FACT SHEET

FARM TRANSFER AND ESTATE PLANNING

DESCRIPTION

Estate planning should lay a framework for a smooth transition of farm or ranch ownership and management. It can provide for the needs of all family members, even those who leave the operation. It can help reduce high inheritance taxes on land made more valuable by inflation and non-farm development pressure. And proper estate planning can address the settlement problems that arise because land is not a liquid asset.

An estate plan is more than a will. A will is an important part of the plan because it names heirs, nominates an executor and appoints guardians for dependents. But a will alone cannot guarantee a secure future for the farm family, land or business.

A good estate plan should accomplish at least four goals:

- Transfer ownership and management of the agricultural operation, land and other assets;
- Avoid unnecessary transfer taxes (income, gift and estate);
- Ensure financial security and peace of mind for all generations;
- Develop the next generation's management capacity.

Laws, especially tax laws, change. Two important elements of estate planning are to set goals and then to revisit them over time as families, finances, priorities and laws change. As part of this goal-setting process, landowners must take inventory of their assets and be sure they fully understand who owns what and how titles to the property are held.

BASIC TECHNIQUES

Farmers and ranchers should complete a will and keep it updated. A living will, health care proxy and the designation of power of attorney are important ways to ensure that the family will be able to make decisions if the landowner becomes seriously injured or terminally ill. The estate planning process is a good opportunity to resolve business operation and management issues and to transfer assets. For tax and other reasons, it makes sense to start transferring operating assets as soon as both generations are comfortable with the commitment.

The estate planning and farm transfer process is also a good time for landowners to evaluate their present business arrangements and decide whether those arrangements meet their current needs and help achieve their goals. They should choose the most appropriate form of business organization, whether it is a sole proprietorship, partnership or corporation. Written agreements are essential.

TRANSFER AND TAX REDUCTION STRATEGIES

- Agricultural conservation easements can permanently protect farmland from non-farm development and significantly reduce transfer taxes in cases where the market value of the land is much greater than its restricted value;
- Annual gifts of assets can help transfer the business and reduce transfer taxes;
- Buy/Sell agreements can ensure an orderly transfer of the farm business;
- Life insurance can be used to fund buy/sell agreements, establish trusts, provide for non-farming heirs or pay estate taxes;
- Limited partnerships or corporations can allow separation of management and ownership of the business, if desired;
- Long-term care insurance can protect family assets from being used to pay for nursing home costs;
- Minority discounts can substantially reduce transfer tax liability when minority interests of family farm businesses are transferred;

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For additional information on farmland protection and stewardship contact the Farmland Information Center. The FIC offers a staffed answer service, online library, program monitoring, fact sheets and other educational materials.

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- Purchase of agricultural conservation easements (also known as purchase of development rights) programs can protect farmland, reduce taxes and provide cash for retirement and estate planning needs;
- Transferring management responsibility and asset ownership gradually can provide a smooth transition for the agricultural operation from one generation to the next;
- Trusts can provide financial security for surviving spouses, children and grandchildren.

ISSUES AND OPTIONS

Liquid assets—cash and cash equivalents—are important to settling farm and ranch estates. Having cash allows farm families to pay expenses and medical bills without selling land or farm equipment. Liquid assets also may be used to divide an estate fairly among heirs.

It is important to remember that an equitable settlement does not necessarily mean creating equal shares of a farm or ranch estate, because the children who are involved in a family agricultural enterprise have generally contributed a substantial amount of their time, energy and resources to make the business succeed. These children may have substantial "sweat equity" in the operation they inherit.

Balancing commercial and conservation goals in farm estate planning also is challenging, because farms are businesses. However, with careful planning, farmers and ranchers can take advantage of conservation options that protect land without unduly restricting agricultural enterprises. These conservation options should be integrated into estate plans to ensure long-term protection of both land and farming operations.

Successful farm transfer and estate planning require a team effort—including family, financial, farm management, tax and legal expertise. Because plans must be tailored to individual circumstances, they must be designed to meet a variety of unique situations. Landowners must be sure to talk to their families and find the professional legal and financial assistance they need to accomplish their goals.

ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001

The Economic Growth and Tax Relief Reconciliation Act of 2001 contains several provisions that affect farmland conservation and farm estate planning and transfer, including:

- A dramatic increase in the estate tax exclusion: $1 million in 2002-3 up to $3.5 million in 2009;
- Repeal of Estate Tax in 2010;
- A reduction of highest tax brackets;
- Modified carryover basis in 2010;
- Removal of geographic limitations for donated conservation easements eligible for estate tax benefits under Section 2031(c) of the tax code; and
- A sunset provision.

JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT OF 2003

The Jobs and Growth Tax Relief Reconciliation Act of 2003 also contains provisions that will affect farm estate planning, including:

- Lower capital gains from 20 to 15 percent (and from 10 to 5 percent for lower bracket taxpayers);
- Reduction of taxes on dividends to match capital gains tax rates.

These recent tax law changes have provided significant estate and income tax reductions as well as some additional uncertainty for estate tax planning and farm transfer. Farm and ranch owners should contact their advisors to determine how those changes will affect their planning efforts.

American Farmland Trust