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Keeping Farmland in the Family

Legal strategies to keep farmland in the family for future generations

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The Ohio State University Extension

National Agricultural Law Center

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Using this information

This publication identifies risks that can affect the goal of keeping farmland within a family and explains legal strategies that can reduce those risks. Please do not use this information to substitute for individual professional legal advice. **The information is based on Ohio law**, but the concepts are broadly applicable across the United States. Even so, it is important to work with a competent attorney in the state where the farmland is located to how a state's laws affect a legal strategy.

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Introduction

Handing down the heritage that comes with owning farmland is a common goal of farm families. But there are many risks that can take farmland out of the family and separate future generations from a farm heritage. For those who want to keep farmland in the family, it is necessary to address the risks through planning. The first step in the planning process is to understand those risks that can cause farmland to leave the family, and the second step is to adopt legal strategies to reduce those risks. This publication offers information on each step of the planning process. As with any legal decision making, be sure to consult a private attorney. If keeping farmland in the family is an important goal, use this information to begin the planning process and use an attorney to help finalize a plan to accomplish the goal.

1. The Risks to Keeping Farmland in the Family

Unfortunately, there are many risks that can cause farmland to leave a family. The type and severity of risks to a family should be analyzed and understood. Assessing a family's risks can help with identifying the strategies to mitigate the risks. The following explains the most common risks and provides examples to illustrate how the risk can result in a loss of farmland for a family.

Partition

It is likely that more farmland involuntarily leaves farm families through partition than in any other way. A partition law allows someone who co-owns property with another (a co-tenant) to force the division or sale of the property. Any co-tenant, regardless of their percentage of ownership, may initiate a partition action. Ohio is one of many states that has a partition law.[1]

The concept of partition is that it provides a remedy to a co-tenant who does not wish to remain an owner of real estate. Without partition rights, a co-tenant might never be able to divest themselves of ownership of the real estate if other co-tenants don't agree to buy their share or sell the entire property. Generally, the law does not favor prohibiting an owner from being able to sell or transfer assets they own. Partition provides the solution for a co-tenant who wants to sell their interest in real estate despite disagreement by other co-tenants.

[1] Ohio's partition laws are in Section 5307 of the Ohio Revised Code. See a compilation of all state partition laws on the National Agricultural Law website at https://nationalaglawcenter.org/state-compilations/.

Partition is also somewhat of a dispute resolution tool because Ohio law does not have rules for how co-tenants are to manage their real estate together. For example, Ohio law does not state how owners jointly holding property can resolve differences about how to manage the property. This means an owner with a minority interest could prevent management actions for leasing, selling, or mortgaging the land even if the majority landowner wants to do so. Partition laws resolve management disputes among co-tenants by forcing a sale or division of the land if the co-tenants cannot agree on how to manage it.

Consider the following example.

John, Karen, and Larry own land jointly. John and Karen own 45% each and Larry owns 10%. John and Karen want to sell the land but Larry refuses. John and Karen's combined 90% interest cannot out vote Larry's 10% interest. Without Larry's consent, John and Karen cannot sell the land. But John or Karen could file for partition and force the sale of the land without Larry's approval.

The risks of partition. Any time two or more people own real estate together, there is a risk of partition. Any co-tenant can file for partition, even if they own only a small percentage of the property. Future owners will also have partition rights, and as farmland moves from one generation to the next and the number of owners increase, so does the risk of partition. When ownership transfers to the surviving spouse of an owner, particularly one who may not have any attachment to the land, partition risks can also increase significantly.

Consider the following examples.

Example 1

Amy, Bob, and Charlie inherit the family farmland from their parents. All three siblings are equal, one-third co-tenants of the land, which has been in their family for many generations. After owning the land for a few years, conflict arises among the three owners about how the land should be managed. Amy, frustrated that her brothers do not respect her suggestions for the use of the land, files a partition action. The land is then sold at auction by order of the court and the sale proceeds are divided among the three siblings.

Example 2

Same facts as Example 1 except Amy dies and her husband Dale receives her one-third ownership interest. Amy's parents assumed Amy's share in the land would go to her children but Amy never bothered with an estate plan, so Dale receives the land. Dale has no ties to the farmland and does not understand what the big deal is about owning farmland. Dale prefers that the land be sold so he can receive his one-third of the value and buy the boat he has always wanted. He files a partition action, the farm is sold at auction, and he receives one-third of the value.

As these two examples show, it is relatively easy for a co-tenant to use partition to force the sale of the land. Also, it is not just known owners who cause partition risk. Partition rights attach to any future owner who ends up on the deed, including non-family members like Dale.

Partition rights are a real and omnipresent threat to keeping farmland in the family. Even a small percentage owner of a large farm may have an incentive to initiate a partition action. Landowners should be aware of the concept of partition so that they can understand and evaluate the risks of co-tenancy and plan accordingly to minimize the risk of partition.

"Partition rights are a real and omnipresent threat to keeping farmland in the family."

The partition process. In Ohio, partition occurs through a lawsuit filed with the common pleas court of the county where the real estate is located.[2] The plaintiff, who is the co-tenant initiating the partition, files a petition with the court asking for the land to be partitioned. The petition must include the identity of all co-tenants and a description of the property. Each co-tenant defendant has an opportunity to respond to the partition. Like all litigation, the parties should engage legal counsel to assist them in the partition process.

After the partition has been filed and all parties notified, the court is required to appoint at least one disinterested person, referred to as the "commissioner," to oversee the partition action.[3] The commissioner must view and examine the property and determine if the property can be physically divided without the loss of value.[4] Due to the unique nature of farmland property and factors such as drainage, soil type, road frontage, and development potential, it can be difficult for a commissioner to physically divide the property fairly among the co-tenants. Instead, the court may order the property to be sold and the proceeds divided. In that case, the commissioner must establish the value of the property by appraisal.[5] Any of the co-tenants then have the option to purchase the property at the appraised value. A co-tenant may pay the purchase price in three installments of one-third cash at purchase, one-third in one year, and one-third in two years.[6] If no co-tenants wish to purchase the property, the court will order it sold.

