CFAES

PLANNING FOR THE FUTURE OF YOUR FARM

Legal tools and strategies for farm transition and estate planning

THE PLANNING FOR THE FUTURE OF YOUR FARM BULLETIN SERIES

Farming takes planning. A lot of planning. Whether for next year's crop, expanding a herd, buying land, constructing buildings, starting a new venture, or upgrading equipment, farmers are nearly always engaged in planning to keep the farm on track. But farm transition planning—that is, planning for what happens to a farm business and its family from one generation to the next—is a whole different kind of planning. And it's one type of planning farmers often avoid.

Farm transition planning can be challenging and uncomfortable, perhaps because it involves dealing with death, uncertainty, and difficult family situations. But like planning for the next year of production, farm transition planning is critical to a farm's success. With good planning, a farm family can protect farm assets, implement family and business goals, and ensure a smooth transition of a viable operation to the next generation. It's the kind of planning that can pay off big.

Our **Planning for the Future of Your Farm** law bulletin series can help with this important planning need. In this series, we explain the legal tools used for planning and present strategies that can address a family's goals. The entire set of bulletins in this series is on the Farm Office website at **go.osu.edu/farmplanning.** We cover these same topics in our popular **Planning for the Future of Your Farm Workshop** offered online and in person each winter. Check the Farm Office website at farmoffice.osu.edu for workshop dates. Reading the series and attending our workshop are two important first steps that can lead to creating a plan for the future of your farm.

The authors of the *Planning for the Future of Your Farm* Series are **Robert Moore and Peggy Kirk Hall**, Attorneys with OSU's Agricultural & Resource Law Program, and **Evin Bachelor and Kelly Moore**, attorneys with Wright & Moore Law Co. LPA. We hope you will find the series helpful in your efforts to plan for the future of your farm.

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.

WHAT'S IN THE PLANNING FOR THE FUTURE OF YOUR FARM SERIES?

1. **Farm Transition Planning: What it is and What to Expect**
   The concept of farm transition planning, common terms, what farmers can expect from the transition planning process, and how to prepare for it.
2. **The Financial Power of Attorney**
   A Financial Power of Attorney authorizes someone to make financial decisions for another. We explain the different types and how they can help a farm business.
3. **The Health Care Power of Attorney and Advance Directives**
   Medical and end-of-life plans can ease decision making uncertainties for families. This bulletin explains the Health Care Power of Attorney, Living Wills, Donor Registries, and Funeral Directives.
4. **Wills and Will-based Plans**
   A will is a commonly known tool for distributing property. This bulletin explains different types of wills and how they can be used in a farm transition plan.
5. **Legal Tools for Avoiding Probate**
   We review legal tools that transfer assets upon death and avoid probate, including beneficiary designations, payable on death accounts, transfer on death designations, and survivorship deeds.
6. **Gifting Assets Prior to Death**
   Gifting is one way to transfer assets to the next generation. In this bulletin, we discuss how gifting works and when it can be advantageous to incorporate gifting into a transition plan.
7. **Using Trusts in Farm Transition Planning**
   Trusts are popular tools in farm transition planning. In this bulletin, we explain how trusts function and highlight how they can meet family and farm planning needs.
8. **Using Business Entities in Farm Transition Planning**
   Many farms have business entities for liability or tax purposes, but business entities can also enable transition of a business to the next generation. We explain how in this law bulletin.
9. **Strategies for Treating Heirs Equitably**
   Whether heirs should inherit assets equally or equitably is a challenging dilemma for parents. We present strategies for equitable distributions of assets in this bulletin.
10. **Strategies for Transferring Equipment and Livestock**
    Equipment and livestock can be more difficult to transfer than other assets. In this bulletin, we review special considerations and strategies that can help minimize the challenges of these transfers.
11. **Strategies for Addressing Special Family Needs**
    Whether a disability, substance abuse, gambling, or second marriage, many farms have special family needs. Strategies that provide solutions to these types of needs are the topic of this law bulletin.
12. **Strategies for Long Term Health Care Needs**
    Farmers today must be aware of the possibility of long-term health care costs. We review strategies for addressing the need and reducing its impact on the farm and farm assets.

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FARM TRANSITION AND ESTATE TRANSITION PLANNING: WHAT IT IS AND WHAT TO EXPECT

Pick up a farm magazine and it's likely to have an article about estate planning. An internet search will yield hundreds of references to passing on the family farm, protecting a farm's legacy, and bringing the next generation into the operation. We focus a lot of attention today on farm transition and estate planning. That's because good planning carries critical consequences for the future of agriculture.

WHAT IS FARM TRANSITION AND ESTATE PLANNING?

Farming is both a unique way of living and a unique way of making a living. It is common for farmers to hope to pass this unique heritage on to future generations. "Farm estate planning" uses legal tools to ensure that the next generation receives farm assets after farm owners retire or pass on. But farmers often want to bring their heirs into the farming operation before passing those assets on. The term "farm transition planning" refers to using many tools to prepare for and transfer the farming operation to heirs, including estate planning and business planning tools. Whether your goals are to pass on land and assets, hand the farm business down to future generations, or both, learning about farm transition and estate planning will help you accomplish those goals.

THE FARM TRANSITION AND ESTATE PLANNING PROCESS

The farm transition and estate planning process begins with **identifying goals** for the future of the farm and the farm family. We frequently hear from farmers whose primary goals are to keep farmland in the family and prepare the next generation of managers. Or perhaps a farmer aims to retire, address special issues with children, or plan for long term health care. Whatever the goals may be, healthy **family communication** and **conflict management** are often necessary to accomplish this important first step of identifying goals.

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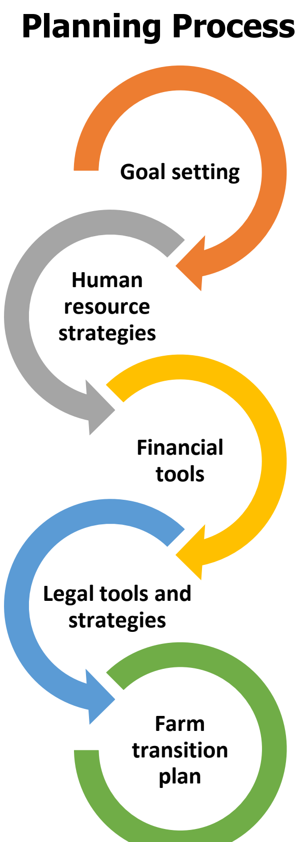
The next step in the farm transition planning process requires **selecting strategies** to implement established goals. Strategies will likely be necessary in several different areas:

- **Human resource** strategies to identify, prepare and train the next generation of the farm business managers.
- **Financial** tools to aid in funding and implementing goals, such as insurance and retirement plans.
- **Legal** strategies and tools for effective asset protection and transfer, such as estate planning and business planning instruments.

The legal tools and strategies component of farm transition planning is the focus of our Planning for the Future of the Farm bulletin series. Some of the legal tools we explain are traditional instruments often used in estate planning, like wills and trusts. But other legal tools can be useful for a farm transition plan, such as business entities, operating agreements, leases, and gifting strategies. These legal tools work together with human resource strategies and financial tools to implement a farm's goals. Putting the legal plan in place is the final step in the farm transition planning process.



PUTTING A LEGAL PLAN TOGETHER

1. Choose an attorney. The legal side of farm transition planning starts with choosing your attorney. Word-of-mouth is one way to identify a good agricultural attorney with expertise in farm transition and estate planning, or check with organizations like Extension, the state or local bar association, or the American Agricultural Law Association. Ask for an initial consultation and meet an attorney before committing to representation. Several factors can aid in selecting the right attorney: competence, personal comfort, and costs.

- Look for an attorney with **competence** in estate and business planning—composed of both legal knowledge and practical experience. But don't stop there-- it's also very important that the attorney is competent with **agriculture** and experienced in working with farm clients. Farm businesses are different than other types of businesses. An attorney who knows farming will have insight into the laws, tools and strategies that apply to farm situations. Be wary of an attorney who has never worked with farm clients and knows little about agriculture.
- **Personal comfort** with an attorney is essential. It can ensure open communication and make it easier to share necessary information about finances, assets, business plans, and family issues and dynamics. Discomfort can lead to misunderstandings, withholding of critical information, and plans that don't align with a family's goals.
- **Costs** can vary. It is completely acceptable to request an estimate of legal fees. Don't be afraid to ask what the entire plan, from start to finish, will cost.

2. Expect to have two or more meetings with an attorney. The first meeting is typically for reviewing goals and information but might also involve discussing strategies and options. Additional meetings could involve reviewing tools and strategies and executing legal documents.

3. Prepare for the first meeting*.* Advance preparation can help the first meeting move more efficiently and effectively. An attorney might let you know in advance of information to gather before the first meeting. Also consider these tips:

- **Write it down.** Write out your goals for the farm business and farm assets. Also include information about the family, its special needs, and its dynamics. Consider details an attorney may need to know about the farm and the family, like who has "sweat equity" in the business, siblings who don't get along, children with problems managing finances, big purchases coming up, and who wants to be involved in the farm—this and similar information will help with developing a plan that addresses future issues.
- **Compile asset and personal information**. Gather all asset information such as deeds, account numbers and balances, and beneficiary designations, along with personal information on you and your family members. OSU Extension offers a helpful document, *Getting Your Farm and Family Affairs in Order,* that can aid in organizing the information. Doing so before meeting with your attorney can save time and the costs of having your attorney track down the information.
- **Organize financial information**. Use the information gathered in step two to prepare a simple balance sheet showing farm assets, non-farm assets, debts, and net worth. Full disclosure of your financial situation is necessary to developing a plan that addresses financial challenges and opportunities and is another way to save on the costs of paying your attorney to compile the information.

4. You may need your other advisors, too. Communication among all your professional advisors may be necessary to ensure all strategies align with one another. You may need to check in with financial advisors, accountants, insurance agents, and other professionals you rely upon.

SPEAKING THE FARM TRANSITION LANGUAGE: COMMON TERMS

Farm transition planning uses many legal terms, and familiarization with the terms should help you through the process. Here are definitions to common terms you may encounter along the way.

