INTRODUCTION

Trusts are a commonly used estate planning tool. They can take a variety of forms and there are many terms used to describe them – revocable, irrevocable, and testamentary are just a few. Trusts are often utilized by farmers. For example, revocable trusts are frequently used as will substitutes. If a person has a revocable trust and moves all of his property to his revocable trust during life, he can prevent his beneficiaries from having to do a probate on his death.

Sometimes trusts are testamentary, meaning they are created at a person’s death by his will or other document. The trust is funded with the decedent’s assets and may be created for the benefit of the decedent’s beneficiaries. Oftentimes, people create trusts for their children at death, so that the assets in the trust are protected from creditor claims, or to prevent a child’s misuse of the inherited property. While trusts are useful and have a variety of purposes, owners of agricultural land need to be aware of the issues associated with using a trust and understand the necessary steps to avoid those potential pitfalls.

THE CORPORATE FARM ACT AND ITS LIMITS ON TRUSTS

Minnesota’s Corporate Farm Act, found in Minn. Stat. Section 500.24, is intended to protect the family farm. Trusts in all forms are subject to the Corporate Farm Act and its restrictions. Trusts that hold farmland must complete the corporate farm application and submit it to the Minnesota Department of Agriculture. As long as the trust satisfies the requirements of the statute, the Commissioner will sign a certificate stating that the trust is in compliance with the law.

In order to conform to the requirements of the Corporate Farm Act, the trust must be a “family farm trust,” as defined in Minn. Stat. Section 500.24, subd. 2(d). One type of family farm trust, which is the most common, must comply with the following elements:

1. The majority of the current beneficiaries of the trust must be people who are related to each other within the third degree of kindred, or their spouses.

2. All of the current beneficiaries must be natural people or nonprofit corporations or trusts.

3. One of the family members, who is a current beneficiary, must reside on or actively operate the farm.

Alternatively, if there is no family member who meets that description, the trust must lease the agricultural land to an entity that complies with Minn. Stat. Section 500.24. Those eligible entities are the following: a family farm unit, a family farm corporation, an authorized farm corporation, an authorized livestock farm corporation, a family farm limited liability company, a family
farm trust, an authorized farm limited liability company, a family farm partnership, or an authorized farm partnership.

There are two other types of trusts that can be defined as family farm trusts. Certain charitable remainder trusts (defined in I.R.C Section 664) and charitable lead trusts (defined in I.R.C. Section 170(f)) are eligible for family farm trust status. A charitable remainder trust is, in short, a trust that pays out either a specified amount or percentage at least annually to one or more people for a certain number of years. After the term of years is complete, the trust terminates and all property remaining in the trust is distributed to the charity, which is the remainder beneficiary. The longest term of years permissible for a charitable remainder trust is twenty years.

Charitable lead trusts can also be family farm trusts. A charitable lead trust is in essence the opposite of a charitable remainder trust. It must pay either a specified amount or percentage at least annually to a charitable organization for a certain number of years. After the term of years is over, the trust will terminate and all property must be distributed to one or more people.

It is also possible for trusts to be grandfathered into the family farm trust definition. If the trust had an interest in agricultural land prior to May 16, 2000, and the trust does not acquire more than 20% of what the trust owned as of the grandfather date in any five year period, then it may also be defined as a family farm trust. The restriction on the addition of land does not include any acreage that is owned to meet pollution control requirements.

If a trust violates the Corporate Farm Act, the violator can be subject to a fine and gross misdemeanor charges for the violation. For that reason alone, it is extremely important to ensure that any trust you want to have hold your farm – whether it is revocable, irrevocable, testamentary, or charitable – is in compliance with the Corporate Farm Act and that you complete the required application.

**AGRICULTURAL HOMESTEAD WHEN PROPERTY IS HELD IN TRUST**

When agricultural property is held in trust, there are specific agricultural homestead classifications available for that property, which give the property preferred tax treatment. Those classifications are the following: grantor occupied agricultural homestead; agricultural relative homestead; and special agricultural homestead.

Agricultural property held by a trust is eligible for one of these agricultural homestead classifications only if it meets certain requirements.