The property can be sold at Sherriff's sale or at public auction. Usually, the parties will agree to sell at public auction in hopes of getting a higher price for the property. A properly advertised public auction is more likely to get a higher price than an unadvertised sheriff's sale. The sale price must be at least two-thirds of the appraised value.[7] Upon completion of a successful auction and receiving the payment, the sheriff will execute a deed to the purchaser.[8] Net proceeds from the sale are divided among the co-tenants according to their proportion of ownership.[9]

[2] ORC 5307.02
[3] ORC 5307.04
[4] ORC 5307.06
[5] ORC 5307.09
[6] ORC 5307.10
[7] ORC 5307.12
[8] ORC 5307.13
[9] ORC 5307.14

Divorce

A well-known statistic is that one-half of all marriages end in divorce. While there is some debate as to the accuracy of this statistic, there is no doubt that many marriages do end in divorce. With a divorce comes the division of assets and the risk that farmland will be sold to provide an equitable result for the divorcing couple, or that a spouse not involved in the family farm will receive the farmland.

According to Ohio law, marital assets are to be divided "equitably" in the event of a divorce.[10] Equitable does not necessarily mean equal although an equal division of marital assets between the spouses is often the result. Divorces can be especially threatening to farmland because of the "land rich, cash poor" dilemma for farmers. In a farm divorce, it is usually not equitable for one spouse to receive all the farm assets if there are not sufficient non-farm assets for the other spouse. Thus, both spouses may receive farmland in the divorce settlement. Either spouse could sell the land out of the family.

It is important to note that only "marital" assets are subject to the equitable division between spouses in a divorce. Non-marital assets, referred to as "separate" assets, are retained by the spouse who individually owns the asset.

Separate assets include the following:

- Property acquired by a spouse prior to the date of the marriage.
- Passive income and appreciation from separate property received by a spouse during the marriage.
- An inheritance received by a spouse during the marriage.
- A gift received by a spouse during the marriage.

The above list would seem to make it an easy exercise to determine which assets are marital and which are separate in a divorce situation. However, like many legal issues, easy is not often the case. That's because Ohio law also provides that income or appreciation on separate property can *become a marital* asset. The law includes as marital property:

> "… all income and appreciation on separate property, due to the labor, monetary, or in-kind contribution of either or both of the spouses that occurred during the marriage."[11]

So, it is possible for an asset to be partially separate (the property) and partially marital (the income and appreciation on the property).

Consider the following example.

Andy and Beth are farmers in the process of divorcing. Shortly after they were married, Beth inherited a 100-acre farm from her grandmother. When she inherited the farm, it was valued at $600,000. A few years after inheriting the farm, Andy and Beth's farming operation paid for and installed $80,000 of drainage tile on the farm. The current value of the farm is $1 million.

In this example, the farm was Beth's separate asset upon inheritance. However, the tile that improved the quality and value of the farm was

[10] ORC 3105.171

[11] ORC 3105.171

a result of Andy and Beth's joint farming operation. Andy likely has a valid claim that at least part of the $400,000 increase in value is a marital asset due to the tile installation.

Perhaps Andy further argues that most of the increase in value was due to the fertilizer, tillage and other soil improvements made while Andy and Beth farmed the land. It is in Andy's interest to make the $400,000 increase in value a marital asset. Conversely, Beth could argue that the increase was not a result of the marital farming operation but was merely a passive value increase due to market pressure. It is in Beth's interest to argue the $400,000 increase as her separate asset.

As this example illustrates, an asset that is initially a separate asset can become, at least in part, a marital asset. Both Andy and Beth have valid arguments. It is not hard to imagine how much time and legal fees could be spent resolving or litigating the issue in a contentious divorce.

Co-mingling assets can also cause a separate asset to become a marital asset. If the spouse owning the asset voluntarily allows the other spouse to become an owner of the asset, it is likely to become a marital asset. Using the example above, after Beth receives the farm, she adds Andy's name to the deed as co-tenant. Because she voluntarily added Andy to the deed and gave him half ownership, Beth has likely changed the property from a separate to a marital asset.

Another example might be that Beth receives a $100,000 inheritance from her grandmother. Beth deposits the money in an investment account owned by both her and Andy. By co-mingling the inherited money with other money owned jointly with Andy, Beth has probably made the $100,000 inheritance a marital asset. If Beth would have deposited the money in an account owned only by her, the inheritance would have remained a separate asset. While co-mingling does not automatically make an asset become marital property, the spouse owning the asset should avoid co-mingling if wanting to keep the asset separate.

Assets acquired *during* a marriage will almost always be considered marital property. This is true even if one spouse provided little or no contribution towards the acquisition of the asset. Ohio law considers marriage to be a sort of equal partnership regardless of the contribution of the spouses. For example, farmland purchased during the marriage will be a marital asset even if only one spouse operates on the farmland and the other spouse is not involved with the land or operation.

A **prenuptial agreement** can help alleviate the issues of marital assets. This type of agreement entered into prior to marriage designates what assets they are bringing to the marriage, what assets will be separate, and what assets will be marital. Especially for people who have accumulated some wealth prior to marriage, a prenuptial agreement is a good option to avoid future disputes of the nature of assets in a marriage and potential risks to farmland.

Debt

The inability to repay debt can cause farmland to leave the family. Farmland is commonly used as collateral for loans. Lenders favor farmland to secure their loans because it is a safe, low risk asset that cannot be moved or hidden like other assets, does not depreciate, and generally holds its value. When a debtor defaults on a debt, the lender has the right to foreclose on the collateral. Many family farms have been lost to foreclosure through mortgages and judgment liens.

Mortgages. One way to foreclose on farmland is through a mortgage that secures a loan. A mortgage is a legal instrument that gives a lender the right to foreclose or sell the property if the property owner defaults on the loan. The mortgage is similar to a deed in that its transfers rights in the property to the lender and is recorded. A mortgage can be placed on any single parcel of land or many parcels of land.

A mortgage includes provisions as to when the lender is entitled to foreclose on the property. Typically, a breach of payment under the corresponding promissory note executed with a mortgage will entitle the lender to foreclose. The foreclosure process is similar to a lawsuit in that the lender files a complaint with the court. Assuming the court finds the debtor is in default, the court issues a foreclosure judgment and the property is sold. Any funds remaining after the lender is paid and costs are reimbursed are given to the property owner.

