

FARM & RANCH TRANSITION WORKSHOPS



UNL Extension

North Central Extension Risk Management Education

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Need For Personal Legal Advice

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Roadmap

- Some issues & terms
- Life Estate Deed
- Lease Rights
- Options & Preemptive Rights
- Using an Entity



“The hardest part of my job is working with family. But that’s also the best part of my job....”

Meghan Kyle, in “Bringing in the Beans,” Ted Genoways, *Harpers Magazine*, Sept. 2017

Issues & Concerns



ISSUES and CONCERNS

- When owner becomes incapacitated or dies, who will have legal authority to act?
 - Leases, POA, PR, successor trustee
- Taxes
- Long term care costs
 - How large is the risk?
- Incapacity – has planning been done?
- Contests – can we head them off

Issues & Concerns

Succession Concerns

- **Feasibility:**
 - Is it feasible to have a successor?
 - How many families can farm support?
 - Is it feasible for successor to buy out off-farm heirs?
 - Succession & Equality
 - Fair & Equal
 - Contributions & Compensation

Issues & Concerns

Succession Concerns

- **Independence**
 - Is successor currently managing?
 - If not, when?
 - Will successor have independence to operate, manage, grow?
 - Will off-farm owners be involved in decision-making?
 - If so, to what extent?

Issues & Concerns

Succession Concerns

- **Uncertainty:**
 - Are successor's contributions acknowledged in the plan?
 - What if plan changes?
 - Will land be sold to pay for long term care?
 - What security does successor have?
 - What stake has been created?

What can next generation do?

- Start the conversation
- Help owners to think about these issues
 - Inform them of resources for succession planning
 - Provide written information
- Inform owners of the risks of failure to plan
 - Loss of farm, taxes, long term care, feasibility
- Discuss values – common ground
 - Shared succession value: farm goes on
- **Acquire present interests, rights, property**
 - Lease rights, incomplete gifts, contracts, entity
 - Build assets – M&E, livestock

Terms & Concepts



Terms & Concepts

A Word About Tax

- Federal Transfer Taxes
 - Estate & Gift Taxes – 40%
 - Unified Credit: Exemption **\$11.18 million per person**
 - Sunsets January 1, 2026
 - Credit estimated at between \$6.5-7.5 million
 - Portability doubles exemption for spouses
- Basis Adjustment
 - Available for time-of-death transfers only
- Nebraska Inheritance Tax
 - 1%: children, siblings, grandkids, parents (\$40k)
 - 13%: niece, nephew, uncle, aunt (lineal descendants of) (\$15K)
 - 18%: others (\$10K)

Terms & Concepts

- Direct Ownership
 - Individual human beings own assets
- Indirect Ownership
 - Assets are held in trust or owned by an entity (e.g. LLC)
 - Individuals own entity or trust interests

Terms & Concepts

Direct Ownership

- Each person owns separate property
 - Not "in business/ownership" together
 - Property not subject to co-owner's risks
- Individuals own property together
 - Joint tenancy or tenancy-in-common
 - No management structure
 - Right of partition
 - Subject to co-owner's creditors

Terms & Concepts

Indirect Ownership

- Property is held in trust or owned by entity, e.g. an LLC
 - Entity provides
 - continuity
 - structure for management/control
 - restrictions on ownership
 - asset protection
 - keep it in family: buy-sell

Terms & Concepts

Asset Protection

- Protect property from individual's debts, obligations and liabilities
- Protect property from conflicts among individuals
- Protect individuals from business/property liabilities (limited liability)

Some Succession Tools



Succession

- Planning may become a tension between
 - On-farm & off-farm heirs
 - Farm viability & inheritances
 - Succession & equality
- What tools can we use for balance
- What tools can we use to secure the commitment of on-farm successors

TOOLS

- Life Estate Deed
- Installment Sales
- Lease Rights & Options
- Ownership Rights: Options & Preemptive Rights
- Entities
 - Buy-Sell Provisions

