



Treatment of Heirs in the Transfer Process

Agricultural Business Management

Gary A. Hachfeld, David B. Bau, & C. Robert Holcomb, Extension Educators

Protecting the On-Farm Heirs:

The farm business can be a fragile structure. The high risk nature of farming coupled with huge start-up costs and generally narrow profit margins, dictate the need for safeguards to protect the farming heirs.

In today's economy, it usually takes a great deal of parental help to get a young person started in farming. This help is usually provided through reduced charges for housing, lower machinery and land rents, lower interest rates, gifting of assets, financial supplements, and various other types of help. Unless the young person starts out with a nest egg, parental concessions are needed if the young farmer is to get started successfully.

Farming heirs can protect themselves by carrying life insurance on the parents, by carrying risk insurance on their assets and by seeking continued education to upgrade farm management skills. However, the parents also have to play a key role in protecting the financial vulnerability of the farming heirs.

It is not enough to say "You'll be taken care of when we are gone". You need to take legal written action to make the transfer happen. Farming heirs who are insecure as to their future in the business are unhappy, often indifferent and easily alienated from farming.

There are several steps that can be taken to insure a successful transfer while at the same time providing for non-farm heirs. These steps are outlined in this information piece.

How Parents Can Help Secure the Financial Future of Farming Heirs:

1. Develop and implement a transfer plan:

Formulate a detailed written transfer plan with the help and input of all farming parties involved, especially spouses and in-laws. Discuss it. Work with your transfer team (attorney, accountant, etc.) to implement the plan so everyone knows what is ahead. Transfer some assets soon so the farming heirs can begin business and feel some pride of ownership. This process includes transfer of management and control of those assets as well.

2. Offer a purchase agreement/buyout provision:

If you haven't made any commitments as to the sale of assets, a purchase option may be useful. The purchase option gives the buyer the right, but not the obligation, to buy farm property at a later date. The agreement can involve land, buildings, livestock or machinery. It should state price, terms of payment and date of execution. It is binding on the spouse and non-farm heirs, so the agreement gives the farming heirs a definite and reasonable purchase price and terms for buying farm assets. This may prevent the farming heirs from having to buy out non-farm heirs in an unsatisfactory lump sum after your death.

3. Provide Protection in Your Estate Plan:

When writing your Will or trust, include the purchase agreement or buy-out provisions. You might wish to establish provisions as to how, when, at what price, terms, etc. the farming heirs can buy out the other heirs.

Example 1: Farm site and adjoining land and equipment to the farming heirs with cash or non-farm assets to the non-farm heirs.

Example 2: Enact a provision allowing your son/daughter to buy the land from your trust over a 15 year period at a stated interest rate with specified principal payments per year.

Example 3: Pass farm property to all children equally but establish reasonable terms, through a buy-out provision, as to how the farming heir(s) might buy out the other heirs.

4. Life insurance planning:

Parents have several options regarding life insurance. Following are a few examples for your consideration.

- Parents carry enough life insurance on themselves to provide adequate dollars at death to pass to the non-farm heirs, leaving farm assets to the farming heirs.
- Parents gift some money to the farm heir during their lifetime which would be used to purchase life insurance on the parents with the farming heirs as beneficiaries. This would provide money to enable the farm heir to exercise the buy-out provision and buy out non-farm heirs when the parents die.

- If you are in debt, a life insurance policy on yourself can provide money for debt payments and for estate tax obligations. This can relieve heirs of having to liquidate vital farm assets to pay off those expenses.

Life insurance should not be your only strategy but it can be a valuable strategy in your planning. Do not buy more than you need or can afford. Remember, if you own the insurance policy regardless of beneficiaries, the death benefit amount will be included in your estate value upon your death. This could cause a tax issue so check with your insurance agent, attorney, or accountant.

5. Passing on your farming know-how:

Pass on your wisdom. Share your "rules of thumb" and "things that went bad" and "what has always worked" philosophy. The entering generation may not always be receptive to your ideas, but this transfer of knowledge and know-how can give them a competitive edge on others. It can also help insure their success in running the farm business.

How to Be Fair With Non-Farm Heirs:

One of the most difficult questions many retiring farm families face is how to get a young son or daughter started farming while being fair to the non-farming heirs.

Non-farming heirs often leave the farm in their late teens for careers elsewhere. Most parents are concerned with being fair to all of their children at estate settlement time. Fairness, however, may not mean equal treatment of heirs.

Many farm families have reasons for unequal treatment of heirs. Some of those reasons include:

- Non-farm children received college tuition, a down payment on a house or other compensation, so they received some of their inheritance early.
- The farming heir helped create part of the final estate of the parents by actively contributing to the parents' business over the years, so they may be entitled to more. This is an issue of "Contribution vs. Compensation" – fair does not always mean equal! See *Transferring the Farm Series #11- Putting a Value on Sweat Equity by Dave Goeller, University of Nebraska, Lincoln.*
- Parents want the farm to "stay in the family". Consequently they are willing to give more to the farming heir whose goal it is to stay on the farm.
- Farming heirs are getting delayed compensation for work performed in years when they were underpaid.
- Farming heirs have been or will be attending to the majority of the physical and business needs of the parents in their declining years.

There are several methods farm families can use to transfer assets unequally but, in their minds, fairly to their heirs. They include but are not limited to the following:

- Parents write buy/sell agreements with farming heirs, committing to exact sale prices, terms, and timing of payments on farm properties. These agreements are binding on non-farm heirs; provide the farm heirs a guarantee of property purchase at an acceptable price and price, and guarantee off-farm heirs a fair price.
- Use of life insurance as mentioned earlier. In addition, parents purchase life insurance on themselves and list the off-farm heirs as the beneficiaries. In this case, farm heirs get farm assets and non-farm heirs get the cash generated by the insurance.
- Parents establish a Testamentary Trust (through a Complex Will) or Revocable Living Trust. It states that the farm heirs have the right to purchase farm assets from the trust at predetermined prices, terms and conditions over a number of years. This guarantees the non-farm heirs their percentage of the estate over time.
- The parent's Will has been used to equalize or to make fair any previous distributions to heirs. The Will may make special provisions to fit the situation. If the farming heirs or any heir has received earlier compensation, they may now get less than other heirs. Non-farm heirs may be given an inheritance of cash, non-farm assets or remote land holdings. Farm assets are transferred to the farming heirs.

It may be beneficial to involve all heirs in the transfer process but certainly to communicate to all heirs the final plans for distribution and transfer of assets. This communication should be done prior to your death so farming heirs are not left in the embarrassing position of trying to explain your actions. Doing this can avoid catastrophic family controversy.

One final point. Parents who develop a business transition and personal estate plan DO NOT have to stop farming the day they sign the plan. Developing a plan preserves what they have worked so hard to build. The plan insures the parent's wishes of having assets pass to whom they want them to go.

Caution: This publication is offered as educational information. It does not offer legal advice. If you have questions on this information, contact an attorney.