Advance directive. A legal document that gives instruction on a person's health care wishes, such as a living will and health care power of attorney.	***Irrevocable trust.*** A trust that cannot be changed or cancelled by the person who executed the trust.
Basis and step-up in basis. The basis is the value of an inherited asset for tax purposes. A step-up in basis is an adjustment of basis to the asset's fair market value at the time of the death that triggers the inheritance.	***Joint tenancy.*** Ownership of real property jointly by two or more parties, either as joint tenants with rights of survivorship or as tenants in common.
Beneficiary. A person designated to receive proceeds from an asset such as an account, insurance policy, or trust upon the death of the owner of the asset.	***Living trust.*** A trust created during a person's lifetime to manage assets before and after the person's death. A living trust can be revocable or irrevocable.
Business entity or structure. An organization formed to conduct business, such as sole proprietorships, partnerships, corporations, cooperatives, and limited liability companies.	***Living will.*** A legal document stating a person's wishes for medical treatment and life-sustaining measures if the person is at the end of life and unable to communicate.
Capital gains tax. A tax on the increase in the value of an asset between the time it is bought and the time it is sold.	***LLC, Limited Liability Company.*** A business entity that can protect its owners from personal responsibility for business debts and liabilities with pass-through taxation.
Deed. A written document that transfers title to real property to a new owner.	***Long-term care insurance.*** Insurance coverage for long-term services and support not covered by health insurance, such as nursing home or custodial care.
End-of-life directive. A written legal document with instructions for end-of-life medical decisions if a person is unable to make decisions at that time.	***Operating agreement.*** A document that governs the internal operations of a limited liability company and is binding on all members of the limited liability company.

Estate. All of the real and personal property a person owns at death.	***Payable on death account.*** An account set up to be directly transferred to a beneficiary upon the death of the account holder, without going through probate.
Estate administration. The process of collecting assets, paying debts, and distributing the property of a person after the person's death.	***Probate.*** A court process to administer a person's estate by paying all claims, expenses, and taxes, and distributing remaining property to heirs.
Federal estate tax. A tax on the portion of a person's estate that exceeds the federal estate tax exemption amount.	***Revocable trust.*** A trust that can be changed or cancelled by the person who executed it prior to that person's death.
Federal estate tax exemption. An amount of assets in an estate that are exempt from the federal estate tax, as determined by Congress and adjusted annually.	***Survivorship deed.*** A deed that transfers the title to a joint owner's share of jointly owned real property upon death to the surviving joint owners.
Financial power of attorney. A legal document that appoints someone to make financial decisions for a person if the person is unable to manage their finances.	***Tenancy in common.*** A form of joint ownership of real property that allows a joint owner to transfer their share of property to a person other than a joint tenant.
Gifting. Giving cash or assets to a beneficiary during the giver's lifetime rather than after death, which can reduce the value of the giver's estate and the possibility of estate taxes at death.	***Transfer on death affidavit.*** A written instrument that establishes a direct transfer of real property to a designated beneficiary upon the death of the owner without going through probate administration.
Health care power of attorney. A legal document that allows an individual to empower another person to make important medical decisions on their behalf when they cannot do so themselves.	***Trust.*** A legal instrument that holds assets and appoints a trustee to oversee and distribute assets according to the terms of the trust.
Intestacy. Dying without a will, which results in the deceased's assets being subject to probate and distributed according to the state's intestacy law.	***Trust administration.*** The process of managing the assets within a trust according to the terms of the trust.

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THE FINANCIAL POWER OF ATTORNEY

We can't always take care of our own financial and personal affairs. Whether due to medical issues, mental incapacity, schedule conflicts, or other unexpected circumstances, we sometimes need someone else to handle those needs. A Financial Power of Attorney (POA) is a legal instrument that can help in those times. It allows you as the "**principal**" to name an "**agent**" to perform duties such as managing your bank accounts, finances, and investments, signing your tax returns, or handling a specific business matter. It's a flexible legal document that you and your attorney can tailor to address different needs at different times. In this bulletin, we explain how financial POAs can be helpful to your situation and how they work.

HOW A FINANCIAL POWER OF ATTORNEY CAN HELP YOU

It gives you control. If you don't have a POA and become incapacitated, a court may have to appoint a legal guardian to act for you. The person the court selects as your guardian may be a person you wouldn't want to be involved in your affairs. With a Financial POA, you have control over who deals with your financial matters, and you can define the scope of that agent's authority.

It creates consistency. Authorizing someone to step in when you cannot avoids disruptions and keeps your finances and affairs running efficiently and smoothly.

It provides certainty. Third parties often want or require proof that someone has the legal authority to handle someone else's finances and dealings so that they don't end up in the middle of a fraud or theft situation. A Financial POA provides that proof to the parties you deal with.

THE UNIFORM POWER OF ATTORNEY ACT AND OHIO'S STATUTORY FORM

Many states, like Ohio, have adopted the **Uniform Power of Attorney Act**, a model law that provides default rules for POAs and standardizes requirements across states that adopt the law. The

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law aims to deter financial abuse by an "agent" appointed in a POA, especially for elderly and disabled persons. Ohio's POA Act outlines general powers of agents and includes a list of powers that a POA *does not grant* an agent unless specifically stated. These "prohibited powers" that must be stated in the POA includes power to:

- Create a trust for the principal or make changes to an existing trust
- Give away the principal's property
- Create or change rights of survivorship
- Change beneficiary designations
- Let others act in place of the named agent
- Waive the principal's right to be a beneficiary of a joint and survivor annuity, including a survivor benefit under a retirement plan.

OBTAINING, EXECUTING, AND RECORDING A POA

It is possible to prepare your own Financial POA using a state's standard form; Ohio provides an example of a POA in its statue. But you should consider **consulting an attorney** for your POA. An attorney can help you decide when you need a POA, address issues unique to your situation, help you decide what types of authority to grant an agent, and determine when the authority begins and ends. Typically, an attorney can draft a Financial POA quickly with minimal legal fees, making it well worth the investment to have a tailored document that protects you and meets your needs.

For proper execution, a person (the "principal") must sign the POA, or if unable to sign, may direct another individual to sign for the principal while in the principal's presence. Acknowledgement by a notary public or local official is the final step in the POA execution process.

If a POA is for the conveyance, mortgage, or lease of an interest in real property, it must be **recorded** in the county recorder's office where the property is located *prior to* recording of the deed, mortgage, interest, or lease. A revocation of a recorded POA must also be recorded in the same county recorder's office where the recording occurred.

GENERAL VERSUS LIMITED POAs

The two main types of Financial POAs differ according to the powers granted to the agent. A general POA grants the most authority while a limited POA limits authority to specific actions or assets.

A **general POA** typically gives the agent authority to do all things necessary to manage assets held by the principal. Examples of powers typically given by a general POA include:

- Buy, sell, lease, mortgage, and give away real and personal property.
- Contract in any manner with any person on behalf of the principal.
- Operate, buy, sell, enlarge, reduce, or terminate an ownership interest in a business.
- Open, close, invest in, and make withdrawals from an investment or bank account.
- Buy, sell, exchange, assign, settle, and exercise commodity futures contracts.
- Buy, cancel, collect, and change beneficiaries on a life insurance policy.
- Litigate for any money or other thing of value owed to the principal.
- Sign, acknowledge, seal, deliver, file, or record any instrument on behalf of the principal.
- Engage, pay, or discharge an attorney, accountant, investment manager, or other advisor.

A **limited POA** grants an agent the authority to act *only* for a specific purpose, during a certain period, or for particular assets. A limited POA will specify actions an agent may take on behalf of a principal and clarifies that the agent has no authority to act beyond that limited scope of authority. For example, a principal selling real estate might execute a limited POA that gives an agent authority to sign the deed for the principal on the day of the real estate closing. The agent does not have authority to act for the principal on any other matter or at any other time.

THE AGENT'S FIDICUARY DUTIES, LIABILITY, AND COMPENSATION

An agent has "fiduciary" responsibilities when performing under a Financial POA, which means the agent must act in accordance with the principal's best interest, in good faith, and only within the scope of the authority granted by the POA. Ohio law details the specific level of competence, care, and diligence required by an agent, as well as duties for maintaining records of receipts and disbursements and cooperating with the principal's Health Care POA to carry out health care needs, if applicable. Ohio law also states that an agent who violates the agent's duties can be financially liable for the violations. On the other hand, an agent who acts in good faith is not liable to the principal's beneficiaries or liable if the principal's property declines in value. Unless a POA states otherwise, the law states that an agent is entitled to compensation and reimbursement of expenses for performing duties, if costs are reasonable.

WHEN POA AUTHORITY STARTS AND ENDS

There are different approaches to setting the times for starting and ending a Financial POA, and it can be quite beneficial to review the options with your attorney before making decisions.

The start of POA authority. When exactly can an agent begin dealing with matters authorized by the POA? This is a very important provision of the POA to discuss with an attorney because the document will be effective immediately *unless* stated otherwise. It's typical for a principal to sign a Financial POA because the need exists at the current time, such as when a farm business owner needs an agent to assist with immediate business matters. But a second option is for a Financial POA to **"spring"** into effect only when triggered by a certain event. This type of POA can be difficult, as third parties might question whether the triggering event has occurred. For example, if a Financial POA is only effective in the event of a medical emergency, a bank might require the agent to offer proof of the medical emergency. For this reason, Ohio law allows a principal to authorize a person, such as the principal's doctor, to make a written statement that the triggering event has occurred, providing the proof necessary to confirm that the POA is valid.

Durability and incapacity. Ohio's Uniform POA Act law states that unless provided otherwise by the principal, a POA is **"durable."** This means that the Financial POA remains in effect if a principal becomes incapacitated. In the above example of a Financial POA triggered by a medical emergency, the POA would continue beyond the emergency if the principal is incapacitated by the emergency. The law provides a definition of "incapacity," which is an inability to manage property or business affairs for because a person is impaired in the ability to receive and evaluate information or make or communicate decisions, even with technological assistance, or because a person is missing, detained, or outside the United States and unable to return.

A principal may authorize someone to determine when the principal is incapacitated, or the law allows a physician or psychologist to establish incapacity and permits an attorney, judge, or government official to determine if a principal is missing, detained or unable to be in the United States.

