STRATEGIES FOR TREATING HEIRS EQUITABLY

Farm families often have children who have stayed on the farm and helped with the farm and operation. Should parents treat these children differently in estate and transition plans than they treat children who have left the farm? Is it fair to favor the on-farm children in your estate plan? Or should parents treat all children equally, despite their differing contributions to the farm? These questions raise the "equal versus equitable" decision many farm families face. It's not an easy one. In this bulletin, we present questions that can help a family work through the "equal versus equitable" debate. We also offer strategies on how to create an "equitable" plan if an equal inheritance is not the best solution for a farm situation.

"EQUAL" VERSUS "EQUITABLE" INHERITANCE

It's common for parents to assume that an "equal" division of assets among their heirs is fair. But it's also common for an equal division to raise issues of unfairness and cause problems for a farming operation. That's because a farm family's most valuable assets are usually the farm assets—its land, buildings, equipment, livestock, and crops—and an equal division of those assets could jeopardize the ability of heirs to continue farming. For example, some children may want to capitalize on their inheritance and sell their share of inherited farmland out of the family, making it difficult or even impossible for other heirs to have a viable farming operation. Additionally, an equal shares division may not reward heirs who've contributed sweat equity over the years, often adding value to the farm for the benefit of heirs who did not contribute to the farm.

An "equitable" approach might be a better solution for a farm family. An equitable approach recognizes that an equal division may not be fair or in the best interest of the farm and family. It operates on the belief that heirs are not automatically entitled to an equal share of the farm assets. Instead, parents may need to allocate assets fairly to accomplish their goals for the farm and family. For families with the common goals of protecting family land and ensuring a viable farming operation into the future, an equitable approach may be necessary.

THE OHIO STATE UNIVERSITY
EXTENSION

USDA United States Department of Agriculture
National Agricultural Library

NATIONAL AGRICULTURAL LAW CENTER

This work is supported by the National Agricultural Library, Agricultural Research Service, U.S. Department of Agriculture. It is provided for educational purposes only, is not legal advice, and is not a substitute for the need to consult with a competent attorney licensed to practice in the appropriate jurisdiction.

WEIGHING EQUAL VERSUS EQUITABLE APPROACHES

Whether to take an equal or equitable approach to inheritance can be a difficult decision. If you're trying to determine which approach is best for your farm and family, the following questions can help you weigh important factors that may lead you to an answer.

What are your goals for the farm? This is a good time to review what you're trying to accomplish for the future, such as leaving wealth for your heirs, protecting family land, or passing on a viable farming operation. Consider how each approach could affect those goals. Would an equal division of assets among your heirs help or hinder your goals? Is an equitable approach necessary to achieving your goals? You might be surprised to learn that taking either an equal or an equitable approach can significantly impact whether you can accomplish your goals.

Are your experiences getting in the way? We sometimes find in farm families that decisions of past generations can affect the emotions and decisions of current generations. For example, if your parents were not fair in how they handled their estate, you may feel you must be fair. Or maybe your grandparents' decision to equally divide up the farm assets ended the family farming operation and deprived you of the opportunity to farm. Consider how your own past experiences play into your situation and be aware that they might affect your judgment now.

Do any heirs want to continue the farm? If no one in the family cares whether the farm continues after you're gone, perhaps an equal division of assets is the appropriate approach. But do you know for certain if any heirs want the farm to continue? Have you discussed the issue with your heirs—including children and grandchildren? If you have raised the issue and know there are heirs who want the farm to continue, consider the next question.

Who wants to be involved with the farm in the future? The answer to this question can be very important, especially if you have several heirs. If all of your heirs want to remain involved in the farm in the future, an equal division may allow for that. But if there is a split between heirs who do and do not want to be involved in the farm, an equitable division may be necessary to protect the land and the farming operation.

Who has helped with the farm? Have all your heirs helped equally on the farm, or have some contributed more than others? Is there a child or a grandchild who willingly volunteers time to care for the land, maintain equipment, plant and harvest, or make capital improvements? Those who've helped have likely increased the farm's worth through their "sweat equity," making the assets more valuable for those who will inherit them. Do you want to consider contributions of sweat equity when dividing the farm assets?