Life Estate Deed

- Owner transfers property subject to life estate (owner retains right to use for life)
 - Owner becomes “life tenant” and transferee becomes “remainderman”
- Life Tenant is legally entitled to possess and control the property for life
 - Receives income, pays taxes, etc
- Remainderman now owns the property but does not possess until life tenant dies

Life Estate Deed

- Transfer is irrevocable
 - Life tenant can no longer sell or mortgage property
 - unless remainderman consents
- The property can become subject to remainderman’s creditors/claimants
 - However, life tenant is protected: property cannot be sold to pay those creditors so long as life tenant is alive

Life Estate Deed

- Remainderman, as owner, can mortgage property or transfer remainder interest
 - **IF** lender is willing
 - Often depends on age/health of life tenant
 - Lender cannot foreclose so long as life tenant alive
- The deed can be drafted to prevent remainderman from transferring or mortgaging so long as life tenant is still alive
 - Ownership would revert to life tenant

Life Estate Deed

- Avoids probate
- Preserves basis adjustment
 - It is an incomplete gift
- Secures remainderman's ownership
 - Property may still be subject to lien of state should life tenant receive Medicaid benefits
- Protects life tenant
 - Entitled to income from property, possession
- It is a simple tool – a deed

Life Estate Deed

- Variation with Use of Charge
 - Life estate deed transfers property to successor and sibling, subject to parents' joint life estate
 - Deed recites successor's option to buy out sibling
 - A separate detailed purchase option is signed
 - Memorandum of option is recorded
 - This option legally is a "charge" against title in favor of sibling

INSTALLMENT SALES

Owners sell assets to successor in installment sale

- Advantages
 - Gives successor legal rights in property
 - Less susceptible to contest by other heirs
 - Fixes obligation – removes uncertainty
 - Can create larger income stream for parents
- Disadvantages
 - Taxes: Capital gain, recaptured depreciation
 - No step up in basis; purchase price is basis

LEASE & OPTION TO LEASE

- Useful succession tool
 - Transfer management to successor
- Long term leases are possible in Nebraska
 - Notice of lease recorded against title to real estate
 - Prevents sale of land out from under the lessee
- An option to lease land can run with the land – recorded against title
- Lease rights in general survive death of lessor/owner

LEASE & OPTION TO LEASE

- Issues include
 - Mechanism for determining rent
 - “Customary & reasonable for like property”
 - Can the lessee/option holder assign the lease or lease option?
 - If so, to whom? And for how long?
 - Lineal descendants of owners only?
 - Only those actively engaged in ranching?
- Disadvantages
 - A lease right is not ownership, only access

LEASE & OPTION TO LEASE

- Lease Price
 - Cash rent
 - Twice per year or up front
 - Variable
 - USDA payments to lessee
 - Bushel share
 - Specific # bushels delivered to elevator
 - USDA payments to lessee
 - Crop share
 - Lessor and lessee each own portion of crop
 - USDA payments shared

LEASE & OPTION TO LEASE

- Lease Price
 - Net share
 - Alternative to cash lease
 - Percentage of actual crop to lessor
 - Strong yield = higher rent
 - Expenses to lessee except drying/storage
 - Custom
 - Custom blend

OPTIONS TO OWN

- Successor has option to own property
- Option can be recorded against title
 - Option can be recorded in time-of-death transfer, e.g. by PR in probate or successor trustee
 - Option can be recorded while parents still alive
- What are the terms?
- Option typically gives holder right to force owner to sell

OPTION TO OWN

- Typical terms
 - What property is option for?
 - What triggers the option?
 - How long does option last? (“the term”)
 - What is the purchase price for the option?
 - How is the purchase price paid?
 - e.g. lump sum or over time
 - How is option exercised?
 - What exactly does holder have to do to buy the property? Notices, timeframes, etc.
 - Can option be assigned?

