Your Land is Your Legacy

A GUIDE TO
PLANNING
FOR THE FUTURE
OF YOUR FARM

by Jeremiah P. Cosgrove and Julia Freedgood

Third Edition

American Farmland Trust

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American Farmland Trust (AFT) is a nonprofit conservation organization founded in 1980 to protect our nation's strategic agricultural resources. AFT works to stop the loss of productive farmland and to promote farming practices that lead to a healthy environment. AFT provides a variety of services to landowners, land trusts, public officials, planners, agricultural agencies and others. Services include workshops on estate planning and farmland protection, Cost of Community Services studies, farmland protection program development and agricultural economic analysis.

AFT's *Farmland Information Center* (FIC) is a clearinghouse for information about farmland protection and stewardship. The FIC is supported by a cooperative agreement between AFT, USDA's Natural Resources Conservation Service and the members of AFT.

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Acknowledgments

This guide is not a substitute for good legal and financial advice. We urge you to read it, reflect on your own situation and then seek the professional assistance you need to accomplish your estate planning and farm transfer goals.

Laws affecting estate planning and farm transfer can, and often do, change. Over the past 25 years, tax rates, exemption levels and eligibility requirements for tax deductions and deferral have been modified substantially at both the federal and state levels. They are likely to change again.

This publication involved a great deal of collective effort—from those who helped underwrite and produce its several editions, to the farm and ranch families who inspired its creation.

We are grateful to the people who contributed to all three editions of this guide, especially our reviewers: David R. Wood, retired executive director of Saratoga County Cooperative Extension who also owns Eildon Tweed Farm; Isabel Prescott, who owns Riverview Orchards; Konrad Liegel, an attorney with Preston Gates & Ellis; Don R. Rogers, First Pioneer Farm Credit, ACA, Enfield, Conn.; Norman Coe, First Pioneer Farm Credit, ACA, Claverack, N.Y.; Bob Sajdak of Comerica Bank; Jeanne Naglak of UBS/PaineWebber; Ryland Howard, an attorney with Oppenheimer, Blend, Harrison & Tate; Cathy Sheils of the New York Farm Net Program, and Lynne Sherrod of the Colorado Cattlemen's Agricultural Land Trust.

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Our deepest appreciation goes to those who work the land—because there would be no farmland without farmers and ranchers.

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Preface

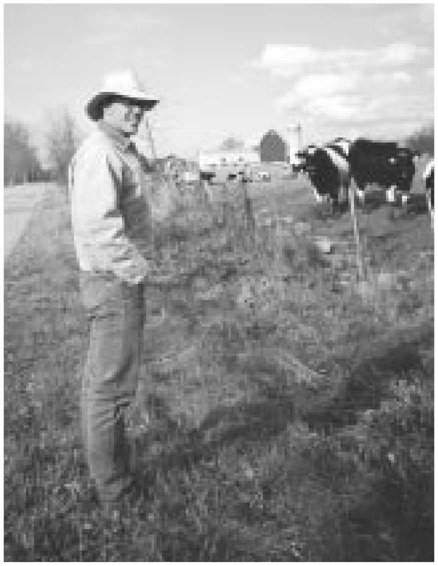

Photo by Teri Ptacek

Jerry Cosgrove

Estate planning and farm transfer are personal issues. Believe me, I know. I grew up on a dairy farm in Clinton, New York. Our family's farm was purchased and farmed by my great-grandfather, Patrick, my grandfather, Jerry, my father, Tom, and now my brother Mike. Even though I have not actively farmed for many years, I still care deeply about the future of the Cosgrove family farm. My brothers and sisters do, too. Mike and his wife, Ruth, have put together an estate plan for our family farm—which they bought from Dad just before we published the first edition of this guide.

When I think about the importance of estate planning and farm transfer, I almost always do so in relation to my family's farm. Good estate planning is one of the most important steps that farm families can take to protect their farmland for future generations. So please, after you read this guide and chew on things a bit, take the next step—call up an expert, convene a kitchen table meeting, discuss these issues, whatever it takes. Just do it! Estate planning is important—for your family, your business and your land.

Jerry Cosgrove

P.S. And as we publish this third edition, the recent estate tax "repeal" (effective for the year 2010 only at this point) serves as a vivid reminder that estate planning, not estate taxes, remains the critical issue.

Introduction

Balancing commercial and conservation goals in farm estate planning is a challenge. It's worth the effort. This guide is for people who want to do it: farmers, ranchers and their families; conservationists and members of land trusts; attorneys, estate planners, financial advisors and other estate planning professionals; interested readers concerned about transferring land to farmers and ranchers while also taking care of their agricultural operations and family needs.

Farmers often say, "The best way to protect farmland is to farm it." We agree. But farming and ranching are risky enterprises. Often, land's market value is higher for non-farm activities than it is for agriculture, so it's tempting to sell farmland for house lots or other development. Land is especially vulnerable to conversion pressures when it passes from one owner to the next. Even families that plan to pass it on can lose their land without sound estate planning.

According to the 1997 Census of Agriculture, from 1982 to 1997, the average age of farmers went up from 50 to 54 years, and by 1997, 26 percent of farm operators were 65 years old or older. According to the National Resources Inventory (NRI), since 1982 we have converted 25 million acres of rural land, and 58 percent were agricultural acres. The NRI reported that from 1992 to 1997 an average of more than 1 million acres of agricultural land were converted to developed use each year—up 51 percent from the rate reported in the previous decade. Millions more acres will change hands in the next generation, likely to be the greatest transfer of wealth in this nation's history. Both the land and the business can be transferred from generation to generation within the family.