Do you have farm and non-farm assets? Non-farm assets such as life insurance, savings accounts, other real estate, and retirement plans can help balance asset division between non-farm and farming heirs. Can you accomplish your goals by giving non-farm assets to heirs who do not want to be involved in the farm while giving farm assets to those who do? If not, are there opportunities to increase your non-farm assets? It may be helpful to consider investment strategies and generate non-farm assets.

Do some heirs need more inheritance than others? Not all equity issues are tied to farming issues. If you have an heir with special needs or limited income earning capacity, you may want to provide additional resources to meet their needs. An equal approach would likely not allow for special treatment. We address this issue in our bulletin in this series, Strategies for Addressing Special Family Needs.

Have you already given more to some children than others? Have you bought a new car for an heir, put another through college, given an heir farm equipment, or made similar contributions to an heir? Do you want to treat an heir who has received more during your life equally upon your death, or do you want to take lifetime gifts into consideration in your final estate plan?

STRATEGIES FOR CREATING AN EQUITABLE PLAN

Developing an equitable plan might require a bit more thought than a plan that equally divides assets among heirs. Many strategies can help with an equitable plan, however, as we discuss below.

1. Assign farm assets to on-farm heirs and non-farm assets to off-farm heirs

Use non-farm assets such as cash, investments, and life insurance for your off-farm heirs. This can allow you to give farm assets to those who want to continue the farm. **Consider this example:**

Farmland, farm equipment and checking account goes to Child One, who wants to continue the farm. Savings and investment accounts go to Child Two, along with a life insurance policy to help balance asset distribution.

2. Include an option to purchase farmland or farm assets

When you know or expect that one or more heirs wants to own the farm, consider giving them the option to buy out the interests of the other heirs if they want and can do so. The non-farm heirs would then receive sale proceeds rather than assets. This approach is often used for land but can also work with other assets. **Consider this example:**

Fred and Wilma know their child Sam wants to own the farm. They give Sam the option to buy the farmland at a specified price and require that the proceeds be distributed among all of their children. If Sam does not exercise the option, all children will receive an equal share of the farmland.

3. Include a right of first refusal on farmland and/or farm assets

A right of first refusal is like an option to purchase, but the heir's right to purchase arises if there is an attempted sale of the asset. Often, this comes into play when an heir who receives land wants to turn around and sell the land, but other heirs want the land to remain in the family. An heir that holds a right of refusal would have the first right to purchase the land before anyone else, and the other heir would still receive the proceeds from selling the land. **Consider the example on the following page:**

> "I leave the Smith Farm to my daughter Jane. However, prior to distribution, my Trustee shall provide a Right of First Refusal to my son John that gives him the first opportunity to buy the Smith Farm in the event Jane intends to sell the farm."

4. Include buy out terms for options to purchase and rights of first refusal

You may also set sale and payment terms for assets to ensure that a farming heir is able to make a purchase of farm assets. You could set the purchase price at a fixed dollar amount or use a calculation, such as 75% of the asset's fair market value as determined by appraisal. You can also allow installment payments over a number of years, such as a 10-year repayment, which can also help farming heirs afford the asset purchase while continuing the farm. **Consider this example:**

> "I leave the Smith Farm to my daughter Jane. However, prior to distribution, my Trustee shall offer my son John the right to purchase the Smith Farm. The purchase price shall be 75% of appraised value. John may elect to pay the purchase price in ten annual installments at the lowest allowable interest rate. If John elects to buy the Smith Farm, all sale proceeds shall go to Jane."

5. Name an on-farm heir as the beneficiary of a life insurance policy

Even with an option to purchase or right of first refusal, many farming heirs find it difficult to exercise their rights because of how much farm assets cost. Discounting and the ability to pay over a number of years helps, but sometimes they still need money for the purchase. A life insurance policy can provide an easy, relatively affordable way for an on-farm heir to buy-out off-farm heirs. It offers a way to expand the non-farm assets because the on-farm heir can collect on the policy and put the money toward exercising their options to purchase and rights of first refusal.

