Farm Estate Planning Presents Unique Challenges

ESTATE TAXES ARE JUST ONE OF MANY ISSUES

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Farming is a complex business. There are many variables that the farmer cannot control. However, there is one factor for success that the family can and should actively control – planning for transition of the family farm from generation to generation.

Let's face it, nobody looks forward to spending time with lawyers, accountants and other advisors mulling over the legal and tax details. It is especially distasteful when you are discussing your own death or disability. Unfortunately, good estate planning is as essential to the long-term success of the family farm as feed, seed and fertilizer. This is definitely not an area where good results simply happen by accident.

Estate planning is easy to put off to a later day because it does not produce any instant gratification or immediate measurable benefit. Farmers spend money on equipment that they can immediately put to use in their farming operation. They plant seeds with the expectation that in a few weeks they will sprout and in several months the crop will be ready to harvest. Estate planning is a long range process. However, you need to plant and nourish the seeds of good planning early if you ever expect your family to reap the benefits of your hard work in the future.

Farmers are often said to be asset rich and cash poor. Most of the value in their estate is tied up in land, buildings and equipment. These are critical components of the farm business, but they are more difficult to divide among family members than cash or an investment account. This presents a significant challenge in farm estate planning.

Many farm operations are highly leveraged with debt. It takes a lot of operating capital to support annual operations, on top of longer term equipment loans and land mortgages. High debt levels and irregular cash flow can create enormous liquidity problems, especially if the primary farm operator suddenly passes away. Add to that the fact that estate taxes must be paid within nine months after the date of death and the result can be a serious cash crunch.

Contrary to popular belief, however, estate taxes are not normally the major destructive force for family farms. There are hosts of ways to avoid or minimize estate taxes. It requires careful advanced planning, though. As much as we all dislike estate taxes, they are a fact of life, just like drought, fuel costs and fluctuating market prices. At least you can control estate tax liability. Consequently, taxes are not usually the problem – lack of planning is.

Perhaps the most challenging task in farm estate planning is determining how to treat each child fairly. It can be a real challenge to devise a way to be fair when some of the kids want to continue farming, but others find careers off of the farm. There are usually not enough non-farm assets to take care of those who do not remain active in the farm. Yet, it can create controversy to force the non-farm children to remain as part owners of the land or farm operation. This issue requires careful thought. Without a good plan, a disaster can erupt and tear the family apart.

Planning can be equally complex if all of the children want to remain active in the farm business. Land is becoming a scarce commodity and its price continues to escalate as suburban sprawl encroaches on traditional agricultural areas. This makes it difficult to increase the size of the farm operation to support multiple families. In the same respect, it is not usually feasible to split the existing farm up among all of the children and hope their share will sustain their independent families. These issues require a lot of planning and a long time to implement.

Fortunately, there are a lot of legal solutions available to deal with the unique circumstances of family farms. The solutions vary with each family, but usually involve a blend of estate planning and business succession planning. This is not normally something you can accomplish with a simple last will and testament.

Using entities such as limited liability companies, family limited partnerships or corporations can be an important component of the plan. Entities can help control estate tax liabilities. They can also facilitate dividing interests among family members without physically dividing land, equipment or other assets. Entities often provide some creditor protection and even protect the operation if one of the family members later divorces.

Life insurance can also play a key role in farm estate planning. It is particularly useful when used in combination with special trusts. The proceeds from a life insurance policy can provide a much needed source of cash to pay debts and taxes. Life insurance can also be helpful in equalizing inheritances among farm and non-farm children. It is important to get a professional assessment of your life insurance needs to be certain that you not only have the right amount of coverage, but also that the ownership is structured properly to coordinate with your overall estate plan. Owning the insurance in the wrong way can increase estate tax liability.

Uncertainty is a fact of farm life. But is does not have to be that way regarding the family's estate plan. Find knowledgeable professionals who understand the unique circumstances that farm families face and who are familiar with planning techniques that work best with farms. Most importantly, take a proactive approach and plan early, but build in flexibility to allow for change. Leaving things to chance will likely assure failure.

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