PREEMPTIVE RIGHT

- Gives the holder an opportunity to purchase property from owner before owner sells to someone else
 - Only effective if owner wants to sell
 - Holder cannot force owner to sell
- Two kinds
 - Right of first refusal (“ROFR”)
 - Right of first offer (“ROFO”)

PREEMPTIVE RIGHT

- Right of first refusal (“ROFR”)
 - Holder has right to match any offer received by owner
 - Owner must sell to holder if he matches the offer price
- Right of first offer (“ROFO”)
 - Holder has right to buy, if owner decides to sell
 - Can work in couple of ways:
 - Owner first offers to sell to holder at a price owner is willing to accept. If holder doesn't accept offer, owner can sell to someone else.
 - Owner notifies holder of desire to sell and holder makes an offer. If owner doesn't like offer, can sell it to someone else, though often not for less than holder's offer.

PREEMPTIVE RIGHT

- ROFO combined with ROFR
 - Owner notifies holder of desire to sell
 - Holder offers \$1500 per acre
 - Owner doesn't like (does not accept) offer
 - Owner free to sell to someone else
 - If owner gets an offer from someone else, holder has right to match it
 - Basically gives holder two shots at buying

A HYBRID RIGHT

- Preemptive right that works like an option
 - If owner wants to sell
 - Then must first offer to sell to holder of right
 - For a stated (and perhaps discounted) price
- How long does this right last
 - Probably only a lifetime

ENTITY



ENTITY

- Why consider an entity:
 - Co-ownership of assets (off-farm and successor) but no off-farm heirs involved in operational decision making
 - Protecting farm from heirs' troubles, i.e. divorce, medical & financial problems?
 - Provide management structure
 - Avoid partition and forced sale of land
 - Keep land together
 - Keep it in the family
 - There may be tax reasons

ENTITY

- Tax considerations play a big role in choosing an entity
 - Income tax
 - Basis issues
 - Self-employment taxes
 - Medicare and NIIT taxes
- Limited liability entities are restricted to single payment limitation under FSA rules
 - Corporations, LLCs, FLPs

ENTITY – Closely Held

- LLC is the generally preferred business entity, these days (“pass-through”)
 - Tax and management flexibility
 - Asset protection
 - Limited liability for owners
 - Owners can be managers
 - Retain control while also transferring ownership
- Some question under TCJA as to C Corp

ENTITIES

- A trust is not commonly a business entity
 - Separate management from enjoyment
 - Best asset protection
 - Less flexibility in general and for taxes
 - Difficult to retain control while also transferring ownership
 - Tax planning tool
 - May present obstacles to borrowing

Buy-Sell Agreement

- An agreement among owners of a closely held company restricting the purchase and sale of interests in the company
 - Buy-sell provisions often come as a condition of ownership
- What it does in a nutshell:
 - If an owner a) wants to sell, b) dies, c) retires, d) becomes incapacitated, or e) gets in financial trouble, (“triggering events”) how is that owner bought out?

Buy-Sell

- Main purpose is a balancing act:
 - How to protect viability of business, i.e. keep it going WHILE
 - Creating a market/value for ownership interests
- Other purposes
 - Prevent oppression by those in control
 - Keep business in the family
 - Protect business from owners’ creditors
 - Protect business from spousal claims
- Sometimes to establish value for estate tax purposes – different tax requirements

Buy-Sell

- Requires an owner to sell ownership interests a) to the company (redemption) or b) to the other owners (cross-purchase), before selling to an outsider
- Terms include
 - Price
 - Fixed price, formula price, appraisal
 - discounts
 - How price is paid (lump sum, overtime, etc.)

Buy-Sell

- Where does money come from?
- Life insurance on lives of owners?
 - Is it affordable?
 - How many policies needed?
 - More for cross-purchase than redemption
 - If company owns policy, can borrow against cash value
 - If individual owns policy, may be subject to creditors
- Installment payment options

Succession Examples

Is there such a thing: a typical farm or ranch succession plan?



Succession Example

- Mom & Dad
 - Most of wealth is in the farm
- Four children
 - One of whom is the successor
 - Successor has built up some of his/her own assets
- Parents are putting together their plan
 - Will they divide estate?
 - Will they balance succession & inheritances?
 - Will they use direct or indirect ownership?

Example 1

Not Paying for the Farm Again

- All farm assets go to the Successor
- Other assets go to Off-Farm Heirs
- Provide a shared appreciation/equity agreement
 - If successor sells out in first 10 years, has to share proceeds with siblings
- Is this fair?

