities. In addition to providing for loved ones, you can also use a trust to support your passions. You can establish a charitable trust that names certain charities, or you can describe causes or issues you want to support with the trust assets.

GIVE CAREFUL CONSIDERATION TO TRUSTS

Trusts are valuable tools for farm transition planning. However, trusts are not necessary for every plan. Consider the benefits of a trust to determine if it is the best asset transfer tool for you. Your estate planning attorney can help guide you through the process.

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Find all our **Planning for the Future of Your Farm** resources at https://go.osu.edu/farmplanning

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