Judgment liens. Even land without a mortgage on it is at risk of foreclosure. A mortgage makes it easier for a lender but it is not the only means to force the sale of land for debt repayment. Whenever a debtor is in default, the lender can file a lawsuit against the debtor to seek payment of the debt. If the lender prevails in the lawsuit, the court can issue a judgment lien on any real estate owned by the debtor and the lender can foreclose on the property that is subject to the judgment lien. The process of filing a lawsuit and using a judgment lien to foreclose on property may take longer and be more complicated than a mortgage, but it has the same result as a mortgage.

Consider the following example.

Charlie owes the fertilizer company $200,000 and is unable to pay his bill. The fertilizer company files a lawsuit against Charlie and is awarded a judgment in its favor by the court. The court then places a judgment lien on Charlie's farm. The fertilizer company uses the lien to foreclose on the farm and force it to be sold at auction. The farm brings $500,000 at auction. From the sale proceeds, legal and court costs of $25,000 are paid and the fertilizer company receives its debt repayment of $200,000. Charlie receives the remaining sale proceeds.

In this example, the farmland was sold even though there was no mortgage on the land. A lender or vendor with an outstanding debt can use a lawsuit and judgment lien to force the sale of farmland to repay the debt.

Long-term care costs

Long-term care (LTC) costs are a significant threat to family farmland. Average annual LTC facility costs in Ohio are $90,000. A long-term stay can deplete financial resources and force a sale of farmland to pay for the care.

While a farmer has little control over the LTC they may need, there are ways to reduce the risk of LTC to farmland. For example, LTC insurance and gifting farmland to family members are two strategies that can protect the land. Each strategy has advantages and disadvantages, and there are no easy solutions.

For a detailed discussion on LTC risk, see our publication, *Long-Term Care and the Farm.*[12] This publication explains common strategies to mitigate LTC risk. Understanding LTC and implementing a plan to help mitigate risk is important to protecting farm assets, especially the land.

Medical costs

As with LTC costs, medical costs are another threat to keeping farmland in the family. While most people carry medical insurance of some type, policies vary greatly in the extent of coverage provided. Even with insurance, a serious illness or injury can cause significant out-of-pocket expenses and debts.

A doctor or hospital carrying outstanding medical debt becomes a creditor, and the law provides mechanisms for them to receive payment. As discussed above for other types of debt, a medical creditor can file a lawsuit for outstanding medical bills, obtain a judgment lien, and use the lien to foreclose on farmland. Unexpected medical costs, and insufficient non-farmland assets to cover them, present another risk for losing family farmland.

Poor estate planning

Poor estate planning can also cause farmland to leave the family. When heirs who inherit farmland have different goals for the land and the estate plan doesn't place any restrictions on their farmland ownership, the land is at risk. For example, an heir who wishes to "cash out" their land has a very different goal than an heir who wants to keep land in the family for future generations. If the estate plan doesn't prevent cashing out, an heir who wants to sell land can do so. And if the heir is a co-tenant, the other co-tenant heirs will lose the land. Either way, the land will leave the family because there wasn't a plan to prevent the loss.

Of all the risks identified, poor estate planning is the easiest risk to manage. An estate plan that keeps the land in the family can be implemented with a modest investment of time and money. All of the strategies discussed in the next section can be incorporated into an estate plan and used to protect the farmland. Meeting with an attorney knowledgeable in farm estate and succession planning strategies who recognizes the goal of keeping land in the family is a good place to start to reduce the risk of poor estate planning.

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[12] Available at https://farmoffice.osu.edu.

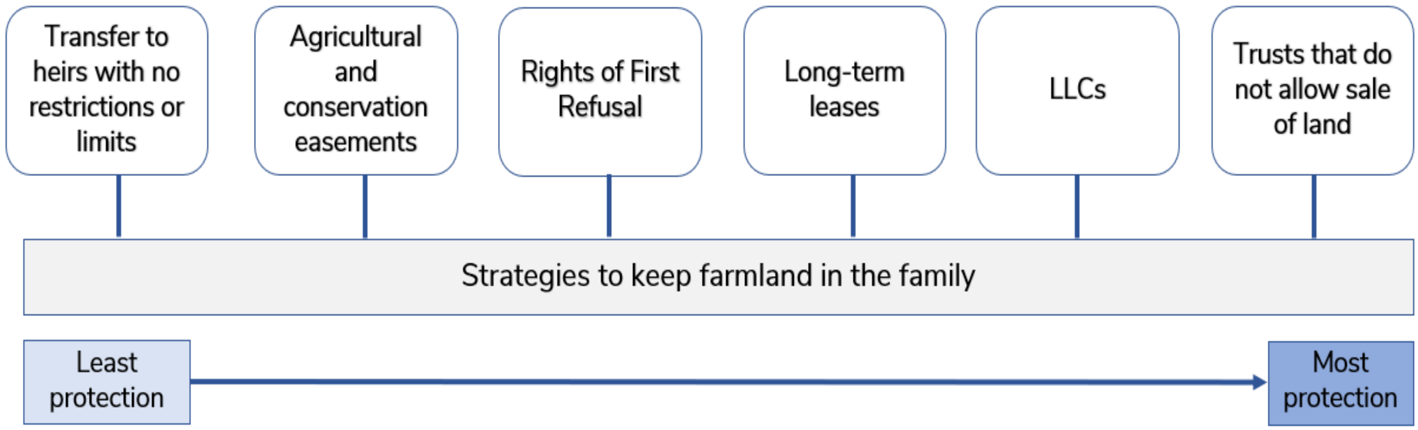
2. Strategies to Keep Farmland in the Family

Part One identified many, but not all, of the risks that can cause farmland to leave the family. For every risk, there is a strategy that at least lessens the exposure of farmland to that risk. Risks can never be eliminated but good planning can help make a risk the exception rather than the rule.

Before deciding which strategy is best, a family must consider their goals for the land and the family. For example, one landowner may not worry very much about the land staying in the family. While this approach is rare for farm families, it can happen. On the other hand, another landowner may not want land to go out of the family for any reason. Somewhere between the two extremes is the goals of discouraging the land from leaving the family but not completely tying the hands of future generations.

Diagram 1 on the following page illustrates this spectrum of goals and provides a preview of the different strategies that follow the goals along a spectrum of protection. The strategies on the left side of the diagram are less protective and can work for those who don't want to put many restrictions on the land – the "they can do what they want with the land" approach. Strategies on the right side are the most protective and would keep land in the family for at least a generation or two. In between are moderately protective strategies for the goal of keeping the land in the family, but they do not make it impossible for the land to leave the family. The following discusses all but the self-explanatory "no restrictions or limits" strategy on the left side of the spectrum. Examples demonstrate the strategies in family farmland situations.