The end of POA authority. It is also necessary to clarify when POA authority ends, or Ohio law will establish its end. If a POA states that it is not "durable," the agent's authority ends if the principal becomes incapacitated. For all POAs, the law states that an agent's authority ends if the principal dies, when the purpose of the POA is accomplished, or if the agent dies, resigns, or becomes incapacitated. A principal can change or terminate the agent's authority at any time if the principal has mental capacity. Giving notice that a POA has ended to financial institutions can ensure the agent no longer acts for the principal. Note that if the POA grants powers to convey interests in property and has been recorded, the revocation must also be recorded in the same county recorder's office.

CHOOSING AND COMMUNICATING WITH AN AGENT

Appointing someone to handle your financial and business affairs is a serious matter and exposes you to risk, regardless of how well you know the person. Choose carefully, appointing a person who will adhere to the fiduciary responsibilities the appointment requires. You can also reduce your risk by communicating the terms of the POA and your needs and wishes to your agent. Proper forethought can ensure that the POA helps you through those times when you need another to act on your behalf.

REFERENCES

Uniform Power of Attorney Act, Ohio Revised Code Sections 1337.21 to 1337.64, https://codes.ohio.gov/ohio-revised-code/chapter-1337

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THE HEALTH CARE POWER OF ATTORNEY AND ADVANCE DIRECTIVES

Health care decisions like deciding whether to have a medical procedure, remain on life support, or donate body organs are challenging, but what if you are incapacitated and unable to make those decisions? Or what if you have wishes for your funeral and burial that you want carried out? There are several legal documents that can address these needs. Ohio law allows you to use a Health Care Power of Attorney, Living Will Declaration, Anatomical Gifts Declaration, Donor Registration, and Statement of Funeral Arrangements to give "advance directives" about your health care and death arrangements. These are important documents that ease burdens for both you and your loved ones.

THE HEALTH CARE POWER OF ATTORNEY

A Health Care Power of Attorney (POA) is a legal document that gives the person you appoint—your "agent"—the power to determine your health care needs. Ohio law provides that, unless you express otherwise in the POA, your agent may make health care decisions to the same extent you could if you were able to do so. For example, your agent could set up appointments, choose treatment, communicate with your doctors, or decide where to obtain long term care. The Health Care POA may also include special instructions about "life support" that authorize your agent to refuse artificial or technology supplied nutrition or hydration if you are in a permanently unconscious state. Alternatively, you may have a separate Living Will Declaration that further addresses end-of-life care, discussed below. Under Ohio law, a Health Care POA begins only if your doctor determines that you have lost the "capacity" to make informed health care decisions. You may revoke or change your Health Care POA prior to death, and it extinguishes upon death.

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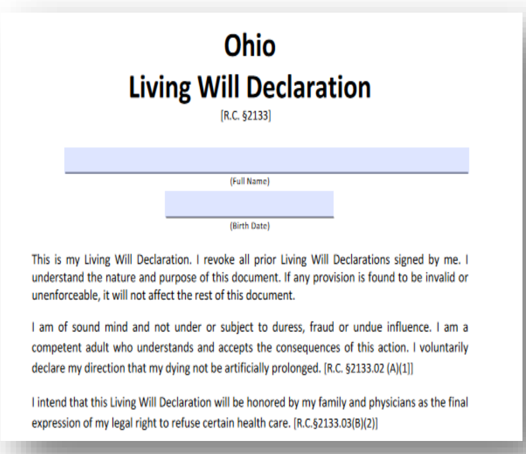
THE LIVING WILL DECLARATION

You may determine your end-of-life care through a Living Will Declaration. The declaration directs your doctor to provide only comfort and pain management care and allow you to die naturally if you are in a terminal condition or a permanently unconscious state. Your doctor is not to administer life-sustaining treatment, CPR, artificially or technologically supplied nutrition or hydration, or take any actions that postpone your death. The declaration also authorizes your doctor to issue a "Do Not Resuscitate Order."



Ohio
Living Will Declaration
[R.C. §2133]

(Full Name)

(Birth Date)

This is my Living Will Declaration. I revoke all prior Living Will Declarations signed by me. I understand the nature and purpose of this document. If any provision is found to be invalid or unenforceable, it will not affect the rest of this document.

I am of sound mind and not under or subject to duress, fraud or undue influence. I am a competent adult who understands and accepts the consequences of this action. I voluntarily declare my direction that my dying not be artificially prolonged. [R.C. §2133.02 (A)(1)]

I intend that this Living Will Declaration will be honored by my family and physicians as the final expression of my legal right to refuse certain health care. [R.C.§2133.03(B)(2)]

According to Ohio's Rights of the Terminally Ill Act, a Living Will Declaration is valid only if you are either in a terminal condition, which means an irreversible, incurable, and untreatable condition from which there is no recovery and death is likely to occur without life-sustaining equipment, or in a permanently unconscious state, which means an irreversible condition in which you are permanently unaware of yourself or your surroundings. Two doctors must examine you and agree that you are in a terminal condition or permanently unconscious state. A Living Will Declaration also directs the attending doctor to make reasonable efforts to notify at least one of three contact persons listed in the document of the determination.

ANATOMICAL GIFTS DECLARATION AND DONOR REGISTRY

Gifting body organs and tissues is also a difficult end-of-life decision to leave to your loved ones. A few options are available to make your decision known in advance and relieve stress and discord among your survivors. If you wish to make gifts of body organs and tissues, it's possible to do so in the Living Will Declaration or Health Care Power of Attorney documents explained above. Ohio and all other states also maintain a separate "donor registry system" that makes your wishes known in a medical emergency. The Ohio Bureau of Motor Vehicles oversees the registration, allowing for immediate recognition on your driver's license that you authorize donations of body organs or tissues.

DISPOSITION OF REMAINS, FUNERAL ARRANGEMENTS AND BURIAL OR CREMATION

Ohio law allows you to appoint a person who can determine what happens to your body after your death, referred to as the "right of disposition." The appointment may grant a person the right to arrange for anatomical gifts, determine the location, manner, and condition of your funeral, and make burial, cremation, and similar decisions. You may also identify the source of funds to be used to pay for arrangements. Ohio law states that a person who acts according to the appointment cannot be held liable for following your preferences. Many courts and organizations provide a form for this type of appointment.

COMMUNICATE YOUR PLANS

Let others know about your Health Care Power of Attorney and advance directives so that the documents are used if a medical or end-of-life situation arises. Give copies to those you've appointed as agents and to your doctors, attorney, and religious advisor, and keep copies with your other important records. Discuss your decisions with family and close friends. Not knowing what you would want can create stress at a very difficult time, and communicating your wishes in advance will likely reduce that stress. Even if others don't agree with your decisions, sharing them beforehand could minimize the potential of conflict, misunderstandings, or a legal battle among family members.

RESOURCES AND REFERENCES

Ohio Revised Code Chapter 1337, Power of Attorney
https://codes.ohio.gov/ohio-revised-code/chapter-1337

Ohio Revised Code Section 2108.70, Assignment of rights regarding disposition of remains
https://codes.ohio.gov/ohio-revised-code/section-2108.70

Ohio Revised Code Chapter 2133, Uniform Rights of the Terminally Ill Act
https://codes.ohio.gov/ohio-revised-code/chapter-2133

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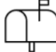 aglaw@osu.edu

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PLANNING FOR THE FUTURE OF YOUR FARM

Legal tools and strategies for farm transition and estate planning

WILLS AND WILL-BASED FARM TRANSITION PLANS

Your will, or "last will and testament," is one way for you to determine what happens to your property after your death. A will is a necessary part of a farm transition or estate plan, but how it is used can vary widely. Some plans may need only a will in conjunction with a few simple tools—we refer to these as "will-based plans." Other plans, however, may be more complex and require additional legal tools. We explain wills and their role in farm transition planning in this bulletin.

WILLS SERVE MANY PURPOSES

The "reading of the will" after someone dies can be a dramatic event, with family members wondering what the will says and who gets what. Distributing property is just one purpose of a will, however. A will can have several helpful purposes, explained here.

Determining where property goes. A will transfers property after death according to a person's wishes. The terms of a will can be quite specific about how property passes. It can include restrictions and conditions tailored to the deceased person's wishes and can "disinherit" heirs that otherwise would receive property if the person did not have a will. A will can also include alternative plans in the event of changed conditions and circumstances.

Minimizing the probate process. A will sends clear directions to the probate court. Without a will, the court would otherwise have to determine how property should pass according to law. And as we explain later, a will can direct property to an existing trust and reduce the need to transfer it through the probate process. Both actions can reduce the time spent in probate, as well as the costs.

Choosing who administers the estate. A person can appoint an **administrator** to help settle the person's estate. The administrator, also called an executor or personal representative, will help resolve the deceased person's financial affairs and carry out the directives in the will. It is an important role, so it's critical to choose an executor carefully.

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Naming guardians*.* One critical role a will can play is to address who will care for dependents such as minor children and incompetent adults upon the death of their caretakers. Parents or other persons with dependents may nominate a guardian in the will, and the court will review that nomination when appointing a legal guardian. The will may also specify whether the guardian is to manage the dependent's personal needs, property, or both.

WHAT IF YOU DON'T HAVE A WILL?

Every state in the U.S. has an "intestacy law" or "statute of descent and distribution" that steps in when a person dies without a will and directs distribution of the person's property. As with other states, Ohio's intestacy law makes assumptions that the deceased would choose to give property to family members. The law establishes an order of preference that gives a surviving spouse first priority, then children of the deceased and their children. If there is no spouse or children, the law looks next to parents, then to other family members. The State of Ohio receives the property if there are no family members. Ohio law also gives the probate court authority to appoint an administrator to assist with settling the estate of a person who dies without a will.

