Estate Planning for **Farmers**

11 Reasons Why Every Farmer Needs An Estate Plan, Now!

LEGACY ASSURANCE PLAN

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Farmers Have Different Needs

EState planning for farmers is really about estate planning for farm families. A primary planning goal of almost every farmer is to keep the farm in the family. The focus is on the land itself instead of the business. Planning for the generational transfer of ownership and management succession at incapacity or retirement, however, needs to be a part of every small business owner's estate plan, especially farmers. A farming operation, however, is more than just a business, and planning for its transfer involves issues unique to this type of business. Farmers generally have a different outlook than other small business owners about their business and its future. Farmers often see farming as a mission and not just a job. Farm families are also different from non-farm families. The differences between on-farm and off-farm children are often more pronounced than those of children who are and are not involved in another type of family business. Farms are also usually cash poor and property rich, limiting some planning opportunities. Finally, farming also involves a range of federal programs that often provide substantial compensation to the farming operation but complicate transfer and succession planning.

Farmers often see farms as more than just a job, business or valuable economic asset, especially those that have been in their family for multiple generations. The farm's owners are usually concerned more about preserving the farm (land) for future generations instead of providing a substantial monetary inheritance to their children. Farming is also a very difficult livelihood, and farm owners may believe the next generation also shares their mission, when farming, as opposed to farmland ownership, may not appeal to them.

Every farm and every farm family are different.

Like all estate planning, farm planning may need to involve the entire farm family discussing the issues and being aware of the plan. Both the on- and off-farm children need to be aware of the plan so that they can order their affairs accordingly. The resulting plan must clearly and completely document the rights and responsibilities of the parties. Farm families should work with an experienced attorney who is knowledgeable of their unique issues and develop a plan that meets their individual goals.

Planning for farm families is further complicated because farming operations usually include participation in a number of government crop programs with specific requirements. The amounts available under these programs is usually tied to the number of people actively involved with farming. For example, many farms are enrolled in one or more U.S. Department of Agriculture (USDA) crop programs, which can pay significant amounts to the farmer. Ownership changes – for example, to a revocable living trust or limited liability company (LLC) – often reduce the annual payment if the estate plan does not take the programs' requirements into consideration. That's because these payments are based, in part, on the number of people actively engaged in farming. For example, if four siblings own the farm, that's four individuals, but if a four-member LLC owns it, that's one individual and payment is one-fourth the original amount unless documented properly. Additionally, estate plans need to specifically authorize an agent, executor or successor trustee to sign USDA documents shortly after the farmer's death. Unlike the plans for other types of small businesses, an estate and succession plan for a farm needs to address government programs in addition to asset management and distribution.

Avoiding Common Planning Mistakes

Farmers can make a number of mistakes when creating an estate plan. When the farmer passes away without a will, his estate is subject to intestacy. Until an administrator is appointed by a court, which can take several weeks, no one is authorized to operate the farm, which could be catastrophic at planting or harvest time. If the decedent operated the farm as a sole proprietorship, no one would be able to access the bank accounts, and the various relationships with service companies and supply vendors may be based on personal relationships instead of written agreements. Intestacy also treats all children the same, which may not reflect the family's on-farm and off-farm children dynamic. The unfortunate result is often the sale of the farmland at "fire sale" prices during the probate process.

The most common estate planning mistake made by farmers is not planning at all.

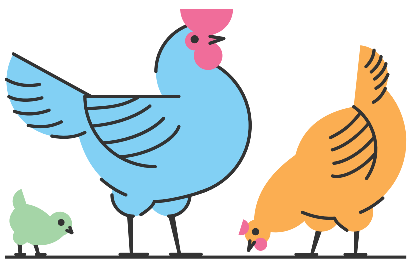
Many farmers' estate plans consist of deeding the farm to one or more of their children during their lifetime with the expectation that they will be allowed to continue living on the farm and receiving a share of the income. This transfer plan has negative gift tax, income tax and liability implications. Gift taxes apply on any gift of more than $15,000 per year (2020) per person. In 2020, the lifetime gift tax exemption is $11.58 million, so if total gifts exceed that amount, a 40% gift tax may be due. While it's unusual for a lifetime farm transfer to result in gift taxes, it does have significant income tax implications. Farmland received as a gift keeps the cost basis of the prior owner. Farmland received as an inheritance receives a stepped-up basis to current fair market value at time of transfer. For gifted property, additional capital gains taxes will likely be owed if the new owner sells part of the farm. Additionally, the farm is now exposed to the child's life events like divorce, bankruptcy and being sued because of a car accident. Each of these events can result in the loss of the farm or its transfer outside of the family.