Example 2

Equality

- All assets are divided equally among the children
 - 25% share for each
 - tenancy-in-common or separate parcels
- Successor is given a right to buy out siblings
 - Even with a discount, is this feasible?
- Is this fair?

Example 3
Trying for Balance

- What are parents' goals or wishes?
 - To see the farm continue as a viable operation into the next generation
 - To compensate successor for his or her contributions
 - To provide an inheritance for all the kids
 - To create opportunity to keep land in family

Example 3
Trying for Balance

Direct Ownership

- All operating assets go to successor
 - M&E, livestock, facilities
- The land is divided up among the four kids
 - In what relative values? Percentages?
 - How much of the value of parents' estate is successor's sweat equity?
 - Will successor receive separate land?
 - Will off-farm kids own separate parcels or own land together (tenants in common)?

Example 3
Trying for Balance

Direct Ownership

- Successor is given a long term lease right
 - When are rights given?
 - How long is right to lease?
 - Lifetime? As long as actively engaged?
 - As long as she wants?
 - Is the lease right assignable?
 - To whom? Conditions?
 - What is the rent?
 - Fair & reasonable? Formula? Extension?

Example 3
Trying for Balance

Direct Ownership

- Successor is given opportunities to own
 - Preemptive right: right of first offer/refusal
 - If sibling wants to sell, Successor gets first right to buy
 - Option: Successor can force siblings to sell
 - At what price? Discounted? FMV?
 - On what terms? Lump sum? Installments?
 - Possible to structure a preemptive right with a discounted price

Example 3
Trying for Balance

Direct Ownership

- Lease rights and ownership rights are recorded against title to the real estate owned by off-farm heirs
 - Documents
 - A lease option
 - A ownership option or preemptive right
 - Memorandum of these documents/rights is recorded with register of deeds

Example 3A
Trying for Balance

Indirect Ownership

- Parents don't want to divide farm into separate parcels
- They are interested in asset protection
- They want to create opportunity to narrow ownership over time
- They want kids to have chance to own a piece of land

Example 3A
Trying for Balance

Indirect Ownership

- Concerns & Issues
 - Do family dynamics allow for ownership of a company together?
 - Will successor have enough independence?
 - How will the company be managed?
 - Will company operate, or only rent out land?
 - Will there be two entities?
 - What happens if someone wants out?
 - What happens when someone dies?

Example 3A
Trying for Balance

Indirect Ownership

- Successor gets operating assets directly
 - Maybe through a separate operating entity
- Parents establish LLC
- The LLC operating agreement contains their wishes
- Land is transferred into LLC either presently or at time of last death
 - Depends in part if successor is still working into operation

Example 3A
Trying for Balance

Indirect Ownership: the operating agreement

- Who can be a member of LLC?
 - Only someone approved by all existing member?
 - Only lineal descendants of parents?
 - Spouses - income interest through trust?
- What percentage will each child own?
 - Equal or Successor's contributions reflected?

Example 3A
Trying for Balance

Indirect Ownership: the operating agreement

- Management/control
 - Successor is named manager
 - Can be removed only by unanimous consent
 - Or, successor owns the only voting interests
 - Or, members choose manager but successor has lease rights
- Is manager's authority unrestricted?
 - Or limited to specific dollar amount

Example 3A
Trying for Balance

Indirect Ownership: the operating agreement

- Manager can enter into contracts with company
 - To custom farm, cash rent, or crop share the land
 - On terms that are fair and reasonable for like property in the area
 - Yes or No: sweet heart deals for manager?

Example 3A
Trying for Balance

Indirect Ownership: the operating agreement

- Manager can pledge company land as collateral for loan
- Amount pledged cannot exceed manager's ownership percentage
- If foreclosed, that is a distribution to manager of his/her interests in company

Example 3A
Trying for Balance

Indirect Ownership: the operating agreement

- What happens when an owner wants to sell?
 - First: Offer to sell to Company
 - Second: If company not buying, offer to sell to other members
 - Members can buy proportional to their interests
 - Or, does successor get first right to buy?