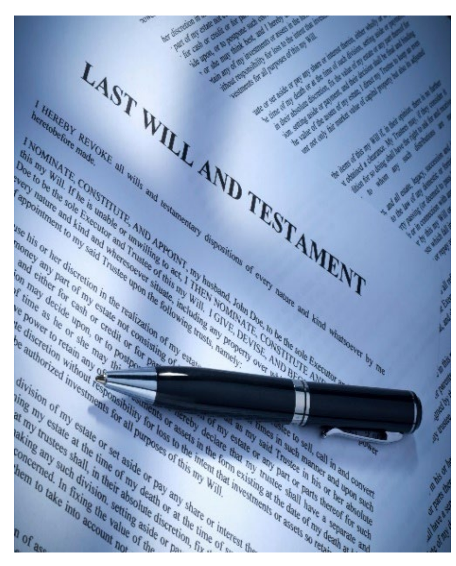
THE FORMALITIES OF MAKING A WILL

Requirements for making a will are straightforward but failing to meet them can result in a will being declared invalid. A person must be 18 years or older to make a will and be of "sound mind and memory" and "not under restraint." These terms mean that a person must know what he or she is doing and that making the will is a free and voluntary act. A will must be in writing, although it need not be typed, and the person making the will must sign it or if unable to do so, direct someone else to sign in their presence. Two or more witnesses must acknowledge that the person made and signed the will and must also sign the will in the presence of the person making the will.

Many "fill-in-the-blank" wills are freely available, but we advise working with an attorney to develop a will. Doing so will ensure not only that the legal requirements for making the will are satisfied, but more importantly that the will properly fits with the farm transition plan.

DIFFERENT TYPES OF WILLS

How a will distributes property can vary. A will can direct property to an identified party, send property to an established trust, or order a trust to be set up to receive the property. Here's an explanation of these three different types of wills:



A **simple will** directs all property to a surviving spouse or if the spouse is pre-deceased, then to the children. A simple will might also make specific bequests of property, name an executor, and appoint a guardian for minor children. The "simple" name for this type of will means that it does not involve a trust, making it less complex than wills that do. Some call this type of will a "sweetheart" will, because the plan is to leave all or most of the property to the deceased's sweetheart. The sweetheart then determines the fate of the property at his or her death.

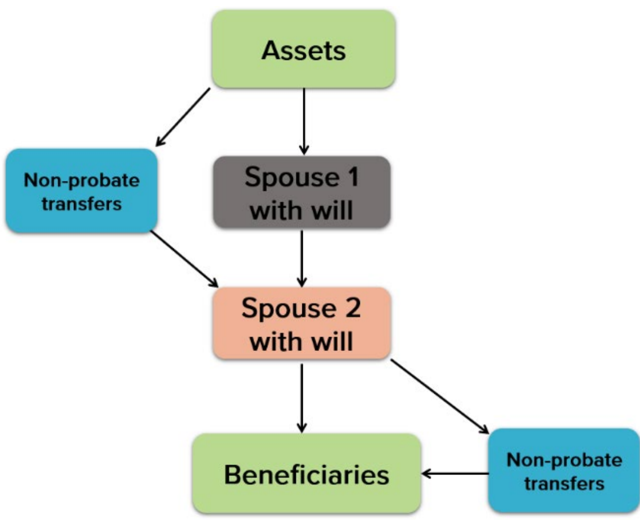
A **pour over will** transfers property to a "living trust" that was created prior to death. The assets "pour over" into the trust at death and the trust provisions then control what happens to the assets. This type of will is an important part of a trust-based plan and ensures that all property goes directly into the pre-existing trust rather than through the probate process.

A **complex will** directs the creation of a trust after death, referred to as a "testamentary trust." A testamentary trust might be simpler than a "living trust" and might only arise if certain conditions exist at death. For example, a simple testamentary trust could direct assets into a trust to support minor children if both parents pass. The trust only arises if the children are minors and both parents are deceased. Because a will creates the trust, the probate court would oversee administration of the trust by the trustee named in the will.

A WILL-BASED FARM TRANSITION PLAN

A plan can use a simple will to pass assets from one spouse to the next and then on to heirs. Other tools might be involved in the plan, such as transfer on death accounts, which we explain in our bulletin *Legal Tools for Avoiding Probate*. But the plan doesn't require the use of a trust. We refer to this approach as a **"will-based plan."** The illustration to the right shows how a will-based plan combined with non-probate tools can transfer farm assets to the intended beneficiaries. This approach can be sufficient for many people, but most often doesn't work well to address the complexities and assets of farm families and transitioning farm businesses.

A simple will-based plan



DO YOU ALSO NEED A TRUST?

Can you accomplish your plans for the future with a will-based plan? Or do you need a trust-based plan that uses a trust to help carry out the transition of your farm and assets? Those are "it depends" questions, as several factors come into play. The complexity of your situation is probably the critical factor that could lead you to a trust-based plan rather than a will-based plan. For example, if you have heirs with special needs, want to place certain conditions on heirs receiving property, need to address details ensuring transition of the farm to a specific heir, or are worried about federal estate taxes, a will-based plan may not be able to address your needs.

Likewise, you might prefer a trust because you want to avoid probate court involvement and have a trustee in charge of administering your affairs. You may also prefer to place details in a trust because of the privacy it offers in comparison to a will, which becomes an accessible public record when it goes through probate. Finally, legal fees are a factor. While a trust-based plan will likely cost more to create at the outset, it can keep assets out of probate and save on probate fees. A will-based plan is probably less expensive to create but could result in higher costs if assets must transfer through the probate process.

In the chart below, we outline how different factors play out in will-based versus trust-based plans. Discussing the factors with family and an attorney can be helpful. To learn more about trusts and using a trust-based plan in farm transition planning, see our other bulletin in this series, *Using Trusts in Farm Transition Planning*.

Comparing a will-based plan with a trust-based plan

Factor	Will-based plan	Trust-based Plan
Complexity of situation	Simple	Complex
Concerns about heirs	Little or none	Some or significant
Remarriage concerns	Little or none	Some or significant
Transition of operation	Little or none	Some or significant
Estate taxes	Little or none	Need to maximize savings
Probate	Don't mind; judge is in charge	Want to avoid; trustee is in charge
Privacy	Not important	Important
Cost	Less at outset; maybe more later	More at outset; maybe less later

UPDATING A WILL

How often should you update your will? It's important to be aware of circumstances that can trigger the need to review and update your will. Major life events are the most common triggers, including:

- Marriage, remarriage, or divorce in the family
- Birth of a child or grandchild
- Death of a spouse or beneficiary
- Change in health status
- Inheritance or other income that affects the value of your estate
- Moving to a different state
- Estate or tax law changes

WORKING WITH AN ATTORNEY

Many "fill-in-the-blank" wills exist but be wary of the one-size-fits-all approach they offer. An attorney plays an important role in developing a will that not only expresses your wishes but also addresses contingencies, considers the estate and tax laws that govern your estate, and fits the will into the overall farm transition plan. See our resources on choosing an attorney and talk with friends and family to find an attorney who will help you with the important task of creating a will that can carry out your plans for the future.

REFERENCES

Ohio Revised Code Section 2105.06, Descent and distribution
https://codes.ohio.gov/ohio-revised-code/chapter-2105
Ohio Revised Code Chapter 2107, Wills
https://codes.ohio.gov/ohio-revised-code/chapter-2107

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LEGAL TOOLS FOR AVOIDING PROBATE

The probate process serves the important purpose of administering a deceased person's estate. During probate, assets are accounted for, outstanding debts are paid, and property is distributed to heirs and beneficiaries, all with the oversight of the probate court. However, the probate process can be time consuming, costly, and open to public records. If these disadvantages of probate are a concern to you, note that there are other ways to distribute most your property to beneficiaries without going through probate. The law in Ohio allows you to make advance plans for transferring certain types of property outside of the probate process. In this bulletin, we begin by examining the costs of probate and then explain legal tools that allow you to avoid probate while guaranteeing that your assets transfer as you intend.

THE COSTS OF PROBATE

There can be time, privacy, and financial costs to sending farm assets through probate. In Ohio, it can take six months to a year or more for an estate to complete the probate process. Trying to continue a farm while its assets are tied up in probate for an uncertain amount of time can hinder a farming operation. Additionally, because a probate court oversees an estate going through probate, estate records are public records. Many consider this lack of privacy an additional cost of probate.

Of perhaps the most concern, however, are the financial costs for sending a farm estate through probate. The attorney that handles an estate can charge legal fees that are usually a percentage of the value of estate assets that go through probate. To limit the fees, Ohio law allows a county to set maximum probate fees attorneys can charge in the county. Even so, because farms tend to be "land rich," these legal fees can add up and amount to a significant cost. **Consider the example on the following page.**

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A county in Ohio sets the maximum fees an attorney may charge an estate in probate as:

For personal property including proceeds of real estate sold:

6% on the first $3,000
4% between $3,001 and $15,000
2% on the balance

For real property transferred but not sold:

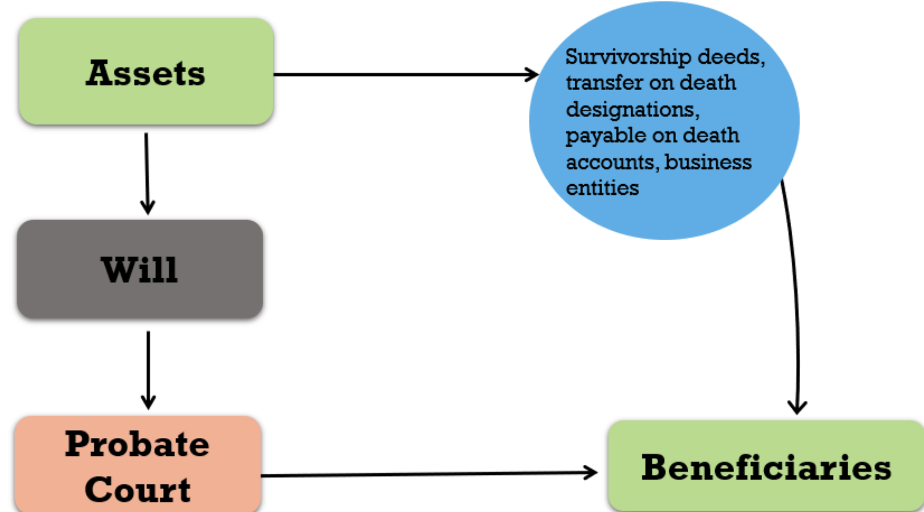
2% on the first $10,000
1% on the balance

For all other property transferred: 2% of the property value

Joe dies owning farmland valued at $500,000. The attorney could charge Joe's estate $5,100 in fees to transfer the farmland to his beneficiary.

