

Estate Planning Challenges and Strategies for Farm Families

NALC Webinar Series

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Issues and Challenges with Farm Succession Planning

- Fair v. Equal
- Designing the distribution plan
- Avoiding conflict
- Protect farmland for future generations
- Pass along a viable farming operation
- Smooth trust/estate administration
- Transitioning to next generation



Determining Sweat Equity or Farming Heir's Share

- This is often the most difficult issue for farm families to make
- Too little to the farming heir could jeopardize passing along a viable farming operation
- Too much to the farming heir may be unfair to off-farm heirs
- There is no formula or easy way to determine this value



Determining Sweat Equity or Farming Heir's Share – Show Each Beneficiary's Share

- Sometimes it can help to show the actual assets and values that each heir will receive
- Show this on a spreadsheet so the assets and values can be changed
- Requires an accurate inventory of assets and a reasonable value of assets (we should have these for good planning anyway)
 - Use fair market value

Determining Sweat Equity or Farming Heir's Share – Show Each Beneficiary's Share

Asset	Value	Andy	Bob	Chris
Cash	\$50,000	\$25,000	\$25,000	
Investments	\$200,000	\$100,000	\$100,000	
Life Insurance	\$500,000	\$250,000	\$250,000	
Crop/Inputs	\$500,00			\$500,000
Farm Machinery	\$600,000			\$600,000
Farmland	\$2,000,000			\$2,000,000
Total	\$3,850,000	\$375,000	\$375,000	\$3,100,000
% of Total		10%	10%	80%

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Life Insurance	\$500,000	\$250,000	\$250,000	
Crop/Inputs	\$500,00			\$500,000
Farm Machinery	\$600,000	\$200,000	\$200,000	\$200,000
Farmland	\$2,000,000			\$2,000,000
Total	\$3,850,000	\$575,000	\$575,000	\$2,700,000
% of Total		15%	15%	70%

Determining Sweat Equity or Farming Heir's Share – Show Each Beneficiary's Share

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Life Insurance	\$500,000	\$250,000	\$250,000	
Crop/Inputs	\$500,00			\$500,000
Farm Machinery	\$600,000	\$200,000	\$200,000	\$200,000
Farmland	\$2,000,000	\$500,000	\$500,000	\$1,000,000
Total	\$3,850,000	\$1,075,000	\$1,075,000	\$1,700,000
% of Total		28%	28%	44%



Determining Sweat Equity or Farming Heir's Share – Value of Farm

- What is value of farm today versus when the farming heir joined?
- What % of the added value is attributable to farming heir?



Determining Sweat Equity or Farming Heir's Share – % of Estate Value

- What % of the total value of all assets should go to farming heir?

A vertical photograph on the left side of the slide shows a tractor pulling a plow across a field. The scene is silhouetted against a bright, golden sunset sky. The tractor is on the left, and the plow is on the right, moving across the field.

Let Them Pick

- Parents will sometimes have difficulty in deciding what assets the farming heir should receive
- Consider allowing the farming heir to pick the assets they want
- Add a provision that allows the farming heir to purchase the farm assets they do not select or are outside of their share
- Can provide a discount on the purchase price and/or a term of years to pay purchase price



Let Them Pick

“Joe shall receive 50% of the value of all my assets. Joe shall have the option to select farm assets to fill his 50% share. If after filling his share, other farm assets remain, Joe shall have the option to purchase those assets. The purchase price for purchased farm assets shall be 80% of the fair market value established by appraisal. The purchase price may be paid over five years.”



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Valuing Farmland

- Many estate conflicts involve the valuing of farmland
- Many farm estate plans include the option to purchase farmland
- The purchaser will want to see a low value, the non-purchaser will want to see a high value
- The appraisal establishing the value will come under scrutiny by whichever party it does not favor
- Consider using a multi-step appraisal process
- Can be used to value any asset but farmland is often the hardest to value and the asset most contested

Three-Step Appraisal Process

- The first appraisal is obtained by and paid for by the estate or trust
- If a purchase or beneficiary disputes the value, they may obtain and pay for a second appraisal
- The first and second appraisal are then compared
 - Having an exact match between the two appraisals is very unlikely. Allow for a range to accept the appraisals.
 - “If the second appraisal is within 10% of the first appraisal, the average of the two appraisals shall be the value”
- If the first and second are not close, the estate/trust and disputing party obtain and pay for mutually agreeable, third appraisal

Three-step Appraisal Process

- Consider using the median appraisal, not the mean of the appraisals
- Using the median will not let an outlier appraisal affect the price
- Consider using licensed appraisers
 - Will cost more but should be more thorough and unbiased