Example 3A
Trying for Balance

Indirect Ownership: the operating agreement

- What happens when an owner dies?
 - Company has option to buy interests of deceased member
 - Option is good for one year from death
 - If company does not exercise option, deceased member's interests may go to eligible lineal descendants
 - May also be sold to other members by offer

Example 3A
Trying for Balance

Indirect Ownership: the operating agreement

- What is **purchase price**? Fair market value. What is FMV?
 - First, company and members try to agree on FMV
 - If cannot agree, then appraisals
 - **Then** a discount of 35% applied to the FMV
- Is price paid in lump sum or installments?

Example 3A
Trying for Balance

Indirect Ownership: the operating agreement

- Put Option
 - If member wants to sell, put requires that the company buy
 - Put is not exercisable until 15 years after parents' death
 - Put is exercisable only once every ten years

Example 3A
Trying for Balance

Indirect Ownership: the operating agreement

- Call Option
 - Requires that the company sell something to a member
 - E.g., parents give their kids a “call” right to purchase an acreage from company
 - Need to define by size, location, impairment to productive ground, etc.

Example 3A
Trying for Balance

Indirect Ownership: the operating agreement

- How long does entity last?
 - Until unanimous vote of members to end
 - Or, perhaps, in second or third generation, a majority can terminate company
 - What kind of majority?

C Corp & Pass Throughs



C Corp v Pass-Through Entity

(Such as S Corporation or LLC)

- C corp –
 - New 21% flat tax rate on income
 - This is 16% lower than highest individual tax rate
- Pass-Through
 - 20% qualified business income deduction
- Which is better?

C Corp v Pass-Through Entity

(Such as S Corporation or LLC)

- It depends on facts
 - For \$75,000 of income or less the individual rates are lower than the C Corp
 - C Corp is still subject to double taxation for qualified dividends & long term capital gain
 - If these apply, pass-through is always better
 - C Corp also potentially subject to accumulated earnings tax
 - 20% tax on earnings unreasonably accumulated (only kicks in above \$250,000 and *if unreasonable*)
 - The 20% qualified business income deduction for Pass-Throughs is also subject to limitations

“S” Election

Making a C Corp a Pass-Through

- In making S election, must look out for passive income
- If more than 25% of gross income is passive income, can limit or undo effect of S election
- Watch out for cash rent: it is passive income
- May need to consider strategies
 - Prepay expenses to offset all passive income
 - Distribute accumulated C corp earnings and profits as dividend to shareholders before end of first election year
 - Use net crop share lease (not cash lease)

Articles Available

<https://farmerandrancher.org.com>

Introduction to Farm & Ranch Estate Planning	
Estate Questionnaire	Federal Transfer Taxes
Health care POA	Durable POAs
Intestacy	Charitable Giving
Future Interests & LE Deed	Joint Tenancy & Tenancy in Common
Options & Preemptive Rights	Spousal Tax Planning & Portability
Personal Representative	PR Checklist
Special Use Valuation	Partition
The Will	Transfer on Death Deeds
Trusts	Buy-Sell Agreements
Probate	Neb. Inheritance Tax

Resources

800-464-0258

- Legal Aid of Nebraska Beginning Farmer and Rancher Development Program
- Business, Succession & Estate Workshops
- Nebraska Farm & Ranch One-on-One Clinics (Nebraska Department of Ag)
- Nebraska Depart of Ag: NExtGen
- <https://farmerandrancher.org/>

Resources

- Some valuable online resources
 - Roger McEowen, Ag Law & Taxation blog
 - <http://lawprofessors.typepad.com/agriculturallaw/>
 - Center for Ag Law and Taxation, Ames
 - <https://www.caft.iastate.edu/Blogpost>
 - Paul Neiffer blog: Farm CPA Today
 - <http://blogs.claconnect.com/agribusiness/author/paul-neifferclaconnect-com/>

Material

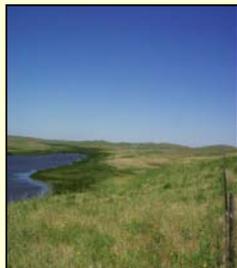


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