Diagram 1. Spectrum of strategies to keep farmland in the family



Trusts

The primary purpose of a trust is usually to transfer assets from the trust's creator (grantor) to the grantor's beneficiaries. A trust allows for much flexibility and creativity in estate planning and can give a grantor control of assets "from the grave." In addition, a trust can hold and manage assets for future generations. For these reasons, a trust can be very helpful when the goals and objectives of the current landowner are to prevent the land from leaving the family.

Consider the following example.

Judy owns farmland that has been in her family for five generations. She wants to make sure her grandchildren will have an opportunity to own the farmland someday. She is concerned that her children may sell the farmland when they inherit it or may get into financial trouble and be forced to sell it. The land is cash rented to a local farmer and is a good source of income for Judy. She would like for her children to receive the rental income without the risk of the land being sold before her grandchildren can enjoy it.

This scenario is an example of a landowner who wants to dictate how the land is owned and managed after her death. While this may seem a bit harsh or controlling, it is completely within the legal rights of a landowner to control land after death. It is obviously important to Judy that the land stay in the family for at least two more generations. Judy is not providing discretion to her children to sell the land in order to accomplish this goal.

The concept of a trust holding farmland works well because the trust is the owner of the farmland, not the beneficiaries. The trust document, established by the grantor sometime before death, establishes the rules that carry out the grantor's goal of protecting the land from leaving the family. The trust document also designates a trustee who is tasked with carrying out the trust instructions. The trustee is obligated to manage the trust assets as directed by the trust document and is not beholden to the beneficiaries.

To illustrate this idea, let's continue the previous example.

Judy establishes a trust and transfers her land into the trust. While Judy is alive, she is the Trustee of the trust and can change the trust anytime she wishes. Essentially, the trust and Judy are the same person while she is alive. The trust is drafted so that when Judy dies, her son Kyle becomes the Trustee. The trust contains the following provisions for the land:

> *"My farmland shall be held in trust for the lives of my children. While my children are living, they shall receive all net income from the land in equal shares. While the land is held in trust, my Trustee may not sell, transfer, convey or encumber the land. Upon the death of the last of my children, the farmland shall be transferred to my then living grandchildren in equal shares."*

By using a trust, Judy can ensure that her children will get the benefit of the land without the being exposed to the risk of the children selling the land. The children will receive the income from the land but not have the ability to sell the land. Judy can be sure that her land will be inherited by her grandchildren in the future.

Trusts can also hold land for a shorter period of time while certain conditions are met. It is not uncommon for farmland to be held in trust for five or ten years so that the heirs, especially heirs not familiar with the farmland, have a chance to enjoy ownership before they may be tempted to sell the land. Also, the land may be kept in trust for younger heirs so that they have time to gain some maturity before becoming owners of the land.

Consider the following example.

Don owns family farmland and his children, Fred and Emily, will inherit the land. Fred and Emily have never been involved in the farm or farmland. They have said they may want to sell the land because they are not sure how to manage it. Don thinks they would be better off owning the land and getting a steady stream of rental income the rest of their lives, but he does not want to tie up the land forever. Don establishes a trust and requires the land be held in the trust for five years before being distributed to Fred and Emily. During the five years, a family friend familiar with managing farmland will be the trustee. The friend will help Fred and Emily with managing the land in the hopes of Fred and Emily wanting to keep the land instead of selling it when they receive it out of trust after five years.

Trusts are an effective tool at keeping farmland in the family. By taking advantage of the flexibility and creativity in planning that trusts provide, the current owner of the land can control how the land is used and who inherits the land in the future. Although trusts are not for everyone, landowners should consider incorporating a trust into their plan to help protect the land for future generations.

Limited Liability Companies

A well-designed LLC can make it very difficult for land to leave the family involuntarily. An LLC can protect land from partition, creditors and even divorces. However, the LLC can also be designed to allow the family to make joint decisions as to how to manage the land and sell the land. Provided the family members who own the LLC agree, they can lease, mortgage or sell the land. The LLC ensures that any transfer of land will only occur as a result of a family decision, and no one owner can force the sale of the land.

Consider the following example.

Linda, Mike, and Nancy own farmland together that they inherited from their parents. They agree they want the farmland to stay in the family for future generations, but they do not want to make it impossible for future owners to sell the land if the right opportunity presents itself. They decide to establish an LLC for the farmland. The terms of the LLC require a two-thirds consenting vote of the Members to sell or transfer the farmland.

Linda, Mike and Nancy can be sure that the land will not be transferred outside of the family unless ta majority of the family decides, as a group, to take such action. They can also be assured that if future generations decide it is best to sell the land and can gain a two-thirds vote, that opportunity will be available.

An LLC is created by state law and is registered with the secretary of state. After forming the LLC, an operating agreement is drafted which establishes the rules, terms and conditions for the LLC and its members. Then, the land is transferred to the LLC by deed. Only after the land is transferred to the LLC is it protected by the LLC.

An important characteristic of an LLC is that it is not subject to partition. As discussed above, partition rights are available to co-owners of real estate. When an LLC holds real estate, the LLC is the legal owner of the property. An owner of the LLC owns the LLC but does not own the land. So, co-owners of an LLC do not have partition rights on the land. This is why LLCs are valuable for protecting family farmland.

Operating agreements. The operating agreement is the key to an LLC's ability to keep land in the family. This document should outline the following terms, all of which are important to protecting the farmland:

- Who are permitted owners of the LLC?
- What happens in the event of an attempted ownership transfer outside the family?
- What percentage of ownership or owners is required for the transfer of land?
- What percentage of ownership or owners is required to amend the operating agreement?
- Can a member voluntarily withdraw?
- What percentage of ownership or owners is required to dissolve the LLC?

Each of the above terms should be carefully considered and discussed among the members establishing the LLC. Not only should the original members consider how the operating agreement terms will affect themselves but also how the terms will affect future generations of owners. In fact, the operating agreement is often more important to future generations that it is to the establishing generation. The following explains two important considerations for the members establishing the operating agreement—permitted owners and attempted transfers outside the family.