Another common mistake is planning with just a will. Wills are subject to the probate process, so

the family farm will be subject to the costs, delays, publicity, lack of control and hassle of the probate system. Typically, probate costs between 3-8% of the estate's total value. For a farm, that could be a substantial amount, especially if an appraisal is required. Farming operations tend to be illiquid, so the money to pay for the costs of probate may be unavailable or require the sales of land or equipment needed for the farm. Or, the money can be borrowed, which places the farm under financial strain at the same time as an ownership change. It can take several weeks to get a personal representative appointed and up to 18 months to complete the probate process. During these delays, farm operations may be difficult because the issues of authority and ownership are not finally determined. Probate is public, so the farm family's personal and financial information will be exposed to public view. The farm family will lack full control since the probate judge needs to approve their actions and the farm's disposition. Finally, in addition to the hard work of operating a farm, the farm family needs to deal with the hassle of a court process. All of these issues increase the chances that the farm may be transferred away from the family.

Some farmers use a revocable living trust as part of a comprehensive plan but make the mistake of doing so without an attorney who is experienced with the specific needs of farmers. If properly drafted and funded, the trust will allow the transfer of the farm to the intended beneficiaries without the probate process. The successor trustee clearly has control over all assets which are funded into the trust and can sign any necessary farm program documents. The farm's transfer is private and without the hassle of a court process. The mistake usually comes from incomplete funding and failure to properly consider the various farm program payments. Farms own and use a lot of very valuable property that does not have a title and still needs to be funded into a trust, like livestock, tractors and combines. If these items are not funded into the farmer's trust, using a Bill of Sale for example, these items may be subject to the probate system and its costs, delays, publicity, lack of control and hassle. Worse, the farm family would be both subject to probate and the need to settle the trust. Unless its drafted properly, funding the farm into a trust can result in fewer individuals being counted as actively farming in calculating farm program payments, reducing the amount received by the farm family. The farm family needs to work with an experienced attorney to avoid probate, authorize uninterrupted farming operations and prevent the reduction of payments under any of the farm programs.

Another common mistake is to force the children into business with each other. Equal ownership of the farm means equal responsibility for the farming operation. This is especially problematic if the farm family includes on-farm and off-farm children. If the children have a strained relationship, it is unlikely to get better after their parents' deaths. When farmers conduct estate planning, the family needs to discuss the goals for the farm and then determine what's best for the farm family. Only the children who can work together and want to work together should be in business together. A "handshake" deal or "family agreement" can result in problems as children's financial and legal needs change that potentially can disrupt the farm's operations. A trust or limited liability company (or both) can provide more structure as circumstances change to avoid costly disputes between unwilling business partners.



Farming operations often involve renting land from someone else or renting the farm's land to someone else. These transactions could represent a major part of the farming operation's cash flow. The mistake is a failure to properly document these relationships. When one of the parties dies, the other could "forget" about the arrangement or decline to renew it with the farm's new owner. These key financial relationships need to be placed in written agreements that address the incapacity and death of the current farmer. These agreements also need to be integrated into the farm family's overall estate plan to keep the farm in the family and make it financially viable after the current owner's passing.

Ensuring Proper Ownership Structure

Direct Ownership vs. Entity (LLC) Ownership

Many family farms are owned directly by the farmer. Other farms are owned by an entity, usually an LLC. LLC ownership can cause problems without proper planning and communication. It would be very frustrating for the on-farm child to be told how to operate "his" farm by his siblings who live in different cities. This could lead to the on-farm child operating the business without following the appropriate formalities, losing the protection of an LLC's liability shield. An entity structure can also offer opportunities to achieve the parents' goal for equal treatment of the on-farm children and off-farm children without disrupting the farm's operations. If the farm is

If the on-farm and off-farm children are given equal ownership in the entity at the farmer's passing and have different goals and ideas about operating the farm, it can inhibit the farm's operation.

owned by an LLC, it can be structured with voting and non-voting members so the on- and off-farm children have equal ownership, and get an equal share of the profits, but only the on-farm child has the authority to operate the farm. The on-farm child can also be given a salary as the LLC's manager to compensate them for their actual work on the farm. As manager, the on-farm child can operate the farm as they feel is appropriate and still follow the necessary formalities to maintain an LLC's liability shield. The parents' goals of equal ownership among their children and continued family ownership of the farm can also be met.