6. Calculate the sweat equity of your on-farm heirs

If you have on-farm heirs who have worked full or part time on your operation, you can calculate their contribution to the farm's value. This calculation can be based on the changed value of the farm operation since they started working for you and the proportion of the growth you believe resulted from their efforts. You can include this calculation to boost the on-farm heir's share of the farm equivalent to what they have contributed but have not fully been compensated for. **Consider this example:**

> June has worked on the family farm full-time since she graduated from college. In that time, the farm has increased in value by $1,000,000. Mom and Dad feel that June has contributed about one-half of the labor and management of the farm since she joined. They determine that June has $500,000 of sweat equity in the farm.

7. Calculate the lost income of your on-farm heirs

On-farm heirs often receive less money while working for the family farm than they would have received at an off-farm job. This may reflect the fact that they also received lodging, food, and other necessities. Nonetheless, the heir may have lost income that their off-farm siblings were able to earn by working off the farm. You can calculate what an heir might have made in another career and compare that number with how much they've received on the farm. Using the difference, you can boost the heir's share of the estate to an amount equivalent to what they would have made in another career.

8. Gift assets while you are still alive

You can begin the process of rebalancing your estate mix between farming assets and non-farming assets by gifting. You can also give a gift of ownership in a business entity. Note that some gifts may be subject to gift taxes. Learn more about gifting in our bulletin in this series, Gifting Assets Prior to Death.

9. Create an LLC with two classes of owners

With an LLC, you can name the LLC as the owner of farming assets such as land and equipment and designate ownership interests in the LLC to your heirs but create two types of ownership interests. Your farming heirs could be in the class of owners who run the day-to-day operation and control the assets, while off-farm heirs are in the class that only receives income from the LLC. We address LLC strategies further in our bulletin in this series, Using Business Entities in Farm Transition Planning.

10. Use multiple entities

Another strategy is to have both a land holding LLC and a second operating LLC that holds the equipment, employs the labor, and manages the farm operation. In this model, you can give some or all ownership in the land holding LLC to off-farm heirs and give the on-farm heirs ownership interest in the operating LLC. You can guarantee the on-farm heirs' access to the land with a longterm lease between the land holding LLC and the operating LLC. This strategy allows off-farm heirs to own and benefit from farm assets without interfering with the farming operation given to the onfarm heirs.

MAKING EQUAL VERSUS EQUITABLE DECISIONS

Ultimately, the decision on how to balance your estate and farm transition plan is up to you but it's a decision that can affect your farm and your heirs long into the future. As you weigh your situation and options, you can benefit by seeking input from others. Consider discussing your situation with your attorney and professional advisors, who can help you select the strategies that address your concerns and move your vision forward. Communication with your heirs is important also, as you will need to know whether heirs want to engage in the farming operation after you are gone. Time spent assessing these issues will help ensure that you're planning for the future of your farm.

AUTHORS OF THE PLANNING FOR THE FUTURE OF YOUR FARM SERIES

Robert Moore and Peggy Kirk Hall, Attorneys
OSU Agricultural & Resource Law Program
State University Extension

Evin Bachelor and Kelly Moore, Attorneys
Wright & Moore Law Co. LPA Ohio
Delaware, Ohio

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

We completed this project with the generous financial support of the **USDA National Agricultural Library** and the **National Agricultural Law Center**, in partnership with **OSU Extension**.

Planning for the Future of Your Farm is a project of the OSU Agricultural & Resource Law Program, an OSU Extension program providing objective and timely legal research on agricultural issues affecting Ohio.

farmoffice.osu.edu
aglaw@osu.edu
614.688.0466
@OhioAgLaw
@OhioAgLaw
farmoffice.osu.edu/blog

THE OHIO STATE UNIVERSITY
EXTENSION