

## Legal Issues Relevant to Estate Planning and Succession



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### WHAT IS A FARM & RANCH ESTATE PLAN?

- Will, Trust or other legal document that provides for distribution and transfer of assets *upon death*
- Distribution/transfer of cattle, real estate, cash, life
- Executor or Personal Representative handles
- Winding up of affairs of the deceased party
- Transfer of *ownership* at a defined time – *static*
- Mostly focused on individual changes at death
- Your “hit by a bus” plan – if unexpected occurs, your affairs are in order

### WHAT IS A FARM & RANCH SUCCESSION PLAN?

- Gradual transfer of labor, management, knowledge assets, risk from the older generation to the younger generation
- Transfer during lifetime rather than solely at death of human, business and financial capital
- Continuous and *dynamic* process
- Individuals, the family and the business are involved
- Retirement, estate, business, transition, land use

### Three Pillars: Labor, Ownership & Management

- **Labor:** you start and end with labor, no changes unless health or age causes change
- **Management:** Who fixes the combine when it’s broke? Who retrieves livestock in middle of night, gradual changes over years
- **Ownership:** Who is the owner of the asset, identifiable date for transition: at death, upon a sale or gift

### Estate, Death & Inheritance Taxes

- Tax payable on the total value of your assets
- Wyoming - no inheritance tax (Nebr. does)
- 2018 federal estate tax exemption - Each person can leave \$10 million without estate/gift tax OR couple = \$20 million
- Annual exclusions for 2018- gift \$15,000 per person per recipient without using exemption and without reporting

### Long Term Care

- **Pay for it** - after tax available income by earnings, assets
- **Long-Term Care Insurance** Sometimes, if you can afford it - *Variations:* Partnership plan that match and protect assets to maintain assets OR life insurance hybrids
- **Qualify for Medicaid – “safety net”** - deprivation of Resources; Transfers for less than “fair market value” within 60 months of Medicaid application (“Look Back” period) are considered available resources and penalties assessed BUT Assets transferred outside of look back period are NOT included as available resources, life estates may reduce value of available resources while maintaining ownership, but note may not be available in all states

### MAKING A FARM & RANCH SUCCESSION PLAN

1. What are the goals of the family?
2. Is there an integrated approach to the family’s planning?
3. What demands are there on the operation? Debt? Divorce? Disability?
4. What security is there for retiring generation?
5. What assets are Ranch / Non-Ranch assets?
6. What are the expectations of on vs. off-Ranch heirs?
7. What is fair (which may not be equal)?
8. What contributions do on vs. off-Ranch heirs make?
9. Is there an exit plan for off-Ranch heirs?

### Exit Plan – Escape Hatch

- Plan in manner to permit off-farm/ranch heirs to exit – an escape hatch helps prevent conflict
- If economics dictate a longer buy-out for full price– make sure there is a reduced buy-out for a shorter time
- Provisions to resolve conflict without court

### SEPARATE THE LAND FROM THE OPERATIONAL ASSETS

- **Livestock & Machinery:** Entity to transition ownership from retiring owners to the on-farm heirs through sweat equity or estate plan
- **Land Ownership:** Entity to discourage sales and provide “rules” for entry/exit and leasing

### Machinery and Retiring Generation Options

- **Leasing:** Fixed rates to cover owner’s depreciation, insurance with lessee to pay for minor repairs and maintenance
- **Installment Sale:** Buyer has immediate possession and use of the machinery and associated costs of repair and upkeep; Seller finances the sale for the purchaser, and periodic payments are made
- **Gradual Sale:** Sell one or two items outright depending on cash flow and available resources of entering generation
- **Lease with Option to Buy (or Gradual Sale):** Lease combined with approaches above
- **Gift**

### Livestock Transfers

- Beneficial when new generation has limited capital
- Lease payments from one generation to the other
- Younger party receives replacements from offspring for labor and gradually acquires ownership

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### Business Entities and Protecting Real Estate Ownership for On-Farm / Ranch Heirs

- Consider more than boilerplate business terms
- Consider business governing documents as they relate to voting requirements to:
  - Sale of all of business assets
  - Change or amend governing documents
  - Sale of a portion of real estate

### Rights of First Refusal

- Right by contract where when the owner goes to sell, then the party holding the right of first refusal has the right to “trump” or enter into the transaction otherwise proposed to a third party
- Holder of the rights (often tenants or on-farm/ranch heirs) benefit by being able to purchase, BUT only when the owner wishes to sell (holder cannot force)
- Seller has the advantage on price – price is often what offer seller receives from a third party
- Make sure terms allow sufficient time for any financing that may be needed

### Option Agreement

- Right by contract where holder (i.e. buyer) has the right to buy certain property at a fixed price within a certain period
- Advantage often to buyer on price, especially in appreciation context, BUT if depreciating parties can agree on a value otherwise
- Beneficial for parties that intend to buy, but need some time to do so

- Buy-Sell Agreements** - D's of Buy-Sell: Death, Disability, Divorce, Departure, Disagreement where triggering event *obligates* either the remaining owners or the business to buy all or a portion of the affected owner that allows owners to value ownership interests in a mutually beneficial way but should consider:
- Valuation: Annually determined value, tied to insurance or appraised value either with or without minority discounts
  - Timing: Provide appropriate time periods
  - Discounts on values

### Put / Call Concept

- PUT forces others to buy out the other one leaving
- CALL forces others to sell and forces exit - allows on-farm/ranch heirs to force a sale

### Farm & Ranch Property Ownership

- **By Name:** (1) Joint tenancy or Tenancy in Common (2) Beneficiary – Transfer on Death Deed or (3) Individual – Estate
- **By Business entity:** (1) Partnership (2) LLC or (3) Corporation

**The General Partnership:** An association of **two or more persons** who operate as co-owners to generate a profit.

- Lacks limited liability protection
- Beneficial for USDA program qualification in viewing pass-through members to overcome one entity rule
- Taxation: Partners report their individual share of income, losses, etc. on individual income tax returns

**Partnership Variations:** limited liability partnership (LLP), limited liability limited partnership (LLLLP), and limited partnership (LP)

- Provides liability protection, but may not fit for USDA qualifications

### The Corporation

- A separate legal entity created under state law
- **Taxation:** S Corporation: Pass through entity and report individual share of income, losses, etc. on individual income taxes OR C Corporation: Income tax paid on profits earned at the corporate level, and then shareholders pay income tax on dividends distributed by the entity – is a separate taxing entity
- Provides limited liability; Any # of shareholders
- Three layers of decision-making: Officers, Board of Directors, and Shareholder

### The Limited Liability Company (LLC)

- Owners are called members and then Member-managed or Manager-managed = who is the decision maker; limited liability
- Operating agreement that governs the members
- Taxation options: Disregarded – Schedule F, Partnership, and S Corporation

### Managing Family Relationships

- Communication is key
- Identify and discuss expectations of on-farm/ranch heirs AND off-farm/ranch heirs
- Balancing on-farm/ranch heirs with off-farm/ranch heirs