AVOIDING PROBATE

Fortunately, there are several legal tools that can keep a farm parcel like Joe's and many other farm assets out of probate, reducing not just the financial costs but also the time and privacy costs of transferring assets through the probate process. Survivorship deeds, transfer on death designations, payable on death accounts, trusts, and business entities are the most common of these tools. We discuss trusts in another bulletin in the *Planning for the Future of Your Farm* series. The other tools, explained below, send assets directly to the intended beneficiaries rather than transferring through the estate administration process in probate court. The illustration below shows how the tools can keep assets out of probate court.



SURVIVORSHIP DEEDS

Ohio law allows co-owners of real property to pass their share of the property to the surviving co-owner(s) upon death through a survivorship deed, also referred to as a "joint tenancy with survivorship rights." This type of deed is common in a marital situation, where the spouses own equal shares in the property and each becomes the sole owner if the other spouse passes away first.

A survivorship deed is useful for other joint ownership situations in addition to marriage, whenever the owners want to ensure that their share goes only to the other co-owners upon death.

The process for establishing a survivorship deed is simple. The property deed must contain language expressing the intent of the joint owners to have survivorship rights. The language signals that the property is to transfer automatically upon death of a co-owner, making it unnecessary for the property to go through probate to accomplish a transfer of ownership. **Consider this example:**

> John and Jane are married and own farmland. The deed to the farmland states "to John and Jane Doe for their joint lives, remainder to the survivor of them." This language indicates an intent for the property to pass to the surviving spouse if the other spouse dies. Upon John's death, the property automatically vests with Jane, who becomes the sole owner of the property. The property does not have to go through the probate process to transfer to Jane.

TRANSFER ON DEATH AFFIDAVIT

Another instrument for designating a transfer of real property upon an owner's death is the "transfer on death designation affidavit." This affidavit allows property to pass to one or more designated beneficiaries if the owner dies. The process is simple but requires a few forms and steps. First, the owner must complete the affidavit and file it with the recorder in the county where the land is located. Then, upon the owner's death, the designated beneficiary must complete an affidavit of confirmation and present it to the county auditor and county recorder along with a verified death certificate for the deceased owner. Once the county recorder files the affidavit of confirmation, the beneficiary holds title to the deceased owner's share of the designated property.

TRANSFER ON DEATH DESIGNATION AFFIDAVIT
[RC 5302.22]

STATE of OHIO
COUNTY of ______________

______________________________________, owner, with a marital status of________________, now owner of record of the following real property located at ______________________________________ as recorded at Instrument No. __________________________ of _________ County deed records, with the following legal description:

Title of record to the above property is held by owner(s) as follows:
____ Sole owner
____ Tenant(s) in common
____ Tenant(s) in survivorship
____ Tenant(s) by the entireties

Hereby designates the following as transfer on death beneficiary to receive the owner's title to that property upon the death of the owner:
____.

VEHICLES

Ohio law also allows motor vehicles, boat, campers, and mobile homes to transfer outside of probate with a transfer on death designation made by completing and filing a Transfer on Death Beneficiary Designation (form BMV 3811) at the county clerk of courts title office. The beneficiary may be an individual, corporation, organization, trust, or other legal entity.

There is a special rule for automobiles owned by a deceased spouse that did not include a transfer on death designation. Upon the death of a married person who owned at least one automobile at the time of death, the surviving spouse may transfer an unlimited number of vehicles valued up to $65,000 and one boat and one outboard motor by taking a death certificate to the title office and completing a Surviving Spouse Affidavit (form BMV 3773). It is important to note that the deceased spouse provision only applies to automobiles used "as a method of conveyance." Grain trucks, trailers and other commercial vehicles are typically not permitted to transfer using this method.

PAYABLE ON DEATH ACCOUNTS

Farmers may have several other types of accounts that can pass automatically to identified beneficiaries. Checking accounts, savings accounts, stocks and bonds, IRAs, life insurance policies, and similar types of accounts can pass outside of probate if designated by the owner as "payable on death." The institution that holds the account requires an owner to complete the institution's forms to make a payable on death designation. As with transfer on death affidavits, the institution will require the named beneficiary to provide a certified copy of the owner's death certificate before transferring the account to the named beneficiary, and the account need not go through the probate process. Institutions often ask for beneficiary designations when a person opens an account, but owners may forget about these designations or fail to change them as circumstances change. For these reasons, it is good practice to review and update your payable on death designations regularly.

BUSINESS ENTITIES

The many advantages of using business entities are well known but avoiding probate is an often-overlooked attribute of business entities. Ohio law allows business entity ownership to be transferred outside of probate by making a transfer on death designation. This is most commonly done with ownership certificates or within the operating agreement. Upon the death of the owner, the ownership is transferred to the designated beneficiary with a simple transfer business document.
Consider the following example:

> Andy and Betty own XYZ Farms LLC. Andy wishes for his ownership to transfer to Betty upon his death. To avoid probate, Andy and Betty create ownership certificates for the LLC. Andy's certificate is titled "Andy, transfer on death, to Betty". This simple certificate with this simple phrase causes Andy's ownership to pass to Betty outside of probate.

Business entity ownership certificates can be relatively simple and are often drafted by the attorney setting up the entity. The certificates do not need to be recorded; they remain private business documents. Existing entities without certificates can create new certificates for a transfer on death designations. Upon establishing a new entity, certificates should be drafted to allow for a transfer on death designation.

NON-TITLED ASSETS

As the above discussion shows, Ohio law allows titled assets to avoid probate rather easily. However, farms have many untitled assets such as machinery, equipment, livestock, crops, and grain. These assets can be made non-probate, but it will require either a trust or a business entity.

The non-titled assets can be transferred to a trust then distributed to beneficiaries without the need of probate. In a similar manner, non-titled assets can be transferred into a business entity and the entity ownership certificates made to include a transfer on death designation. If neither a trust nor business entity is used, the non-titled assets will likely need to pass through probate upon the death of the owner.

REVIEWING YOUR NON-PROBATE TRANSFER OPTIONS

It's surprising to learn how much of an estate can transfer to beneficiaries without going through the probate process. Whether you need a simple or complex transition and estate plan, these tools will likely contribute to your plan. Review your assets and their transfer options with your attorney to see how these tools can help you plan for the future of your farm.

REFERENCES

Ohio Revised Code Section 5302.20, Survivorship tenancy
https://codes.ohio.gov/ohio-revised-code/section-5302.20

Ohio Revised Code Section 5302.22, Transfer on death deed form
https://codes.ohio.gov/ohio-revised-code/section-5302.22

Ohio Revised Code Section 2106.18, Transfer of vehicle by surviving spouse
https://codes.ohio.gov/ohio-revised-code/section-2106.18

Ohio Revised Code Section 2106.18, Transfer on death designation for business entities
https://codes.ohio.gov/ohio-revised-code/section-1709.05

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GIFTING ASSETS PRIOR TO DEATH

Gifting assets before your death may seem like an obvious strategy for those who want to transfer assets to their heirs. If you don't need the assets, why not transfer them now rather than after your death? It's true that gifting can be a good strategy for transferring assets, but gifting can have tax implications and transferring the same assets through an estate plan may be a better strategy. In this bulletin, we discuss how gifting works, gifts and taxes, and when it is advantageous to incorporate gifting into a farm transition plan.

WHAT IS A GIFT?

According to the Internal Revenue Service (IRS), a gift is property transferred to another without receiving the full value of the property in return. Just about any asset can be a gift. Cash is the most common gift but many farm families also gift machinery, livestock, grain, and land.

MAKING A GIFT

The process for making a gift depends upon the asset being gifted. Some assets can only be gifted by executing documents while other assets can be gifted by simply handing the asset over to the person receiving the gift. Here is a list of commonly gifted assets and how they are gifted:

- **Real estate.** May only be transferred with properly executed deeds.
- **Financial accounts**. Transfer forms must be completed with the financial institution.
- **Vehicles and trailers.** Title must be transferred, and a new title issued by the county Clerk of Courts title office. Note that some smaller trailers may not have titles.
- **Machinery, equipment, livestock, and grain**. These assets do not have titles, so they are transferred by giving possession of the asset to the giftee.
- **Cash.** Direct transfer of funds to the giftee.

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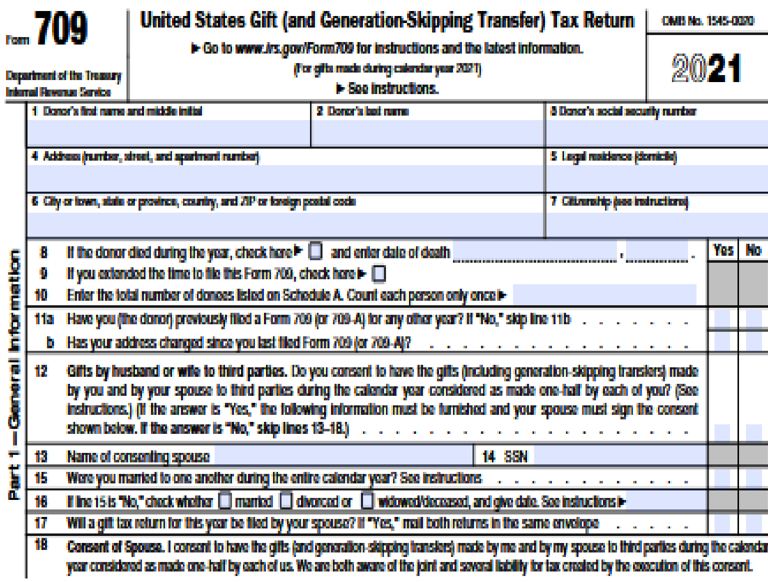
Regardless of what type of asset is gifted and how it transfers, it is good to keep a **written record** of the gift. Documenting the gift is important to avoid misunderstandings about what asset was gifted and helpful if there is an IRS audit. The written record should include a description of the gifted asset, the value of the gift, who is receiving the gift, and the date of the gift. For cash, consider using a check as further record of the gift. The person receiving the gift should also date and sign documentation to confirm that they have accepted the gift.