First, the land must be held by an authorized trust. An authorized trust is a family farm trust, as described above, that complies with the Corporate Farm Act. The type of trust that owns the property is not the main concern of this law. The agricultural property can be owned by a revocable trust or an irrevocable trust, and that trust could be established at death or during life.

The grantor of the trust is the creator of the trust. If the grantor wants to claim homestead of agricultural property in trust, the grantor must be a beneficiary of the trust. For example, the land cannot be in a trust that benefits only the grantor’s children if the grantor is the individual claiming the homestead. In addition, the grantor must be a Minnesota resident. The grantor of the trust can claim grantor occupied agricultural homestead in the following situations:

1. The grantor occupies the property and uses it as a homestead.

2. The grantor lives in a town within four contiguous cities or townships or a
combination thereof from the land and the grantor, the grantor's spouse, or a grandchild, child, sibling, or parent of the grantor or grantor's spouse is actively farming the land.

Agricultural property held in trust can also be agricultural relative homestead. If the property is occupied and used as a homestead by a qualifying relative of the grantor of the trust, the property is eligible for agricultural relative homestead classification. Spouses are not considered relatives for homestead purposes. A qualifying relative of the grantor is any of the following: a grandchild, child, sibling, or parent of the grantor or the grantor's spouse. The grantor must be a Minnesota resident and neither the grantor, nor the grantor’s spouse, can receive another agricultural homestead in Minnesota. In addition, the qualifying relative may not claim another agricultural homestead in Minnesota, as this homestead classification is limited to one per family. When applying for a relative agricultural homestead, the qualifying relative should complete the homestead application.

The grantor of the trust does not need to be alive for a qualifying relative to claim relative agricultural homestead. In fact, the grantor may have created a trust that receives the agricultural property at grantor's death, rather than during grantor's life. If a qualifying surviving relative of the grantor is a beneficiary of that trust and occupies the trust property, using it as a homestead, the surviving relative is eligible for relative agricultural homestead.

Trust-held property can also be eligible for “actively farming” special agricultural homestead. Actively farming special agricultural homesteads are generally granted under Minn. Stat. 273.124, subdivision 14. Special agricultural homestead is sought when neither the grantor, nor the grantor’s spouse, nor any qualifying relatives lives on the agricultural property or occupies it as a homestead. In these circumstances, one of the following must be true in order for the land to be eligible for special agricultural homestead.

1. The land must be actively farmed by the grantor, the grantor's spouse, or a qualifying relative either on that person's own behalf or on behalf of an authorized entity of which they are a qualified person. An authorized entity is any entity that complies with the Corporate Farm Act. The individual that is actively farming must be a Minnesota resident; or

2. The land is rented by an authorized entity of which the grantor or grantor's surviving spouse is a shareholder, member, or partner and a qualified person of the authorized entity that leases the property is actively farming the property on behalf of the authorized entity. The individual that is actively farming must be a Minnesota resident.

In addition, all of the following requirements must be met for the agricultural property to qualify for special agricultural homestead:

1. The agricultural property must be at least 40 acres, including government lots and correctional 40s;

2. Neither the grantor nor the grantor's spouse can claim another agricultural homestead in Minnesota; and

3. Neither the grantor nor the person who is actively farming can live farther than four cities or townships or a combination thereof from the agricultural property.

If all of the above requirements are met, then the property, even though held in trust, qualifies for special agricultural homestead.
Agricultural property classified as class 2a property owned by the same individual or entity can be linked together and classified as homestead. Even if the property is noncontiguous, it can be linked if it is classified as class 2a and located within four townships or cities or a combination thereof from the homestead. Married couples owning property in their names individually can link their property, even if not owned jointly and title is in their separate names. But if married couples own different parcels of agricultural property in two separate trusts, the property cannot be linked and placed together under the same agricultural homestead classification. Under the statute, the property is considered to be owned by two separate entities, rather than married individuals, so it cannot be linked. If all of the parcels are owned by one spouse’s trust, then they can still be linked together if they are class 2a property and located within four townships or cities or a combination thereof from the homestead.