Set Up a Land Holding LLC in the Trust

- LLCs are good for holding family farmland that will be owned by multiple family members
- Eliminates the possibility of partition
 - Partition allows a co-owner of real estate to force the division of the real estate or the sale of the real estate
- Establishes rules for who and how the farmland will be owned
- Many people like the idea of their children owning farmland in an LLC but they do not want to establish and manage an LLC themselves

Set Up a Land Holding LLC in the Trust

- Upon death, the land is in trust or is transferred to the trust
- The trustee is instructed to establish an LLC and transfer the land into the LLC
- The trustee also creates an operating agreement for the LLC
 - Who can be owners?
 - How are decisions made?
 - Who is the manager(s)?
- The LLC is then transferred to the children who receive their ownership of the LLC subject to the LLC operating agreement

Set Up a Land Holding LLC in the Trust

“My Trustee shall establish an LLC or similar entity and shall transfer all of my real estate into the LLC. My Trustee shall then transfer the LLC to my children in equal shares. The LLC shall be subject to the following provisions:

- only my lineal descendants may be permitted owners of the LLC
- real estate may only be sold or conveyed with a 75% affirmative vote of the ownership interest in the LLC
- The LLC may be dissolved with a 75% affirmative vote
- My daughter Andrea shall be the initial managing member. Subsequent managing members shall be appointed by a majority vote of the members
- All other terms and conditions of the LLC shall be at the discretion of my Trustee”

Use a Charity as Deterrent

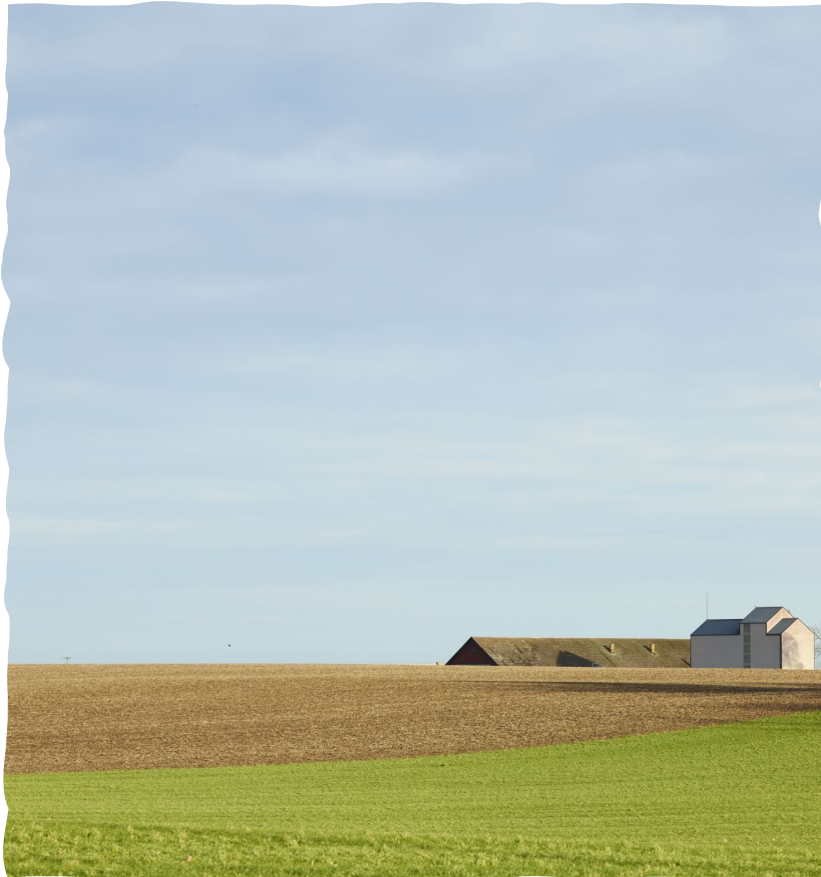
- Some farmers want their assets, usually farmland, held in trust for one or two generations or for a term of years
- These farmers want to ensure that the land is kept in the family
- A trust can instruct the trustee to not sell the farmland for a certain period of time or for a generation or two
- “How can we make sure the trustee follows the trust terms and does not sell the farmland?”