GIFTS AND TAXES

The gift tax. The federal government and many states assess a tax on gifts, but Ohio does not have a gift tax. The federal gift tax was developed to prevent individuals from avoiding federal estate taxes by gifting away significant assets prior to death. For this reason, it is the giver of a gift who is responsible for paying the gift tax. The gift tax begins at 18% on the first $10,000 and increases by 2% every additional $10,000, to 40% on gifts over $1 million. A giver uses IRS Form 709, pictured here, to document a gift that may be subject to gift tax.


Form 709
Department of the Treasury
Internal Revenue Service

United States Gift (and Generation-Skipping Transfer) Tax Return
▶ Go to www.irs.gov/Form709 for instructions and the latest information.
(For gifts made during calendar year 2021)
▶ See instructions.

OMB No. 1545-0020
2021

Part 1—General Information

1 Donor's first name and middle initial | 2 Donor's last name | 3 Donor's social security number
4 Address (number, street, and apartment number) | 5 Legal residence (domicile)
6 City or town, state or province, country, and ZIP or foreign postal code | 7 Citizenship (see instructions)

		Yes	No
8	If the donor died during the year, check here ▶ ☐ and enter date of death ______ , ______ .		
9	If you extended the time to file this Form 709, check here ▶ ☐		
10	Enter the total number of donees listed on Schedule A. Count each person only once ▶		
11a	Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If "No," skip line 11b		
b	Has your address changed since you last filed Form 709 (or 709-A)?		
12	**Gifts by husband or wife to third parties.** Do you consent to have the gifts (including generation-skipping transfers) made by you and by your spouse to third parties during the calendar year considered as made one-half by each of you? (See instructions.) (If the answer is "Yes," the following information must be furnished and your spouse must sign the consent shown below. If the answer is "No," skip lines 13–18.)		
13	Name of consenting spouse — 14 SSN		
15	Were you married to one another during the entire calendar year? See instructions		
16	If line 15 is "No," check whether ☐ married ☐ divorced or ☐ widowed/deceased, and give date. See instructions ▶		
17	Will a gift tax return for this year be filed by your spouse? If "Yes," mail both returns in the same envelope		
18	**Consent of Spouse.** I consent to have the gifts (and generation-skipping transfers) made by me and by my spouse to third parties during the calendar year considered as made one-half by each of us. We are both aware of the joint and several liability for tax created by the execution of this consent.		

Exceptions to the gift tax. The good news is that federal law grants many exceptions from the gift tax. A gift to a spouse or a political or charitable organization is not subject to the tax, nor is tuition or medical expenses paid for another. Additionally, federal law allows a certain value of gifted assets to pass free of gift taxes, referred to as the "annual exclusion." Gifts in excess of the annual exclusion may also be given tax free if they count toward the "lifetime exemption" from estate tax. Here's how these two types of gifts work:

1. **Annual exclusion gift.** The annual exclusion gift is truly a "free gift." A person may gift up to $16,000 annually to an unlimited number of people. These annual exclusion gifts have no gift or estate tax implications. Neither the person who gives or the person who receives the gift is subject to a tax. As an example, a person can gift $1 million tax free by giving the annual exclusion gift of $16,000 to 63 different individuals. Note that federal law indexes the annual exclusion gift amount and occasionally increases it by $1,000 as it did in 2022, when it increased from $15,000 to the current $16,000.

2. **Lifetime exemption gift.** Many people are surprised to learn that large gifts can also be free from gift tax by counting toward a person's lifetime exemption from federal estate tax. The lifetime exemption is the amount of wealth a person can have at death that is not subject to federal estate taxes, as determined by Congress and indexed and increased each year. For 2022, the amount is $12.06 million but in 2026, the current federal estate tax law is set to sunset and the exemption will be reduced by one-half.

Federal law allows the lifetime exemption to be "used up" during a person's lifetime. The amount of a gift that exceeds the $16,000 annual exclusion can reduce the giver's lifetime estate tax exemption by that amount when they die. If not, the amount of a gift over $16,000 can be subject to gift tax rates that start at 18% and increase to 40% on gifts over $1 million. People often choose to avoid the gift tax and reduce their lifetime exemption when making gifts over the annual exclusion amount.

The best way to explain these two important gift tax exceptions may be by using examples. **Consider the following examples**:

Example 1. John's net worth is $10 million at death and his lifetime exemption is $12.06 million. John's estate owes no estate taxes because his net worth is less than his lifetime exemption.

Example 2. John gives a single gift of $1 million to Daughter while alive and counts it toward his lifetime exemption. John's net worth at death is $10 million. The gift to Daughter was $984,000 over the $16,000 annual exclusion, which reduces his $12.06 million lifetime exemption by that amount to $11.076 million. John's net worth of $10 million at death is still less than his remaining lifetime exemption, so his estate will owe no estate taxes. The $1 million gift to Daughter was essentially a free gift because his net worth remained under the lifetime exemption.

Example 3. Same scenario as Scenario 2, but John dies with a net worth of $12 million. After the gift to Daughter, John's remaining estate tax exemption is $11.076 million. Now his net worth exceeds his remaining lifetime exemption by $924,000, so John's estate will owe federal estate taxes on that amount. John's large gift in this scenario had federal estate tax implications. Had he given Daughter the $1 million in smaller gifts to Daughter and her family over the years, John could have reduced the amount of

EFFECT OF GIFTING ON TAX BASIS

An asset's tax basis is generally the purchase price or its value when inherited, less depreciation taken. For example, a tractor purchased for $100,000 with $60,000 depreciation taken has a tax basis of $40,000 remaining.

The tax basis of an asset has significant tax implications. The higher the tax basis, the more depreciation can be taken and the less taxes owed when sold. Using the above example, if the tractor is sold for $70,000, the $40,000 tax basis is not taxed, only the $30,000 gain (sale price – tax basis) is taxed. The higher the tax basis, the less taxes are upon sale.

As noted above, the tax basis is usually established at time of purchase or inheritance. This is known as a "step-up" in tax basis because the tax basis is stepped-up to either the purchase price upon purchase or the fair market value upon death of the owner. This step-up in tax basis is particularly important when an asset is inherited because **when an asset is gifted, a step-up in basis does not occur**. For estates with no estate tax liability, an inherited asset with no estate tax also receives a full stepped-up tax basis. The person inheriting can re-depreciate the asset or sell the asset and pay no taxes on the sale, if sold for no more than the stepped-up tax basis. **Consider another example**:

> Bill inherited the tractor above from his father's estate. Prior to his father's death, the tractor had a tax basis of $40,000. The tractor appraised for $80,000 at the time of father's death, so Bill receives the tractor with a stepped-up tax basis of $80,000. Bill can either depreciate the tractor and offset $80,000 of income or sell the tractor for $80,000 and pay no tax on the sale. If Bill's father would have gifted the tractor to Bill during life, Bill would have received it with the lower $40,000 basis. From a tax perspective, Bill was better off inheriting the tractor rather than being gifted the tractor.

As these examples show, there can be negative consequences to gifting assets. Before gifting an asset, be sure to analyze all the tax implications of the gift. You may find that passing the asset by updating your estate plan is a better strategy for your heirs.

USING GIFTING STRATEGIES IN A FARM TRANSITION AND ESTATE PLAN

While gifting is not always the best tax strategy for farm transition plans, there are times when its advantages outweigh the loss of a step-up in tax basis. Gifting can be, and often is, an important part of a plan. The following scenarios illustrate situations where gifting can be a good option:

Transferring a depreciating asset. Sometimes the older generation owns machinery, equipment, livestock, or other assets that will lose value over time. Owning these types of assets also carries with them some degree of liability exposure. If an owner does not need income from the assets, it can make sense to transfer the assets now rather than upon death. In this situation, transferring the assets during life to remove the challenges of ownership outweighs the lost step-up in tax basis.

Gifting appreciating assets. For people who are close to or over the estate tax exemption, gifting appreciating assets can be a good strategy. If the asset is gifted now, the future appreciation of the asset is transferred out of the giver's estate. For example, a farm is gifted that is worth $1 million today but is expected to have a significant increase in value. When the value of the farm doubles, the additional $1 million in appreciation occurs in the giftee's estate rather than the giver's estate. The gift causes a loss of a stepped-up tax basis, but it is probably well worth it to avoid a 40% estate tax on the $1 million appreciation.

REVIEW GIFTING WITH YOUR LEGAL AND TAX PROFESSIONALS

Gifting can be a good tool to help build a farm transition plan, but sometimes it should be left in the toolbox. Be sure to have a discussion with your attorney and tax advisor before making any significant gifts. A thorough analysis can reveal tax implications for both you and the person receiving the gift.

REFERENCES

26 U.S. Code Subtitle B Chapter 12, Gift tax
https://www.law.cornell.edu/uscode/text/26/subtitle-B

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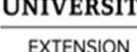

EXTENSION

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PLANNING FOR THE FUTURE OF YOUR FARM

Legal tools and strategies for farm transition and estate planning

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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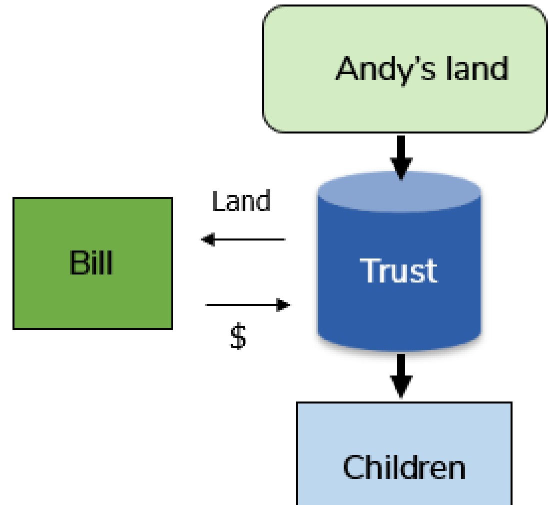
In this example, after Andy's death, his assets will be held in his trust and eventually distributed to out to his beneficiaries. While the assets are in the trust, the trustee will administer the terms and conditions of the trust as established by Andy prior to his death. Here's how the trust could 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 trust-based 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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PLANNING FOR THE FUTURE OF YOUR FARM

Legal tools and strategies for farm transition and estate planning

USING BUSINESS ENTITIES IN FARM TRANSITION PLANNING

A formal business entity can be a valuable tool in farm transition planning. Many attorneys advise forming a formal business entity to limit liability and manage taxes, but an increasing number of agricultural attorneys have found that business entities are excellent tools for transitioning the farming operation to the next generation. We explain business entities and how they can be used in farm transition and estate planning in this bulletin.

