

CHAPTER 9

TRANSFERRING THE FAMILY FARM

Transfer of the family farm to succeeding generations is one of the most complicated areas of estate planning. All of the traditional planning considerations come into effect, such as how to transfer the property in the most cost-effective manner, consideration of federal and state estate taxes, and a determination of who the transferors desire to eventually own their property. In addition, family farm estate planning is complicated by the fact that there are generally children who are working on and off the farm. Most farm operations have been operating at a certain size, and it's difficult to reduce the size of the farming operation in order to make equal distributions to farming and non-farming children. The manner in which the parents treat the transfers between their children who are farming and those who are not will generally make a difference in whether the family farm will be continued by the next generation.

In most family farm situations, both spouses are involved in the farming operation in some way. It's important for spouses to discuss what should occur in the event of the death of the spouse who has been primarily responsible for the farming operation. A detailed plan should be discussed so that the surviving spouse knows what would be the best way to manage the farm in the event of a death. Among things to be considered would be the sale of livestock, liquidation of a cow herd, and the leasing of the farm to third persons, if there are no children to take over the farming operation, or if the children are not old enough to do so.

TRANSFER OF FARM ASSETS

There are many decisions that parents or grandparents need to make when considering the transfer of the family farm to succeeding generations. This chapter will discuss arranging for the transfer of the family farm to children or grandchildren who are operating the farm and will continue to do so in the future.

Transfer of Livestock and Machinery

There are several ways to transfer livestock and machinery to children involved in the farm operation. One of the better ways is to

establish a Limited Liability Company, farm corporation, or farm partnership and transfer those assets into that entity. Gifts of interest in those entities can be made on an annual basis, which allows for a percentage transfer to the next generation without having to transfer an interest in the combine or so many head of cattle per year. If not all of the entity has been transferred at the time of death of the parents or grandparents, the operation of the farm through the entity allows it to continue, under most circumstances, without interrupting the farming operation.

If an entity has not been established, a good way to effectuate transfers over a period of time is for the parents to gift machinery being traded for new equipment and allow the child to buy new equipment with the trade-in. In the transfer of livestock, if the parents lease the cow herd to a child and receive lease payments and proceeds as cows and bulls are culled from the herd, the offspring belong to the child. Eventually, the cow herd can be moved over to the next generation without making gifts.

Transfer of Farmland

The next generation needs to be sure that the land will be available for them to farm. There are a variety of ways to do so, but the most preferred is for the next generation to own the farmland.

There is usually an area of the farm designated as the headquarters which will include cattle and livestock handling facilities, barns, machine sheds and grain storage. It's important that this portion of the farm be transferred to the child that is continuing to farm, as they will need to use these assets in future farm management. There are also portions of the farm that are more integral to the farming operation, usually closer to the headquarters, which would be helpful for the child who is farming to own. If the parents or grandparents desire to divide the estate between the farming and non-farming children, it's usually preferable to allow the non-farming children to own the land that is not so directly integral to the farming operation and lease that back to the child who is farming. That child would then have the option to purchase the property in the future. This can be done by direct transfer to the non-farming children with requirements that they lease the property to the farming child with option to purchase.

Another alternative is to allow the property to remain in trust for a period of years, and the trustee directed to make these types of lease

arrangements with the farming children and the non-farming children receiving the income from the trust.

Gifts of the farm can be made on an annual basis to the children by using the annual gift tax exclusion previously discussed or by using up a portion of the lifetime exemption. Undivided interests in the land can be transferred. If the property is not gifted during the lifetime of the parents or grandparents, then they should provide in their Wills or Trusts which portions of property are to be distributed to the farming and non-farming children. The Wills or Trusts can also provide that the farming children have the option to purchase the property should they desire to do so from their brothers or sisters. The Wills or Trusts can provide for a method by which the value of the property will be determined. This can be done by appraisal at the time of death or a set “per acre value” can be placed in the Will or Trust. If that is done, it assures the farming children of being able to purchase the property without having to worry about the value of the property being highly inflated.

It’s usually preferable for the farming and non-farming children to have their own individual tracts of land, if possible, rather than undivided interests owned by everyone. The interests of the farming and non-farming children are usually different. The farming children will want to put income from the farm back into the farm in improvements to the farm property. The non-farming children may wish to receive the income from the farm, rather than placing the income back into the farming operation. If both own their own land, they may do this more easily. Also, if the non-farming children desire to sell their land, they may do so without affecting the land owned by the children who are farming. Allowing the farming children the right to purchase the land is important if that property is something the farming children need to keep as part of their farm unit.

Financing Alternatives

If the farming children are going to be required to purchase a portion of the farm assets from the non-farming children, some thought as to how this would be done is important. There are a variety of alternatives that could be considered.

The Will or Trust may allow the farming children to acquire farm assets from the estate, trust, or non-farming children on an installment basis. The interest rate could be established so that the farming children will know exactly what is required in terms of their payout. The non-

farming children would then receive payments over a period of years. Generally, the property will receive a stepped-up basis for income tax purposes at the death of the parents or grandparents. The principal payments should be without significant tax consequences to the non-farming children, and only the interest would be taxable income. Parents or grandparents may also sell property on installment basis during their lifetime to the farming children. This approach is not recommended since it creates taxable income for the parents or grandparents selling the property. If there are installments left at the time of death of the sellers, then the estate heirs have to pay tax on the remaining income that was not taxed during the lifetime of the sellers. If property is sold on installments following death, generally a stepped-up basis will avoid most of that income taxation.