Permitted owners. Perhaps the first issue to consider when establishing a land LLC is permitted ownership. The operating agreement should clearly define who may become an owner in the LLC. The permitted owner definition can be very narrow or quite broad, depending on the goals of the LLC. Generally, the broader the definition the more risk of a transfer outside the family. A permitted owner can become a member of the LLC at any time without consent from the other members.

The hardest decision with defining the permitted owners of an LLC may be what to do about spouses of the owners. On the one hand, an owner may want their surviving spouse to have adequate income for the remainder of their life if the owner passes away. Therefore, it may be appealing to permit a surviving spouse to become an owner of the LLC. On the other hand, a surviving spouse can remarry while they are an owner of an LLC. Remarriage creates the risk of family LLC ownership being transferred, intentionally or unintentionally, to a surviving spouse owner's new spouse. The new spouse is unlikely to be related to the family members that own the LLC, creating a risk that the new spouse will transfer ownership to other non-family members.

Consider the following example.

Linda, Mike, and Nancy establish LMN Family Farms LLC to hold their family farmland. The operating agreement allows Linda, Mike and Nancy's spouses to be permitted owners of the LLC. Linda passes away and her share of the LLC goes to Oscar, her husband. Oscar later marries Patricia. Oscar never bothers to implement a proper estate plan and has a simple will leaving all his assets to Patricia. Oscar dies and Patricia claims that his ownership transferred to her and that she is now an owner of LMN Family Farms LLC.

Mike and Nancy are now left with having to deal with Patricia, a person who has no ties to their family and whom they may not even know. Additionally, Patricia may have no appreciation or sentimentality with the family farm and may see this as an opportunity for a payout. While Patricia may not be able to force the sale of the land or have voting rights, she will likely be entitled to a share of the LLC profits. [13] That is, a share of the profits are lost to someone who has no connection to the family.

Conversely, if LMN Family Farms had prevented spouses from being owners in the LLC, Linda's share may never have gone to Oscar. Perhaps, instead, Linda set up a trust to hold her LLC ownership for Oscar's life so he could receive the income for his life. Then, at Oscar's death, the ownership would transfer to Linda's children. Or Linda's ownership may have gone directly to her children at death.

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[13] A person who receives an ownership interest in an LLC and who is not a permitted owner nor admitted by the other members is an Assignee. An Assignee is generally limited to an economic interest (profits) but does not have voting or management rights.

The point of the previous example is to closely analyze the implications of allowing spouses to be owners in a family-held LLC. There are advantages and disadvantages to including spouses as permitted owners. Allowing spouses to be owners can help provide for them upon the death of the LLC owner. However, allowing spouses to be owners can allow ownership to be transferred outside the family.

The purpose of many land LLCs is to pass the ownership from one generation to the next. Therefore, children and other lineal descendants are usually included as permitted owners in a family land LLC. This allows the ownership to pass down through generations.

Using the same scenario as above, assume the LMN Family Farms LLC operating agreement allows only lineal descendants to be permitted owners. Linda's estate plan leaves her LLC ownership interest to her children. When Linda dies, her ownership will be inherited, without the consent of Mike and Nancy, by her children. Linda's children will become full owners with voting and management rights. Linda's children will be able to transfer their shares to their children, and so on. Ownership can be transferred through generations indefinitely.

> *"A poorly drafted operating agreement or one that is not reflective of the family's goals can cause farmland to leave the family."*

Trusts and estates may also be permitted owners. An LLC owner can direct their ownership interest to be held in a trust that is set up for a spouse or children. Also, an estate may be a permitted owner, which would allow a member's ownership interest to be transferred to other permitted owners via their estate. Without including trusts and estates as permitted owners, upon the death of an owner their ownership interest may not be transferable to their spouse or heirs.

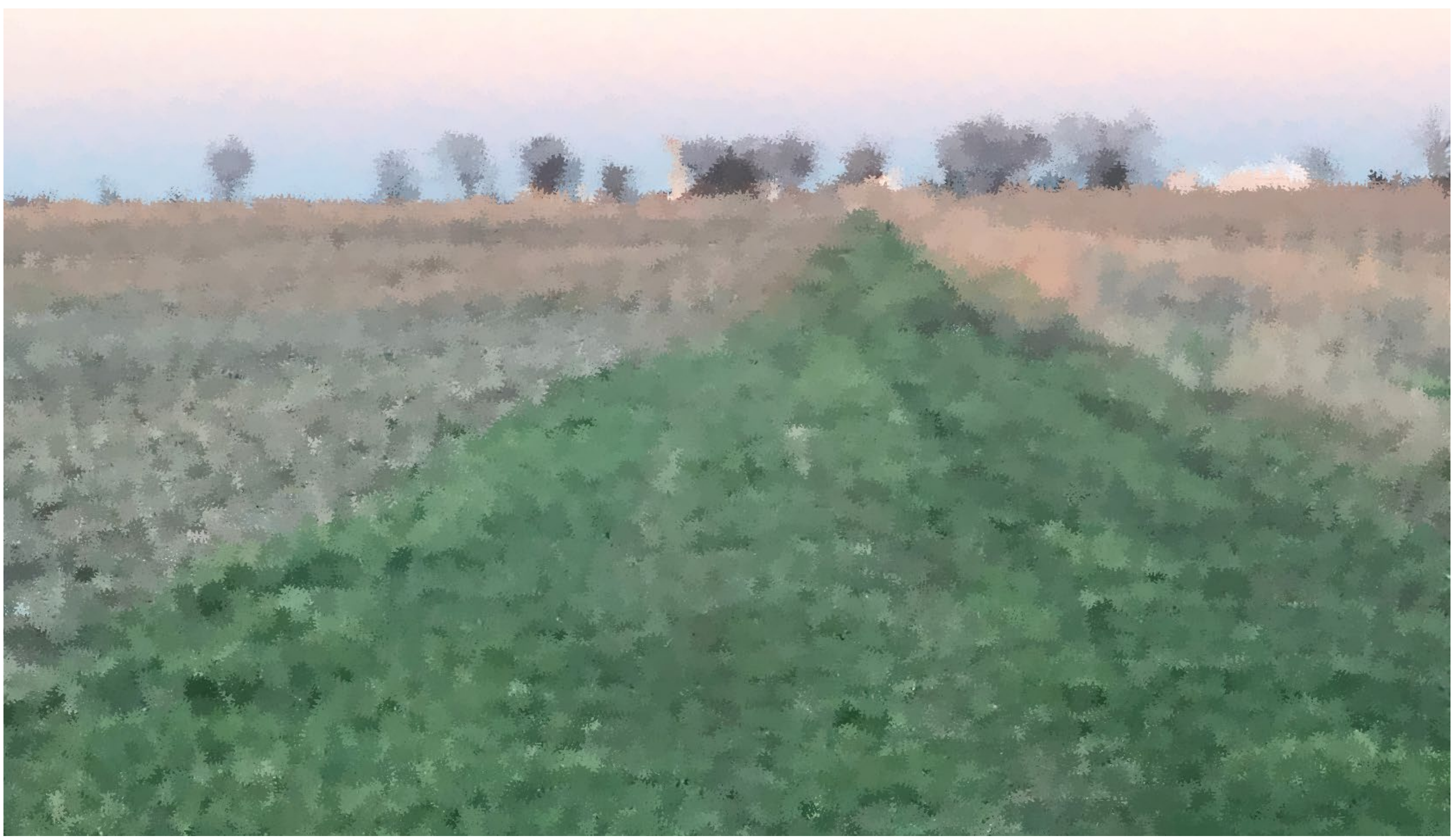
As the above discussion shows, establishing the class of permitted owners is an important part of establishing a family farmland LLC. The family should work closely with an attorney familiar with family farm issues to ensure the operating agreement matches their goals and objectives for the family farmland. A poorly drafted operating agreement or one that is not reflective of the family's goals can cause farmland to leave the family.