Another alternative to direct ownership is to separate the farming operation into two separate entities: one that owns the land while the other owns and purchases the equipment, tools, implements and supplies needed to operate the farm. The operating LLC also purchases the necessary grain and livestock. The operating LLC enters into a detailed written lease with the land LLC and deducts the amount of that rent from its income. The current owners give the off-farm children a percentage of the land LLC with a first right of refusal to the on-farm child if the off-farm children chose to sell their interests. The on-farm child alone receives the operating LLC, so he or she can operate the farm without the input (and "interference") of their siblings. The siblings also lack the authority to force the sale of the land to the highest bidder and the on-farm child can buy their siblings out if they decide to sell. This structure can also be tax-efficient since the operating LLC can deduct the rent as a business expense, while the owners of the land LLC will not be subject to self-employments tax, since collecting rent is considered a passive activity, not an active business. This structure also meets the parent's goals of keeping the farm in the family and treating their children equally, while avoiding many of the issues caused by direct, equal ownership by all of the children.

Having a Succession Plan

In addition to being a valuable asset – land – a farm is also a business. A farmer's estate plan needs to address the continued management of the business at his retirement, incapacity and death. A simple will does not accomplish these objectives. Operating the farm as one or more manager managed LLCs can facilitate the management succession plan and process. The operating agreement of a manager managed LLC clearly defines the role and duty of the manager. It can also name one or more successor managers and the circumstances under which they become the manager. This structure allows the farm's operations to continue without interruption when the farmer retires, becomes incapacitated or passes away. The farm's business is not "paused" while waiting for the court to appoint a guardian, administrator or personal representative. And the business' agreements remain valid, while someone is clearly authorized to enter new ones. Additionally, the farmer's other children, who may become part owners of the farm on his passing, cannot interfere with the on-farm child's (manager's) operation of the farm.

Farmers usually believe they need to own the land. It can be difficult, however, for the on-farm child to secure sufficient capital to buy the land from either their parents or their siblings. An alternative is for the on-farm child to enter into a long-term lease of the farm. The lease is signed between the farmers (parents) and the on-

farm child for a period of years with clearly spelled out terms. The on-farm child would acquire control of the farm at much lower costs then needed to buy the farm for fair market value from either their parents, the farmer's estate or their siblings. The lease would need to be very detailed to avoid disputes after the farmer dies. For example, to avoid disputes both with the state Medicaid agency and the off-farm children, the rental rates can be tied to the USDA's information in farm rental rates. It would need to include provision for its term, renewal, purchase option, who owns equipment, who gets farm program payments, who pays the property taxes and utilities, who maintains the fences and mows the ditches, who handles the weeds and other farm-specific topics. Documenting these details can reduce the chances of a dispute among the siblings after the parents' passing regarding who is responsible to pay what.

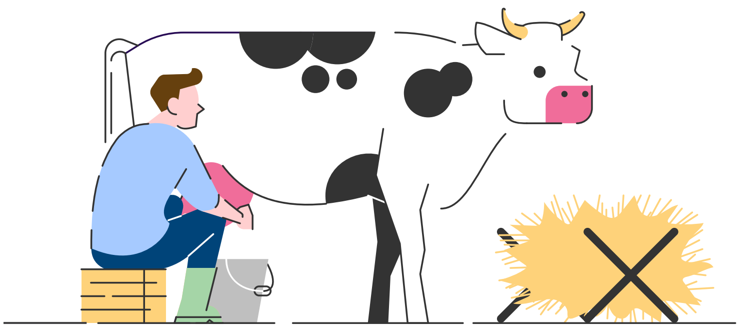
The farm's business plan needs to reflect the farm family's dynamics, needs and goals, which are often different from other family business situations.

A life estate is another succession plan tool, but it's less advantageous than the other options, especially if the current owner becomes incapacitated. A life estate is easy to create. It's created by recording a deed which transfers ownership of the property to another person(s), known as the remainderman, while retaining the right to occupy the farm for the rest of your life. For a family farm, the land is transferred to the farmer's children as the remaindermen. When the life estate holder dies, the property fully belongs to the new owners without probate. In addition to being quick and cost-effective, a life estate can usually lower an asset's value for Medicaid qualification purposes. Life estates, however, have some significant disadvantages. The remaindermen don't have authority over land at the life tenant's incapacity. A guardian may be needed to have someone authorized to run the farm. They are irrevocable by the original owner alone. The life estate holder cannot sell the property, and it's highly unlikely that a mortgage could be obtained. The property is now owned by the remainderman and subject to their life events including divorce, bankruptcy and judgments. A revocable trust and LLC are much more flexible and advantageous alternatives, despite their higher initial cost.

