Farm Management

Fair vs. equal: Providing fairly for your non-farming heirs

Farm & Family

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FOR families with a farming heir, deciding who will take over the farming operation is simple.

A much more complicated decision, however, is deciding how to transfer the farm to a farming son or daughter while still providing fairly for the non-farming heirs.

A notion that arises frequently with farm clients is the idea that in order to be fair, they need to transfer everything equally among all the children. It is important to remember that fair is not necessarily always equal — and that's OK.

Let's take a look at a scenario with real clients "Vern" and "Margie" (not their real names). Vern and Margie have farmed for 40 years. They own 200 acres valued at $1.2 million, a home and building site valued at $450,000, farm equipment worth $250,000, retirement assets worth $1 million and $400,000 in whole life insurance.

They have three children. Ben lives nearby and works in town, but has helped on the farm for the last 10 years. He eventually wants to quit his job and take over the farm. Sally and Anne both have professional jobs in the city. They have no desire to move back to rural Minnesota or to farm.

In discussing their goals, Vern and Margie express their desire to leave the farm to Ben so that he will be able to carry on the family farm business. Remembering the struggles they faced starting out, they don't want to leave Ben with a significant debt burden.

Vern and Margie also express concern that their daughters will certainly feel they got the short end of the stick if they leave the farm solely to Ben. They want to minimize conflict and provide fairly while ensuring Ben can continue to farm.

If they transfer everything equally among the three children, Ben will receive a one-third interest of the agricultural land, the building site and the equipment. Sally and Anne don't necessarily want the land, and they surely don't want the equipment or building site.

As a one-third owner, Ben will need to either rent the land and equipment from his sisters or buy them out. To buy them out of equipment, the building site and the farmland at appraised value, he will need more than $1.2 million.

Since Ben won't be able to afford to buy his sisters out immediately, the result is that Sally and Anne will be landlords, claiming rental income each year (that they may or may not desire, based on their respective income tax brackets) until Ben is able to come up with the purchase money.

When this occurs, it will trigger income tax implications for the sisters if land values have appreciated.

Thoughtful plan

A better option for Vern and Margie is to structure their estate plan to leave their farming assets to Ben and non-farming assets to Sally and Anne. They know Ben would want to live at the home place, and the girls would just sell it. They know Ben needs access to the building site and will farm all the acres. They know Ben will need the equipment.

Further, they acknowledge that Ben should receive some form of compensation for the work he has put into the farm over the last decade.

Vern and Margie now have a plan that,

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while not equal in the dollar sense, does allow them to sleep well at night feeling they provided for all three of their children fairly.

Through their revocable living trusts, the farm equipment is left to Ben in exchange for his past and future work on the farm. He also will get the home place and the building site.

And regarding their daughters, Vern and Margie designate Sally and Anne as beneficiaries on their retirement accounts and current life insurance policies. Vern and Margie use their required minimum distributions from their IRAs, windmill income and Margie's Social Security (they don't need the income for living expenses) to fund a $1.5 million, second-to-die life insurance policy, on which Sally and Anne are listed as beneficiaries.

With the new life insurance policy providing for their daughters, Vern and Margie feel comfortable leaving the agricultural land to Ben so he can continue the farming operation without having to spend years paying down real estate debt.

Every client's situation is different. Some clients want to give the farm to their children. Others want the children to purchase it. Some clients are able to use life insurance to provide for non-farming heirs, while others either can't afford it or can't qualify for it.

Developing a farm succession plan is a complex endeavor, specific to each individual client's goals. Make time to sit down with an estate planning attorney to discuss your situation.

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