Attempted transfer of LLC ownership outside of family. Sometimes there can be an attempt to transfer LLC ownership outside of the designated permitted owners or family. Such a transfer can be voluntary, but it is usually involuntary due to divorce, death, creditors, or a legal judgment. The LLC operating agreement should address the possibility of an ownership transfer outside of the family. A transfer receiver who is not permitted to be an owner in the operating agreement will likely only be an assignee with limited rights.[14] But a provision in the LLC can allow the ownership rights to instead be bought back by the permitted family owners.

A “buy-back” provision states that either the LLC or other LLC members have the right to buy back someone’s ownership before it would be transferred to a non-permitted owner. The LLC or other members would have the option to purchase the ownership before it is transferred to a non-permitted owner or could allow the ownership to transfer if they don’t want to purchase it. This provision can help ensure that ownership, as well as all income from the LLC, remains in the family.

Consider the following example.

Linda, Mike, and Nancy are members of LMN Family Farms LLC. The LLC operating agreement states that the only permitted owners are Linda, Mike, Nancy, and their lineal descendants. A buy-back provision also states that other members of the LLC can buy another member’s ownership interest before it is to be transferred to a non-permitted owner. Linda dies and her husband Oscar inherits her assets, including her LLC ownership. Mike and Nancy decide to purchase Linda’s ownership interest. Oscar will receive the sale proceeds and Linda and Mike will now be the sole owners of the LLC.



[14] An assignee is someone who has received an ownership interest in an LLC but is not permitted to be a member and/or has not been voted in as a member of the LLC. Assignees have no voting or management rights.

As this example shows, a buy-back provision allows the family to keep control of ownership. Even though Oscar would be an assignee who is only entitled to an economic interest in the LLC, it is often better to purchase the ownership so that the family retains full control of the LLC and its economic interests.

The LLC operating agreement can also include favorable purchase terms for a buy-back. One term often included is a discount on the purchase price. The discount allows the other family members or LLC to buy back the transferring ownership at less than fair market value. The discount can be small or as much as 35-40%, depending on the situation. The discount gives an incentive to the other family members to purchase the ownership rather than have it held by a non-family member.

Another term that may be included in a buy-back provision is a payment term that would allow the purchase price to be paid over several years. Reducing the need to come up with a lump sum purchase price can help the other LLC members be able to buy the ownership interest. When the purchase price is relatively large, the LLC or family members may not have the funds available or be able to obtain a loan to make the purchase. Like the discount on purchase price, extending the payment schedule is likely to help keep ownership in the family.

Consider the following example.

Using the previous example, assume Linda's share of the LLC is valued at $1 million before discount. The LMN Family Farms LLC operating agreement states that a discount of 25% will be included in any purchases triggered by a transfer to a non-permitted owner. Additionally, the buyer(s) may pay the purchase price over 10 years at the minimum IRS allowable interest rate. Instead of Mike and Nancy having to pay $1 million to Oscar up front, they can pay him $750,000 over 10 years. Between the discount and the payment term, Mike and Nancy are much more likely to be able to buy-back Oscar's share into the family.

As these examples demonstrate, a well-designed LLC can make it difficult for farmland to leave the family. Because LLCs take away partition rights, a family decision is required for any action regarding the land. Ownership of the LLC can be restricted to family members and their lineal descendants. Buy-back provisions can further ensure that ownership of the LLC doesn't transfer outside of the family. For landowners who anticipate their land being owned by multiple family members in the future, including an LLC into their succession plan can be a useful tool for keeping the land in the family.

Rights of First Refusal

Sometimes the right estate planning strategy for a family can be for each beneficiary to receive a specific farm or parcel of land. This type of plan is often a good strategy when the current owner of the land does not want the land to be owned jointly by the future owners and also does not want to tie the land up in a trust. In situations such as these, a Right of First Refusal (ROFR) can be used to help keep the land in the family.

A ROFR requires an owner of land to enter into a sales agreement with a designated person before anyone else if the land is to be sold. In the context of family-owned farmland, a ROFR requires one family member to offer to sell to another family member before attempting to sell the land outside of the family. The ROFR can include many different terms and conditions and a landowner should include many details to avoid confusion or disputes related to the purchase rights. The most important details to address include purchase price, timeline, exempt transfers, and term of the ROFR.

Purchase price. The purchase price of the land is the most important term in a ROFR. One way to establish the purchase price is by matching a bona fide offer. Upon receiving an offer to purchase the land, the owner must offer to sell the land at that same price to the holder of the ROFR. If the holder declines to purchase the land at that price, the owner is free to sell to the third party at that price.