Generating Retirement Income

Farmers often lack a "nest egg" other than the farmland itself, so when it comes time for the next generation to take over the operation of the farm, the parents still need to receive income from it. The farm's ownership transfer and succession plan can be structured in a number of ways to achieve this goal. A multiple-entity LLC structure can be used as a retirement plan to provide income to the parents while one or more children operate the farm. The parents retain ownership of the land LLC while the on-farm children get the farming LLC. The farming LLC pays rent to the land LLC, which is distributed to the parents as their retirement income. The children can pay themselves a salary as managers from the farming LLC to provide income. If they want to forego the multiple-entity route, the parents could sell the farm to the children using a promissory note. The children's payments on the note are the parent's retirement income. The note can provide that any unpaid amount at the parents' deaths is forgiven. The major problem with this type of planning is that the parents are totally dependent on the children for their income and no longer own the farm itself. It can also cause issues about who is responsible to maintain the parents' home if it's located on the farm.

Balancing Differences Between On-Farm and Off-Farm Children



One of the most troublesome issues for the inheritance and succession planning for a farm family is being fair to the on-farm and off-farm children.

The parents generally want to be fair (which usually means equal) to all of their children, but the estate's value is usually dominated by the farmland, making equal distribution difficult. The parents also need to consider the difference between being fair and being equal. The on-farm and off-farm children have likely made very different contributions to the farm's success while the parents are alive. The on-farm children may have contributed livestock, tools, seed and equipment in addition to their actual time working on the farm. The on- and off-farm children may also have very different views on the future value and use of the farm. The on-farm children may want to continue the operation as a farm, while the off-farm children may want to sell the land, especially given rising land prices. The on-farm children have likely substantially contributed to the farm's recent success, making an equal distribution of the farm itself to all children unfair to them. If the farm is left to all of the children equally, the on- and off-farm children (now joint owners) may have different ideas on how to maximize the farm's value. The on-farm child may want to invest in seed or equipment, while the off-farm children may want to repaint the house, barn and other buildings to increase its sale value. A farm is unlikely to generate sufficient funds for both goals. Plus, the on-farm children will likely resent their siblings' involvement in the operation of "their" farm. The resulting disputes will cause both family strife and economic trouble for the farm.

The parent's estate plan will need to be drafted to address the fair versus equal issue in light of the parents' goals and farm family's dynamics. Do they want to treat the children fairly or equally? Do the children expect to own the farm equally? Would equal ownership be fair to all of the children? It will likely require discussing the future of the farm with the children. The on-farm and off-farm children both need to know where they stand and what to expect. An equal distribution, by value, is unlikely given that alternative assets may not exist equal to the farmland's value to allow the on-farm child full control. If the on-farm children are getting the land, what about the tools and equipment? The off-farm children can also receive the house (if it's not on the farm), any other business and personal accounts and assets, for example. Estate litigation often results from expectations not being met. The parents will need to explain why an unequal distribution of the farm and estate is fair to all of the children and meets the farm family's goals.

Dealing with Inequities and Liquidity Issues

One of the planning issues frequently faced by a farm family is equalizing the inheritance among the children, when the parents' wealth is dominated by a single, and somewhat illiquid, asset. That needs to be left intact. Another issue is a lack of liquidity at a farmer's passing because farm income is usually seasonal, and farmers tend to be land rich and cash poor. Life insurance can be a solution to both of these issues. If the parents have both on-farm and off-farm children, life insurance can be used to provide all of the children with a financially equal inheritance while keeping the farm intact. The on-farm children are also going to need liquidity along with the land, tools and equipment to operate the farm. Life insurance can provide the farm operation with that liquidity while the new owners adapt to their roles and provide a financial bridge to the next harvest. If the on-farm child rents the farm from the parents (or the operating LLC rents it from the land LLC), the rental payments can provide the funding for the life insurance policy used to equalize the children's inheritance and provide additional liquidity for operations when the parent's die.