BUSINESS ENTITY BASICS

The farm business can be an informal structure, such as a sole proprietorship, or can be formally organized, such as a corporation or limited liability company. Each type of entity has its own set of liability protections, tax issues, ownership transfer processes, and other characteristics.

Sole proprietorships and general partnerships. Sole proprietorships and general partnerships are the simplest business entities, and according to the U.S. Census of Agriculture, the majority of U.S. farms are one of these two types. They are business entities that generally require no filing of paperwork with a state. While the details may vary from state-to-state, the characteristics of these types of entities are fairly consistent nationwide. They afford no liability protection to the owners because any liabilities of the business are also the personal liabilities of the owner, and taxes are assessed directly to the sole proprietors or the partners at individual tax rates.

By default, if there is no formal business entity, an individual who owns lands, equipment, and other goods to make a profit will own those assets as a **sole proprietor**. The sole proprietor is the business, and the business is the sole proprietor. The business has no existence beyond the sole proprietor, so when the proprietor dies, the business ends and the assets are divided up through the proprietor's estate. A sole proprietorship has limited usefulness in a transition plan because entities that are separate from the owners are best suited for farm transition planning.

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If two or more people own land, equipment, and other goods to make a profit with no formal business entity, then they own the business as general partners in a **partnership**. A partnership may or may not have a formal written partnership agreement. In either event, Ohio's Uniform Partnership Act provides laws that govern partnerships in Ohio and provides default rules if the partners haven't addressed them in a partnership agreement. In the eyes of the law, a partnership is a "person" and can own assets and conduct business as a person would. Partnerships are typically more flexible and less formal than corporations. A partnership may and often does continue after the death of a partner. For these reasons, a partnership can be an effective component of a farm transition plan.

The simplicity of sole proprietorships and general partnerships come with the tradeoff of **no liability protection**. The sole proprietor is personally responsible for any liability of the business because there is no separation between the proprietor and the business. In a general partnership, all partners can be personally liable for any losses, debts, or mistakes related to the business and the other general partners. For example, if one partner signs a contract for the partnership, the other partners are bound to and personally liable for the contract.

Corporations. A corporation is an organized business entity with a separate legal status from its owners. Corporations have the right to buy and sell property, carry debts, enter into contracts, and more. This is why we hear the phrase "corporations are people." Shareholders own the corporation and typically elect a board of directors who in turn select officers to run the day-to-day operations of the corporation. Shareholders have limited liability and are only liable for losses up to their investment in shares.

State laws governing corporations can be rather complex and burdensome. The shareholders and board of directors must hold annual meetings and keep detailed records of meetings and activities. Corporations are typically governed by majority rule, such that the owners of 51% of voting stock decide how the corporation operates.

There are two primary types of corporations: C-corps and S-corps.

1. **C-corps** are taxed directly, but shareholders are also taxed on any dividend they receive, which results in double taxation. When people think of a corporation, they often think of C-corps.
2. **S-corps** are a sub-set of corporations with special rules. People often refer to these as closely held corporations because they may have no more than 100 shareholders and have pass through taxation. S-corps may not have corporate shareholders and can only issue one class of stock.

Limited liability companies. A limited liability company (LLC) combines features of partnerships and corporations, and many attorneys describe the LLC as the best of both worlds. Like a corporation, an LLC is an organized business entity that has a legal status separate from its owners with personal liability protection for the owners. Like a partnership, owners of an LLC can create flexibility in how the LLC is governed. For taxation, LLCs may choose to be taxed directly like a C-corporation or to pass taxes to the members as in a partnership or S-corporation.

LLCs are the entity of choice for most new farm businesses, for many reasons. We discuss the usefulness of LLCs in transition planning in the rest of this bulletin, but be aware that there are times when a partnership or corporation may be a better choice than an LLC. The concepts we discuss below can apply similarly to partnerships and corporations.

USING THE LLC FOR FARM TRANSITION PLANNING

LLCs allow for considerable creativity when designing a farm transition plan. Here are several roles an LLC can play in carrying out the goals of a farm transition and estate plan.

1. Protecting farmland

No asset is more important to a farmer than the land. An LLC can protect the land for future generations by preventing any one family member from forcing the sale of the land and making it difficult to transfer land unless the family collectively agrees to do so. But leaving land to family members outright to own jointly exposes family land to risk**.** That's because Ohio's **partition law** allows a co-owner of land to ask the court to sell the land and divide sale proceeds among the owners. A co-owner can seek partition regardless of what share they own, as can successor owners and creditors. With partition rights, the original co-owners and their spouses, heirs, and creditors all have the ability jeopardize the goal of keeping land in the family.

An LLC removes the risk of partition. Ohio law grants partition rights only to co-owners of land, not to co-owners of an LLC. When land is placed in an LLC, partition rights are extinguished because the LLC owns the land rather than the individuals co-owning the land. The owners of the LLC do not have the ability to use the partition law to force the sale of the land. **Consider the following examples!**

*Example 1***.** Mom and Dad want to leave their farmland to their three children. They have a simple will that gives all the land to the three children as co-owners. After the parents die, Arthur, one of the children, decides that he would rather have money than continue to own the land. The other two children are unable or unwilling to buy Arthur out at his asking price, so Arthur files a partition action. The court orders the land to be sold at a Sheriff's sale and the sale proceeds to be divided among the three children. The family no longer owns the land.

Example 2. As above, Arthur is a co-owner of the land given by Mom and Dad to the three children. Arthur gets into financial trouble and must sell his one-third of the land to pay his creditors. Arthur files for a partition so that he can receive his value of the land in cash to pay the creditors. The family no longer owns the land.

Example 3. Mom and Dad put their land in an LLC. Their three children inherit the LLC. Now, when Arthur wants to sell, he does not have partition rights. Arthur is an owner of the LLC, not a direct owner of the land. The only way Arthur can cash out is if one of the other owners agree to purchase his ownership. If Arthur gets in financial trouble, his creditors do not have partition rights and cannot force the sale of the land. At most, the creditors are only entitled to Arthur's share of the profits from the LLC. The family continues to own the land.

2. Discounting value

An LLC can be used to decrease the value of assets. This is important when a person's net worth exceeds the federal estate tax exemption. All wealth exceeding the federal estate tax exemption is taxed at 40%, so it is important to make all efforts to minimize the negative effect the estate tax can have on the goal of transitioning the farm to the next generation.

An LLC can decrease net worth with a concept called **discounting**. Essentially, the value of the ownership in a closely held company is discounted to be less than the value of the assets in the company. This is due to minority ownership, shared management, and transfer restrictions of the LLC ownership, all factors that reduce values. Discounts can be as high as 30-40%, which can minimize the risk of estate taxes being assessed on farm assets. **Consider this example**:

> Mom and Dad own a farm and their net worth exceeds the federal estate tax exemption by $1 million, so their heirs will owe $400,000 in estate taxes upon their death.
>
> Mom and Dad own 500 acres of land valued at $5 million. They put the land in an LLC, and each holds 50% ownership in the LLC. They also set up the LLC so that a decision requires a majority vote and ownership interests can only be transferred to direct family members. Neither Mom nor Dad have majority ownership or control, and each is limited as to whom they can transfer their ownership – all important factors to obtaining a discount.
>
> Let's assume a 35% discount applies to Mom and Dad's LLC ownership interest because the discounting factors exist. Now, instead of owning land valued at $5 million, they co-own an LLC worth $3.25 million. Mom and Dad have reduced their net worth by $1.75 million by placing their land in the LLC. They have given up little to receive a significant reduction in the value of their estate.

3. Designating management

An LLC can also designate the future managers of the farming operation or its assets. Not all beneficiaries of a transition plan may be qualified or willing to manage the farm's assets, or maybe the beneficiaries don't get along well and wouldn't make joint asset management decisions easily. An LLC can address these issues by determining who will have management and decision-making authority. **Consider this example:**

> Mom and Dad want their three children to jointly inherit their farmland. Two children live out-of-state and have never been involved with the farm while the third child lives locally and has been involved. Mom and Dad's transition plan transfers the land to an LLC, makes the children owners of the LLC, and designates the local child to be the manager of the LLC.
>
> The management provisions help ensure that the land will be managed properly and the out-of-state children's unfamiliarity with the land will not cause disruptions or poor decision making.

4. Removing the need for a trust

Many farm transition plans include a trust as the primary estate planning document, as we explain in other bulletins in this series. Using a trust can avoid probate and include terms and conditions for the distribution of assets at death. But in some cases, an LLC can negate the need for a trust. Like a trust, an LLC can avoid probate and contain ownership restrictions, management responsibilities and other terms and conditions. An LLC may also save time and legal fees. An LLC can replace a trust, or sometimes LLCs and trusts are used in combination in a transition plan. Before assuming that you need a trust, explore the possibility of using business entities instead. **Consider this example**:

Mom and Dad want their children land to inherit their farmland. They don't want the land sold outside of the family and want one specific child to manage the land. Instead of a trust, Mom and Dad establish an LLC with their required terms and conditions and make ownership of the LLC "transfer on death" to their children. The children inherit the LLC without going through probate and are subject to the transfer and management terms of the LLC. Mom and Dad accomplished their transition plan without the use of a trust.

5. Balancing assets between heirs

LLCs can also be used to balance assets between farming heirs and non-farm heirs. For farm families, it can be difficult to provide a fair inheritance to non-farm heirs without including at least some farm assets. Farm assets, such as land, can be put into an LLC. Then, the non-farm heirs are provided ownership in the LLC, perhaps even a majority. The farming heir is provided at least a small percentage of ownership and may have the ability to prevent the sale of the land or have an option to buy out the non-farm heirs. LLCs can provide non-farm heirs ownership of farm assets without the risk of those assets leaving the farm. **Consider this example:**

Mom and Dad own a farm business that includes machinery, livestock, and land. They have three children–Bill, Chris, and David. Only Bill is involved with the farm and will continue it after Mom and Dad's deaths. Like most farmers, Mom and Dad's wealth is almost entirely wrapped up in the farm. If Bill were to inherit all the farm assets, little value would be left for the inheritance of Chris and David. However, if Chris and David were to inherit two-thirds of the farm assets, it could jeopardize Bill's ability to continue a viable farming operation.