Life Insurance

A common way that many people use for financing of the farm purchase for the farming children is the use of life insurance. There are two ways that this can be done. The farming child can take out a life insurance policy on their parents, and the parents or the farming child can pay the premium. Upon the death of the insured, the farming child will have insurance proceeds to be used to buy out the farm personal and real property. The Will or Trust can give the farming child this option, and since they would have the funds, it would flow fairly smoothly. The second option would be for the non-farming children to be beneficiaries of life insurance on the lives of their parents. That could then constitute their inheritance. The Will or Trust would then provide that the farm and related assets would go directly to the farming child, and they would not be required to buy out their siblings' interests. This allows the parents to set the amount that they desire the non-farming children to receive in the form of the insurance proceeds, and for the farming child to know that they should receive the farm without having a large payment obligation.

Transfers to Surviving Spouse

An important consideration in transferring the family farm is coordinating this transfer with the surviving spouse. This is particularly important if the spouse who dies first has been the one that's been primarily involved in the farming operation. Some of the considerations for the surviving spouse are as follows.

A plan should be established during the lifetime between spouses as to what would be intended insofar as the farm is concerned if something happened to the spouse who has been instrumental in the farming operation. If there are farming children, that decision is somewhat easier. The surviving spouse may continue to own and operate the farming operation with the assistance of the children who are farming. A determination needs to be made as to how that would be handled most effectively. The two alternatives would be: 1) the surviving spouse leasing the farm to the farming child, or 2) the surviving spouse continuing to operate the farm with the child performing labor and management. The surviving spouse and the farming child could then make a determination how they wish to go forward insofar as the operation of the farm is concerned.

If the surviving spouse is not familiar with farming and there are no children to take over the operation of the farm, then a plan needs to be in place to liquidate portions of the family farm to preserve its value. This is particularly important with livestock and machinery. The surviving spouse should proceed to liquidate the livestock as soon as possible to preserve its value. Consideration should also be given to liquidate the machinery as well. To the extent the livestock and machinery receive a stepped-up basis for income tax purposes, they can sell these assets without a great amount of income tax. The surviving spouse would then be in a position to lease the land to someone else to farm or to pasture cattle. The spouses should discuss this prior to the death of either. Potential good tenants for the farm and a list of individuals the surviving spouse could count on for advice and support should be considered.

The surviving spouse would need to coordinate with a group of advisors. Important advisors would be an attorney, an accountant, someone that would assist with investment decisions, and possibly a friend or neighbor familiar with farming. By networking with all of these advisors, the surviving spouse should be able to work through the transition of the family farm.

The family attorney will help determine if any legal or tax work is necessary from an estate tax standpoint. He will assist in preparing an inventory of the farm and valuing farm assets. He can help with leases of the family farm to third parties, and if there is a child who will be

taking over farming, work on arrangements with that child. If there are assets that need to be transferred legally, the attorney can help with that.

An accountant will assist with income tax matters which could be important insofar as transition of the farm is concerned. He will provide advice concerning income tax on the sale of farm assets and what would be preferable there. He will also help with preparation of income tax returns for the surviving spouse and for the estate or trust, if indicated.

A financial advisor will be important to help with investment of proceeds from the sale of livestock or machinery in a manner that will be most beneficial for the surviving spouse.

A person should be designated as a trusted advisor to the surviving spouse to deal with transition issues. This would include advising as to how best to sell livestock and equipment, who would be appropriate for the leasing of the farm property, and whether any of the land should be sold.

If all of these advisors are in place, the surviving spouse will have the best chance of success insofar as the continuation of the farming operation is concerned.

For More Information:

Transferring Estate Property - Selected sites for transferring the family farm can found online at:

- Nebraska Cooperative Extension – Relationship and Working Together With Extended Family
<http://ianrpubs.unl.edu/family/nf555.htm>
- Ohio State University – Transferring Your Farm Business to the Next Generation
<http://ohioline.osu.edu/b862/>
- University of Minnesota Extension Service – Transferring the Farm
<http://www.extension.umn.edu/distribution/businessmanagement/DF6317.html>
- University of Minnesota Extension Service -Preparing to Transfer the Farm Business
<http://www.extension.umn.edu/distribution/businessmanagement/components/6317-1.pdf>

- Purdue University - A Retirement Estimator for Farm Families
<http://www.ces.purdue.edu/farmretirement/>
- Purdue University – Frequently Asked Questions
<http://www.ces.purdue.edu/farmtransfer/faq.htm>
- Plan Farm Transitions Between Generations
http://www.findarticles.com/p/articles/mi_m0HEE/is_8_61/ai_113714174
- Manitoba Agriculture, Food and Rural Initiatives – Home Economics
<http://www.gov.mb.ca/agriculture/homeec/index.html>
- Maryland Cooperative Extension
www.agnr.umd.edu/MCE/Publications/Publication.cfm?ID=138

CONCLUSION

We hope the information found in **Securing a Solid Future: Farm Financial and Transitional Planning Guidebook** will be helpful to you in planning for the future of your farming operation. This publication is designed to provide you with practical and useful information, and to suggest possible solutions to problems encountered in operating a farm.

The Kansas Farm Bureau Legal Foundation intends to update this publication on our Kansas Farm Bureau Legal Foundation web site: <http://www.kfb.org/legalfoundation.htm> so that up-to-date information is readily available. As other web sites become available for references, they will be included on our web site as well.

This guide is not a substitute for legal and accounting advice. You should contact qualified professionals to assist you with your estate planning. The time to begin the planning is now. Even though the laws may change in the future, having a good estate plan in place will allow transfer of your family farm in the manner you decide. You will maintain control rather than relying on the law to distribute your estate. This will be beneficial to your surviving spouse and your children, who will appreciate the thought and effort you put into your estate plan. In the final analysis, it may allow the family farm to continue, rather than being consumed by estate administration expense and taxes. It will also assist the children remaining on the farm to have the opportunity to carry on the farm in the best possible way.

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