Having a Plan for Long-Term Care

Long-term care in an assisted living facility or nursing home is very expensive. Four primary ways exist to pay for that expense: paying with cash, long-term-care insurance, veterans' benefits and Medicaid. Farmers generally have limited liquidity, so the self-pay and long-term-care insurance options are usually not practical. Veteran's benefits are an option for some, but many will likely need to qualify for Medicaid. The good news is that most of a farmer's major assets, including their home, any income-producing farmland and their farming equipment, are all exempt assets for Medicaid eligibility purposes. They are not, however, exempt from Medicaid estate recovery. To protect the family farm, therefore, many farmers who are facing the possibility of needing Medicaid will gift the farm to the next generation. Several problems, however, result from this strategy. First, such a gift is subject to Medicaid's five-year lookback period, so it could result in a substantial penalty period. Second, the farm is now subject to the divorce, bankruptcy and other liabilities of the new owner. Third, if the new owner needs to sell part of the land during the penalty period, higher capital gains taxes will result because of the transferred basis. Fourth, the farmer losses all control over the farmland.

Reducing or Eliminating the Impact of Taxes

State and federal estate taxes are another issue faced by many farm families because of the value of the farmland. Like estate equalization, liquidity is often an issue. If owed, estate taxes are due within 9 months of the farmer's death. If the funds are not otherwise available, some of the farmland would need to be sold, usually quickly, at less than full value. Such "fire sales" can be avoided by using life insurance to provide additional liquidity. If estate taxes are an issue, then the life insurance policy would likely be owned by a family member or an irrevocable life insurance trust so that the death benefit is not included in the taxable estate. The life insurance proceeds are then used to pay the taxes and the farm continues to operate. Any additional funds can provide needed liquidity.

The estate tax burden on family farms is less than on other types of assets and land. Farm Families are eligible for favorable federal estate tax treatment to avoid the reduction in the number of family farms. If the farm's value exceeds the estate tax threshold amount ($11.58M in 2020), a special-use valuation can be used. Under this option, the farm is valued not at its "highest and best use," but at its value as an ongoing farm. This alternative value is usually substantially less than its value to a developer, which would otherwise have to be used. However, the farm family can only use this valuation if members of the deceased's family will be materially and personally involved in the farming operating for the next 10 years. Renting the farm to someone else not material involvement in farming. So, if the farmer's family does not clearly intend to continue farming for a full 10 years, this special valuation is not appropriate since the reduced amount is subject to full recapture with interest. The farm family can pay any federal estate taxes due over a15-year period, but that places an ongoing burden on the farm which can limit its success.

Estate Administration and Protecting Government Farm Programs

An estate that includes a farm is going to face several unique challenges. The farm itself will need to be operated during estate administration. Most federal farm programs have very specific requirements and tight deadlines to continue payments after a farmer passes. Beneficiaries, including trust beneficiaries, need to be prepared to cooperate with the completion of USDA forms to keep those payments flowing. The on-farm children are likely familiar with the programs, but the off-farm children may need to be advised about them. The death of the farmer can also reduce payments, which are often based on the number of active farmers, so farm operating may need to be adjusted. Advance communication about these requirements between the farmer and the beneficiaries is essential to avoid the interruption of payments from federal farm programs.

A delay in getting a personal representative or administrator appointed can place farm operations and on going farm program payments in jeopardy, making a trust or LLC-based plan a better option.

Providing Access to Digital Assets

Farmers create a lot of data about their operations. This information is usually critically important to the profitable operation of the farm, based on the farmer's experience. Some of this data is stored in farm-specific programs in proprietary formats, while others are in folders and journals. A number of stumbling blocks exist to accessing the digitally stored data, including two federal statutes that prohibit using someone else's password. Additionally, the Terms of Use for these programs could prohibit someone else from accessing the deceased farmer's accounts. If a farm is owned by an entity, this would not be an issue since the entity did not die and the current manager would be legally entitled to use the entity's passwords to access its accounts. Farmers need to plan ahead so that the next generation of farmers has access to the information, digital or otherwise, collected about the operation. The farmer also needs to leave behind a detailed summary of where the data is located and how to access it. Reviewing the information and its location with the next generation can also enhance the farm's odds of a successful transition.

Conclusion

A farmer's estate plan is different from that of a non-farmers. First, it's really more of a "farm family plan" than one designed for an individual or married couple. Second, it is also a "business owner's plan", which needs to provide for the smooth operation of the business at the current farmer's incapacity and death. Another difference is that the plan is dominated by one asset: the farmland. This valuable and illiquid asset makes a traditional equal distribution to the children a challenge. It's far more likely that a fair, but unequal, distribution is appropriate. The farm family can also have a very emotional viewpoint of the farm, which may vary substantially between the on- and off-farm children. Finally, the plan must account for the requirements of farm payment programs and create access to substantial amounts of data and digital assets. Given the many differences from traditional estate planning, it's especially critical for farm families to work with an attorney and trusted planning partner who is both experienced and who has specific knowledge of farm-related issues when developing an estate plan.

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