Mom and Dad establish an estate plan where Bill will inherit all the machinery and livestock. They form an LLC for the land and grant ownership shares to Bill, Chris, and David, with Chris and David receiving a larger share to offset the machinery and livestock Bill received. The LLC names Bill as the Manager and allows the land to be leased back to Bill.

In this scenario, the land LLC allows Chris and David to inherit farm assets without being able to interfere with Bill's farming operation. Chris and David will receive their share of the land rent, but Bill will retain control over the land. This strategy provides farm assets to non-farm heirs while leaving control of the farm with the farming heir.

FORMING A BUSINESS ENTITY

The internet is full of advice and fill-in-the-blank forms for forming a business entity. It's a decision that requires more than an internet search, however. Your attorney is a necessary resource not just for selecting an entity that carries out your goals, but for designing your entity so that it does what you want it to do. An attorney can tailor the legal documents for your business entity to your goals, ensuring that they contain the appropriate provisions and mechanisms to achieve those goals.

Choosing the right business entity for you, your family, and your farm is an important step in the farm transition planning process. An LLC is one type of entity that can help protect farmland, minimize estate tax risk, designate management authority, and keep assets out of probate. If any of these goals are in your farm transition plan, be sure to review them with an attorney who can help you design the entity that fits your plan for the future of your farm.

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PLANNING FOR THE FUTURE OF YOUR FARM

Legal tools and strategies for farm transition and estate planning

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.

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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 long-term 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 on-farm 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.

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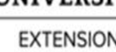

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PLANNING FOR THE FUTURE OF YOUR FARM

Legal tools and strategies for farm transition and estate planning

STRATEGIES FOR TRANSFERRING EQUIPMENT AND LIVESTOCK

Machinery and livestock can be the most challenging farm assets to transfer to the next generation. That's because transferring these assets during life can have negative tax implications but waiting to transfer them at death can have timing issues for the farming operation. For many farmers, there is no perfect solution. However, there are several strategies that can pass your machinery and livestock to the next generation while addressing your goals for your farm transition situation. In this bulletin, we present these strategies and review the advantages and disadvantages of each.

DETERMINE YOUR GOALS

While land is often a farm's most valuable asset, equipment and livestock are also significant assets on a farm's balance sheet. What are your goals for these assets? Assessing your current situation and determining your goals for transferring equipment or livestock is an important step in planning for the future. Ideally, your equipment and livestock goals will fit well with the other pieces of your farm transition or estate plan.

Consider these questions to help define your goals:

- Do you need income from the assets? If so, when do you need that income?
- Do you want to transfer the assets now to help the next generation?
- Do you want to keep control of the assets until your death or use them to some degree?
- Do you want to reduce your costs and liability risks for the assets?

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STRATEGIES TO IMPLEMENT YOUR GOALS

If you have a good idea of your goals, consider the different strategies that can help you accomplish those goals. Each strategy has advantages and disadvantages and analyzing these factors can help you decide which strategy best fits your goals and your farm transition plan. This can be a cyclical process, where understanding the implications of a strategy might alter your goals for transferring the assets.

1. Outright sale

Selling the assets outright is always an option. The advantages of an outright sale are that it generates income and relieves the owner of liability and the costs of maintenance. Additionally, selling now allows the next generation to use the assets for their current farming operation.

As for disadvantages, selling equipment and livestock means you no longer control that asset. Especially for equipment, you may have to buy, lease, or borrow in the future if you still have need for the equipment. However, the major disadvantage to selling equipment and livestock outright is that it will likely create a significant tax bill if the assets have little or no tax basis. When the assets are sold, there can either be capital gains or depreciation recapture issues. **Consider the following example:**

> Farmer bought a tractor for $100,000 and has taken $90,000 of deprecation on the tractor. Farmer sells the tractor to Daughter for $70,000. Farmer will pay ordinary income tax on $60,000 of depreciation recapture, which is the sale price less the remaining tax basis in the tractor ($70,000 - $10,000 = $60,000).

2. Installment sale

Installment sales provide the benefit of income but instead of generating that income all at once, you receive it through a number of payments over a certain period of time. This period could be months or even years, giving you a steady flow of income. But an installment sale often advantages a buyer because it can help the buyer meet cash flow needs. If you're trying to transition the operation to the next generation, an installment sale is likely to help them be able to purchase the assets.

A disadvantage of an installment sale is that you still run into the problem of depreciation recapture. Even though you receive income over a period of time, the Internal Revenue Service (IRS) considers an installment sale to be complete in the year of you transfer the asset. You must pay all depreciation recapture that first year. Installment sales should be closely scrutinized with a tax professional. Many farmers who make an installment sale without tax advice may be unpleasantly surprised that the recapture is due in year one. **Consider the example on the following page**:

Farmer sells his tractor to Daughter for $100,000, with $25,000 due now and $25,000 due every January 1 for the next three years. Farmer has completely depreciated the tractor so that it has a $0 tax basis. The sale will create $100,000 of depreciation recapture (sale price of $100,000 less remaining tax basis of $0). The IRS treats Farmer as having realized a $100,000 financial gain in the year of the sale. Even though Farmer will not receive the full $100,000 for three years, Farmer must pay the full income tax on the depreciation recapture in year one.

3. Gifting

If you do not need income from your equipment or livestock and there is someone you wish to receive the asset, gifting may be a good strategy. Because you are not gaining financially from the gift, there are no capital gains or depreciation recapture taxes due on the transfers. There may be federal estate tax implications in the future, however. Gifts exceeding the annual gift tax exclusion allowance, currently $16,000 per gift, will either trigger a gift tax or reduce your federal estate tax exemption. Also, the person receiving the gift does not receive a stepped-up tax basis in the asset. For a detailed discussion on the strategies and implications of gifting, see the *Gifting Assets Prior to Death* bulletin in this series.

4. Inheritance

Anther strategy if you do not need income from the asset is to transfer it at death through your estate. This strategy gives you control of the asset until your death, so is useful if you still need the asset. One disadvantage is that you remain responsible for maintenance, repairs, and liability.

There are clear advantages to the heirs who receive equipment and livestock through inheritance—the assets will have a stepped-up tax basis equivalent to the fair market value of the asset at the date of death. By inheriting the asset with a stepped-up basis, the recipient can re-depreciate the asset or sell it right away and pay little or no taxes. **Consider the following examples**:

Scenario 1. Farmer owns a tractor that he had fully depreciated. When Farmer dies, the tractor's fair market value is $100,000. Daughter inherits the tractor. She receives the tractor with a stepped-up tax basis of $100,000. She now has $100,000 she can use for depreciation, or she can sell the tractor for $100,000 and have no tax on the sale since the tax basis and sale are both $100,000 and there is no gain to tax.

Scenario 2. Farmer gifts the tractor to Daughter while he is still alive. Daughter receives the tractor with Farmer's $0 tax basis. She cannot depreciate the tractor and if she sells the tractor, she will pay income tax on the depreciation recapture.

5. Lease-to-own

A lease-to-own agreement appears similar to an installment sale in that the owner receives income from the arrangement over time and the buyer possesses the equipment, but a primary difference between an installment sale and lease-to-own is the tax implications. The tax treatment of a lease-to-own agreement differs from an installment contract in two ways. First, the IRS considers the lease payments that the owner receives to be ordinary income taxable in the year received. Second, the lease payments are fully deductible to the buyer. Another difference is that the purchase in a lease-to-own strategy occurs at the end of the lease term. Instead of having to pay all the depreciation recapture up front, the owner pays these taxes at the end, when the value of the machinery has significantly declined. While the IRS assesses all taxes on the gain from an installment contract in year one, a lease-to-own agreement allows you to spread out the tax burden. **Consider the following example:**

> Farmer owns a tractor valued at $100,000. He leases the tractor to Daughter for seven years for $10,000/year. Farmer also gives an option to Daughter to buy the tractor at the end of the lease. The value of the tractor will be determined at the end of the lease when its value is less.
>
> Farmer will report $10,000 of income for each year of the lease. Farmer will pay depreciation recapture on the sale at the end of the lease, based on the value of the tractor at that time.

There are a few possible disadvantages to a lease-to-own agreement. First, the owner continues to retain ownership of the asset until the term of the lease has ended and the purchase is complete. By continuing to own the asset, the owner retains liability for it. This liability can be limited with liability insurance or an LLC. Second, the owner may still be responsible for maintenance and repair depending upon the terms of the lease arrangement.

Compared to other strategies, a lease-to-own agreement is also a bit more complicated because it requires the preparation of a lease and a later sales contract with a method for determining the purchase price when the lease ends. It is important that the lease be legitimate and charge a reasonable lease rate. Also, the option to purchase the lease asset at the end of the lease must use a reasonable method to determine the value of the asset at the end of the lease. Leases and options that use less than fair market value can be scrutinized and challenged by the IRS.

6. Transfer to a Limited Liability Company

A Limited Liability Company (LLC) can be a useful tool to transfer equipment. In this scenario, the owner transfers the machinery into an LLC. Then, the owner sells a percentage of the LLC each year to the recipient. The sale of the LLC ownership spreads out the potential tax liability and provides some liability protection to the owner. **Consider the following example on the next page:**

Farmer owns several pieces of machinery worth $500,000. He transfers the machinery into an LLC. He then agrees to sell 10% of the LLC each year for the next 10 years to Daughter.

Generally, the sale of the LLC ownership will be subject to capital gains. However, the tax paid on the sale depends on the type of asset in the LLC and other factors. The tax implications of the strategy should be fully explored with a tax professional.

There are two potential disadvantages of this strategy. First is the cost of setting up a new LLC and administration costs of operating an LLC. Second, this strategy causes the owner to become a business partner with the recipient for as many years as the transition takes.

ASSESSING THE STRATEGIES

There are many strategies for transferring ownership of equipment and livestock out of your hands and to the next generation. Using one or a combination of strategies might help you accomplish your goals. Assess each scenario carefully with your professional advisors and heirs to find those strategies that accomplish your goals for planning for the future of your farm.

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