Use a Charity as Deterrent

- Name a charity, or any person or entity, as a beneficiary of some or all of the sale proceeds if the land is sold contrary to the trust terms
- “My trustee shall not sell or otherwise convey the farmland held by my trust for 20 years after the date of my death. In the event that any of the farmland held by the trust is sold prior to the expiration of the 20-year period, all sale proceeds shall be given to St. Jude Children Research Hospital.”
- If the land is sold or transferred to anyone other than the charity, the trustee is liable to the charity
- Can be used with any asset

Long-Term Leases



- Long-term leases can be a way to transfer ownership of land to off-farm heirs while securing the land base for the farming heir
- The length of the lease often covers the farming career of the farming heir but can be any length
- Should incorporate a mechanism to occasionally update the lease rate
- Consider the impact on the off-farm heir. The long-term lease makes the land essentially unmarketable.



Long-Term Leases – Example Trust Provision

“My Trustee shall distribute the Smith Farm to Andy. Prior to distributing the the Smith Farm, my Trustee shall enter into a cash farm lease with Chris subject to the following terms:

- The lease term shall be 20 years or until Chris discontinues actively farming
- Actively farming shall be defined as the production of crops or livestock by Chris or an entity owned by Chris and shall not include subleasing or custom farming

An aerial photograph of a large agricultural field, likely a wheat field, during harvest. A combine harvester is in the foreground, moving from left to right, leaving a trail of harvested grain. Behind it, a tractor is also visible, moving in the same direction. The field is a mix of golden-brown harvested areas and unharvested sections. The sky is not visible, and the overall scene is bright and clear.

Long-Term Leases – Example Trust Provision

- The lease rate shall be \$200/tillable acre for the first 5 years of the lease. Thereafter, the lease rate shall be adjusted every 5 years by mutual consent of the parties. If the parties are unable to agree on a lease rate, they shall agree on a mutually agreeable third party to establish the fair market rent. The lease rate shall be 80% of the FMR.
- The lease shall be binding upon the heirs and successor owners of the Smith Farm”



Right of First Refusal

- Instead of the long-term lease or in addition to a long-term lease, a Right of First Refusal can be added as a condition to receiving land
- The ROFR does not prevent the land from being sold but it does give other family members the first chance to buy, maybe with favorable terms



Right of First Refusal

“My Trustee shall distribute the Smith Farm to Andy subject to a Right of First Refusal to include the following terms:

- In the event Andy intends to sell or convey the Smith Farm, he must give Chris the first opportunity to purchase the farm
- The purchase price shall be the lesser of a bona fide offer or the fair market value as established by appraisal



Right of First Refusal

- The ROFR shall be in effect for the remainder of Chris' life and shall be binding on all successor owners of the Smith Farm
- Chris shall have 60 days to elect to purchase the farm and an additional 60 days to close the purchase
- Chris may pay the purchase price over 10 years"

Trust Protector

- A trust drafting strategy developed in the last 10 years or so is to include a Trust Protector
- The role of the Trust Protector is to protect the intent of the trust
- The Trust Protector is permitted to make changes to the trust after the grantor has died
 - Tax provisions
 - Administrative provisions
 - Ambiguities
 - Errors
- A Trust Protector can save much time and legal fees

Trust Protector

- The Trust Protector can be anyone other than the Trustee and/or trust beneficiaries
- The law firm drafting the trust often serves as the Trust Protector
- The grantor decides how much or how little authority they give the Trust Protector

Transitioning to Next Generation

- Farmers tend to have higher value balance sheets
- Farm families often have on-farm heirs and off-farm heirs
- Transitioning the farm to the next generation while maintaining a viable farm operation and being fair to all heirs can be challenging
- Business entities can help with this challenge



Transitioning to Next Generation

Farming Operation

Crops/Grain = \$500,000

Machinery = \$1,000,000

Land = \$2,000,000

Having all farm assets together can be prohibitive to bringing next generation

Transitioning to Next Generation

Dividing assets into different entities will lower the value of the operating entity allowing for easier transition to next generation



Lease

Lease



Transitioning to Next Generation

**Farming Heir
Operating LLC**
Crops/Cash
\$500,000

A land LLC can be a good asset to give to non-farm heir because it provides asset/income to non-farm heir without interfering with farming operation

Lease

Lease

**Farming Heir
Machinery LLC**
Machinery/Equipment/Trucks
\$1,000,000

**Farming Heir & Non-Farm Heir
Land LLC**
Farmland
\$2,000,000



Avoid Probate

- Take the escalator, not the stairs
- Probate can be avoided by having beneficiaries on titled assets
- States vary but in Ohio any asset with a title can avoid probate
- Non-titled assets can avoid probate with a trust
- Probate is slow, cumbersome and can be expensive

Questions?

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