Another way to establish the purchase price is by appraisal. If the appraisal method is used, a multi-step approach should be considered to avoid the effect of an outlier appraisal. For example, the owner can obtain an appraisal first and if the buyer objects to the owner's appraisal, the buyer can obtain another appraisal. If the two appraisals do not match or are not within a certain percentage of difference, the owner and buyer would agree to have a third appraisal. After the third appraisal is conducted, the middle appraisal of the three establishes the purchase price. Also, the ROFR could include any qualifications for appraisers such as licensing or not being affiliated with the parties. This method is used when there is no offer to establish a price but the owner wishes to sell the property.

An ROFR could contain both an offer matching and an appraisal method for determining the purchase price. Terms could state that the price will be the lesser of an offer and an appraisal. The important point is to make it very clear how the purchase price is established and avoid disputes between the owner and potential buyer.

Timeline. Timelines in a ROFR ensure that the parties understand deadlines and keep the transaction moving. The following timelines are important for an ROFR:

- Number of days to provide an offer to the ROFR holder.
- Number of days to establish the purchase price by appraisal.
- Number of days to accept or reject an offer by the ROFR holder.
- Number of days to close the purchase.

Exempt transfers. Another term to consider is transfers that will be exempt from the ROFR. The owner may want to be able to transfer the land to a family member or spouse without triggering the ROFR. Therefore, the ROFR should specifically state all exempt land transfers.

Consider the following example. Tom agrees to give Susan a ROFR on land he owns. The ROFR expressly exempts any transfers to Tom's children. Tom later dies and his son, Ron, inherits the land. Susan's right to buy the land under the ROFR is not triggered because a transfer to children is exempt from the ROFR. If son Ron later attempts to sell the property, Susan's rights under the ROFR apply. The only exempt transfer is to Tom's children and all other transfers will trigger the ROFR.

Term. The length of term of the ROFR is also an important provision. Causing future owners of land to be subject to a ROFR indefinitely can cause problems if the rights under the ROFR pass to future generations. The landowner may have to track down many successors to the ROFR before being able to sell the land. Limiting the term of the ROFR to a certain number of years or to specific generations can avoid this problem.

Consider the following example.

In 1980, Joe granted a ROFR to Keith. The ROFR says it is binding upon their "heirs, assigns and successors." Joe and Keith have both passed away. Larry, Joe's son, inherited the land from his father and now wants to sell it. Because the ROFR from 1980 never terminated, Larry must find all of Keith's heirs and have them release their ROFR interest or exercise their right to purchase. Larry has difficulties finding all of Keith's heirs as they are scattered across the country.

This scenario shows the problems of having an indefinite term for the ROFR. If Joe and Keith would have made the ROFR effective for their lives only or for a certain number of years, Larry would not have to track down all of Keith's heirs, who may not have any connection to or interest in the land.

"A Right of First Refusal is relatively easy to implement and allows the landowner to still have the ability to sell the land."

ROFRs in estate plans. An ROFR can be coordinated with an estate plan and set up through a trust. It is common for a trust to include a provision that land being distributed to a beneficiary is subject to a ROFR in favor of another family member. The trust or will creating the ROFR should include the terms and conditions of the ROFR. The more detail provided, the less likelihood of future conflict among beneficiaries.

Consider the following example.

Henry owns two farms, Blackacre and Greenacre. Henry doesn't think his two children should own assets together because they don't get along well. He doesn't want to tie the land up in a trust and wants his children to have significant control over their land. His preference is for the land to stay in the family but that is not an absolute restriction he wants to place on the land.

Henry establishes a trust that gives Blackacre to son Isaac and Greenacre to daughter Jane. The trust also states that before distributing the land the Trustee is to execute a ROFR for each farm with the following terms:

- Before selling the farms, each child must offer the other child a chance to purchase.
- Purchase price is the lesser of a bona fide offer and an appraisal.
- The appraisal must use the three-step appraisal method.
- The purchase price is to have a 10% discount and can be paid over 10 years.
- Once the price is established, the child has 30 days to decide to purchase the farm and an additional 60 days to close the sale.

- Transfers to Henry's descendants and spouses of children are exempt from the ROFR.
- The term of the ROFR is only for as long as Isaac and Jane are alive.

When Henry dies, Isaac and Jane will each receive their specific farm subject to the ROFR. If either wants to sell during their lifetime, they must offer the farm to their sibling. The ROFR gives the other sibling a chance to buy the farm before it is sold outside of the family. The ROFR doesn't guarantee the land will stay in the family after Henry's death but it does at least allow a family member a chance to buy the land and keep it in the family.

ROFRs do not provide the same level of protection for farmland that trusts and LLCs provide. However, when heirs will own land individually, and not jointly, a ROFR will at least give other family members the right to buy the land before it could leave the family. A ROFR is relatively easy to implement and allows the landowner to retain the ability to sell the land, providing a moderate level of protection for keeping the land in the family.

Leases

Leases are also a tool that can keep land in the family. Like ROFRs, leases do not provide the same protection as LLCs and trusts but they can help. Leases can secure the land base for a farming heir by requiring non-farm heirs to lease their land to the farming heir. Typically, these types of leases are long-term, sometimes as long as 30 or 40 years. Note that in Ohio, a lease for more than three years must be notarized and should be recorded.[15]

Leases can be set up during life or at death through a trust. A trust can include a leasing provision requiring the non-farm heir to lease their land back to the farming heir and receive the rental income. A lease can also be used for land held in an LLC by off-farm heirs.

Consider the following example.

Keith and Lisa own two farms and want Mary to inherit Blackacre and Nancy to inherit Greenacre. Mary will continue the farming operation after Keith and Lisa's deaths, but Nancy is not involved in the farming operation. Keith and Lisa's trust includes the following provision:

> *"Our trust shall distribute Greenacre to Nancy. However, prior to distribution, the Trustee shall offer to cash lease Greenacre to Mary for 20 years provided Mary is farming. The lease rate shall be the county average and all other terms shall be at the discretion of the Trustee and Mary."*

In this example, Nancy will inherit Greenacre and will own it outright. However, she must offer to lease it back to Mary for 20 years. Keith and Lisa's plan makes sure that Nancy will inherit the farm but also will protect Mary's land base for her farm operation.