You should check with the county assessor if you have concerns about your homestead classification. Sometimes counties may interpret the laws differently, so it is important to ensure that you comply with their requirements for obtaining homestead status.

TRUSTS’ EFFECTS ON CLAIMING THE QUALIFIED FARM PROPERTY DEDUCTION

The qualified farm property deduction is an estate tax deduction in the state of Minnesota that was passed during Minnesota's 2011 special session. There were many concerns about how the law may affect property held in trust in its first version, and the law was amended and clarified during the 2013 legislative session to quell these concerns and correct and clarify the law. One of the most important parts of the recent law corrections and clarifications deals with trusts that hold agricultural land and the eligibility of that land for the deduction.

The state of Minnesota has a $1.4 million state estate tax exemption in 2015, which is set to increase by $200,000 annually until the exemption reaches $2 million in 2018. For owners of agricultural land, this deduction can be increased to $5 million, if they own qualified farm property that meets specified requirements. Therefore, in 2015, an individual that qualifies for the qualified farm property deduction can pass an additional $3.6 million of assets to the next generation without incurring a Minnesota estate tax. In 2018, when the exemption has increased to $2 million, an estate can transfer an additional $3 million of assets to beneficiaries Minnesota estate tax free, for a total of $5 million being transferred with no transfer tax. This additional exemption is only available if the property passing subject to the additional deduction is qualified farm property.

In order to be considered qualified farm property, the agricultural property must meet the following requirements at the time of decedent’s death:

1. The property’s value must be included in the decedent’s federal adjusted taxable estate.

2. The property must consist of agricultural land and must be owned by a person or entity that is either not subject to or is in compliance with Minn. Stat. Section 500.24.

3. The property must be classified for property tax purposes in the taxable year of death as agricultural homestead, agricultural relative homestead, or special agricultural homestead under Minn. Stat. 273.124.

4. The property was classified for property tax purposes in the taxable
year of death as class 2a property under Minn. Stat. 273.13, subdivision 23.

5. The decedent continuously owned the property for the three-year period ending at the decedent's death.

One of the requirements that can cause problems is the homestead requirement. As indicated in the above section, after transferring property from an individual's name into a trust, the property owner must ensure that the trust complies with the Corporate Farm Act and reapply for homestead. Agricultural property held by a trust is often eligible for some type of agricultural homestead, but the owner of the property must follow the steps to get the official homestead classification. If the property is not classified as agricultural homestead on decedent's date of death, the deduction is not available.

The other requirement that may cause concern is the requirement that the decedent has continuously owned the property for the three-year period ending at the decedent's date of death. Property held by a revocable trust of which the decedent was grantor will be considered owned by that person.

There are two additional requirements for the qualified farm property deduction. They are as follows:

1. A family member must maintain the 2a classification for the three years following the decedent's death.
2. The estate and qualified heir must agree to pay the recapture tax, if applicable.

In order to be a qualified heir, the recipient of the property must be a family member as defined by the statute. A family member is any one of the following: the decedent's ancestors (parent, grandparent, etc.), the decedent's spouse, a lineal descendant (child, grandchild, etc.) of the decedent, of the decedent's spouse or of the decedent's parents or a spouse of a lineal descendant, or a trust whose present beneficiaries are all family members. The permissible trust could be a family trust, which benefits the surviving spouse and the decedent's children during life. It could also be a trust for a child, which permits distributions to the child, the child's spouse, and the decedent's grandchildren.

If the property passes into a trust, the trustee of the trust has the responsibility to maintain the 2a classification to prevent the recapture tax, as well as file the required informational returns, whether the trustee is a family member or not. If these actions are not completed, the trust is responsible for paying the recapture tax.

CONCLUSION

Trusts have become an extremely important and effective estate planning tool for many people, and farmers in particular often utilize them for estate tax savings, probate avoidance, and privacy. Even though agricultural property is commonly placed in trusts, the follow-up required to comply with the Corporate Farm Act and ensure that owners retain agricultural homestead can sometimes be overlooked. It is important to understand that whenever ownership of your agricultural property is transferred from you to a trust, there are steps that must be taken to maintain tax benefits associated with that property today and in the future.

For more information:
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