While a long-term lease can protect the land base for a farming heir, leases can significantly impede an owner's ability to sell the land. That is, land subject to a long-term lease may be difficult, if not impossible, to sell because a

[15] A short-form memorandum of lease may be recorded rather than the actual lease. ORC 5301.251

written, recorded lease is binding on the next owner. In the above example, Nancy may have a difficult time finding a buyer for Greenacre while Mary's lease is in effect. So, while Nancy will own Greenacre, she is severely restricted in how she can use it. If Nancy was expecting to cash out and receive money from the sale of Greenacre, she will be disappointed with the long-term lease requirement. This negative impact should be taken into account when considering long-term leases.

If a plan does use a long-term lease, a lease rate adjustment mechanism should be included in the terms of the lease. A 20-year lease with no allowance for a rental rate adjustment may become unfair to either the owner or tenant by the end of the term. Requiring the new owner and the tenant to negotiate a new lease rate every few years can address this problem. If the owner and tenant are unable to negotiate a new lease rate, the lease can include a means to determine the new lease rate.

One way to determine the rental rate is to use university or government lease data for the state or county. This method has a potential weakness, as the county and state averages may not accurately reflect the rental rate for a specific farm. For example, a farm may have much better soil and productivity characteristics than the average farm in the county. Another way to determine the new lease rate is the use of a third-party. An appraiser or other person familiar with farmland rent in the area can establish a farm market lease rate for the farm at issue. The third-party should be agreed upon by the owner and tenant. The disadvantages to this method are the potential for the two parties to be unable to agree upon a third-party and the third-party may expect to be paid for their services. Regardless of the method used, it is important that long-term leases have a solution for resolving lease rate adjustments.

Leases can be valuable tools to allow non-farm heirs to own farmland while protecting the farmland base for the farming heirs. The terms of the lease should be carefully considered to be sure the leases will be effective and meet the goals of the current owners. Both the benefits to the farming heir and the disadvantages to the non-farm heir owning the land should be considered when considering a long-term lease.

Agricultural or conservation easements

Placing a conservation or agricultural easement on land can ensure that the land will remain in agricultural or conservation use in the future. An easement strategy involves voluntarily agreeing to use the land only for agriculture or conservation and forfeiting the right to develop the land for other purposes. A legal deed of easement on the land documents the agreement to restrict the land use to agricultural or conservation purposes and gives the "holder" of the easement the right to enforce its provisions. The holder is typically a land trust or a government agency.

Beyond ensuring that the land will remain in agricultural or conservation use in the future, there are also financial incentives for entering into an agricultural or conservation easement that can help keep the land in the family. Through the Office of Farmland Preservation's Local Agricultural Easement Purchase Program, the Ohio Department of Agriculture uses Clean Ohio bond revenues and federal funds to pay landowners who qualify for the program and agree to place agricultural easements on their land.[16] A qualifying landowner is paid part of the development value of the land and must also "donate" a portion of that value. Land trusts and local governments hold the easements and may also have federal and private funds for easement purchases. Selection for easement purchase programs can be competitive.

Landowners may also "donate" an agricultural or conservation easement without receiving any payment. In either a donated or purchased easement situation, federal income tax benefits are available for the value of the portion of the easement a landowner donates. [17]

Easements that receive payment or federal income tax credits are intended to be permanent and the landowner seeking an easement should assume as much. An easement will prevent any residential or commercial development on the property. Improvements and land use activities on the land may or may not be allowed and will depend upon the specific terms of the easement. Also, many easements prohibit the land that is subject to the easement from being subdivided into smaller parcels. Due to the inability to develop the land or divide the land, the market value of the land can reduce but it likely holds greater appeal as agricultural land because it is protected from development.

Selling an agricultural easement allows a landowner to tap into the land's equity and use the proceeds to pay debt, purchase additional land, or address other risks to the land. Additionally, it may be less appealing to sell the land out of the family because the land can't be developed and future owners must use the land only for agricultural or conservation purposes in perpetuity.

Consider the following example.

John and Sue are fourth generation owners of 300 acres of farmland that they plan to leave to their son Lee, and they want it to remain as farmland. Lee is committed to farming and wants to farm, but John and Sue would like Lee to have more land and improve the viability of his operation. They apply to Ohio's Local Agricultural Easement Purchase Program and are selected for the program. They receive a payment of $2,000 per acre for entering into an agricultural easement that protects the land permanently as agricultural land. They use the $600,000 in easement proceeds to purchase additional farmland for Lee and apply for a federal income tax credit for the portion of the easement value they donated to qualify for the program.

[16] https://agri.ohio.gov/programs/farmland-preservation-office

[17] Internal Revenue Code §170(h).

This example illustrates how landowners who are comfortable placing a permanent easement restriction on their land can use the agricultural easement strategy. The strategy can protect the land and provide financial benefits that can help ensure the land will remain in the family as part of a viable farming operation.

Combining strategies

The strategies discussed above are not exclusive and can be combined to serve the needs of a farm family. For example, perhaps a family uses an LLC in combination with a long-term lease. Or a family could place an agricultural easement on land that goes into a trust. All strategies should be considered, as well as the possibility of using a combination of strategies to carry out the goal of keeping the farmland in the family.

Summary

Real threats exist that can cause farmland to leave the family. When landowners want to reduce those threats, there are several tools that can help protect the farmland. The level of protection can vary from near absolute, like a trust, to merely giving other family members a first chance to buy the land, like a ROFR. The level of protection and the methods to enforce this protection are key decisions in keeping farmland in the family.

Finding legal and professional assistance

The need for legal counsel in providing guidance for the best strategy to protect farmland is critical. There is likely a solution that meets the goals of the current landowners and experienced legal counsel can help find that solution.

Farmers can find attorneys familiar with keeping farmland in the family in a number of ways. Often the best way is through referrals from friends and family. Another way to find an attorney is to contact the local or state bar associations and agricultural Extension Educators. If a referral is not available, a simple internet search can be effective. Searches for "agricultural estate planning," "farm estate planning," and "agricultural attorneys" will often identify attorneys that may be able to assist with planning strategies.

Whatever the method to search for an attorney, be sure the attorney has experience dealing with farmland and farming operations. Family farms have unique issues that an attorney unfamiliar with farming may not understand or recognize. Using an experienced agricultural attorney to implement a strategy is the final step toward keeping farmland in the family

This 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. Find other law bulletins in this series and all our resources on OSU's Farm Office website, a one-stop shop for agricultural law and farm management information.

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