At least that is the way it is supposed to work. But you have probably heard disaster stories. For example, Dad dies suddenly without a will, and state law—not Dad—decides who gets the farm. Or Mom and Dad leave the farm to their four children in equal shares; one son stays on the farm but he cannot afford to buy out his siblings, so they sell the farm. Or Mom leaves the farm in a trust managed by a trustee who does not know anything about farming. This trustee refuses to let the children expand the operation because he does not like big farms. Eventually, the ownership is transferred, but the children never develop the management skills to run the business. As a result, no one is able to run the farm after the mother dies.

More than half of the land in the United States is privately owned and managed, generally as part of a farming or ranching operation. Thus,

We approach estate planning with two basic goals:

1. To help farmers and ranchers find the best way to transfer their operations to other farmers and ranchers;

2. To keep productive land in agriculture.

Estate planning isn't easy and is likely to take longer than you think. But time is slipping by—so let's get started!

How can you and your family ensure a smooth transfer of assets and management?

Through sound estate planning.

landowners play a critical role in safeguarding its future. While we all care about good food on our tables, environmental quality and economic development, it is generally up to farmers and local communities to protect farmland for agriculture and the benefit of society as a whole.

We all must work together to ensure public policies will conserve American farmland. Estate planning is a private way to achieve this goal. Planning for the agricultural business can help maintain farming and accomplish conservation objectives. Conservation planning can help integrate resource protection goals into agricultural decision-making. Everyone must develop their own strategies and employ their own choices of tools to transfer their land and operations.

One thing is certain: You can't take it with you. The question is, do you want to have a say in its ultimate outcome? If so, it's time to get to work on your estate plan.

Successful estate planning and farm transfer require effective communication and a team effort—including financial, farm management, tax and legal expertise. Because plans must be tailored to individual circumstances, they must be designed to meet a variety of unique situations. We hope this guide will help.

We provide information and examples to help you assess your own situation and form an action plan. We discuss basic estate planning as well as some strategies and techniques to transfer your operation and land, using case studies and examples to illustrate some of these. While we place special emphasis on conservation options, we cover a variety of approaches to keeping land available to the next generation. Since combining land transfer and protection can complicate other estate planning efforts, it is important to understand all the alternatives.

Remember, this guide cannot substitute for good legal and financial advice. Our discussions are general in nature and intended to outline opportunities and stimulate thought. Make sure you find the professional assistance you need to accomplish your goals.

Rank your priorities for developing your estate planning goals:

DURING YOUR BUSINESS YEARS (1-6; 1 being the most important)
___ Be in control of the entire farm operation
___ Develop a successor
___ Specialize in one area on the farm that you like
___ Find time to do other things
___ Plow excess funds back into the farm business growth
___ Build independent retirement nest egg

FOR YOUR RETIREMENT YEARS (1-8; 1 being the most important)
___ Retire as early as possible, age ___
___ Still be involved in farm operation about
___10% ___ 50% ___ 75% of the time
___ End management responsibilities
___ Don't want to worry about farm finances
___ Get rid of my debt
___ Find off-farm work
___ Move away from farm
___ Travel ___ 10% ___ 50% ___75% of the time

IN ANTICIPATION OF DEATH (1-8; 1 being the most important)
___ Keep the farm in the family
___ Maximize financial security for spouse
___ Cut estate settlement costs
___ Be fair to all heirs in property distribution
___ Distribute some of my assets before I die
___ Keep assets from nursing home care
___ Pull the plug if on a life support system
___ Minimize financial management for the surviving spouse

Worksheet developed by First Pioneer Farm Credit ACA and used with permission.

Primary Strategies

Three phrases worry us most :

"We don't need a will."

"We have a will — we're all set."

"We want to treat our children fairly, so we will divide everything equally among them."

Every estate planner has a list of top planning mistakes, most common errors and omissions, pitfalls of estate planning, and so on. These are common for good reason. Estate planning and farm transfer can get very complicated. They are a means to an end, not an end in itself. At a minimum, an estate plan should accomplish four basic goals:

1. Transfer ownership and management of the farm business, farmland and other assets;
2. Avoid unnecessary transfer taxes (e.g., income, gift and estate taxes);
3. Ensure financial security and peace of mind for all generations;
4. Develop the next generation's management capacity.

These three phrases worry us most, reminding us why we need to plan ahead:

"We don't need a will."

Dad dies suddenly without a will. He had farmed together with his son Jack for almost 15 years, but they had no formal operating agreement. Dad had always assumed that Jack would take over the farm some day. Without a will, the entire estate, including the farm, is divided between Jack, his mother and his two sisters. This family was fortunate: They manage to work out a joint ownership arrangement and Jack continues to run the farm. But without a will, Dad had no say in how the assets were transferred or to whom.

"We have a will—we're all set."

Steve and Sally have three young children and a small farm in Ohio. Their farm business is doing well, and they recently completed wills that leave all their property to each other. Since they have relatively little net worth, they don't think they need anything else. But what if Steve died suddenly in a car crash and Sally were disabled? Who would assume guardianship of their children? Would there be financial assets, such as life insurance, to support the family? A simple will does not address these important issues.

"We want to treat our children fairly, so we will divide everything equally among them."

Let's go back to our first example, but change things a bit. Suppose Mom and Dad complete a will that leaves everything to the survivor and then equal shares to the three children. They assume that Jack will take over the farm someday. But unexpectedly, Mom and Dad die within one year of each other. Jack's sisters need money to pay for tuition and to support young children. What if the bank won't loan Jack the money to buy out his sisters' equal shares? Is this the fair scenario that Mom and Dad wanted?

Who do you want to own and manage your farm after you die?

How will estate settlement costs be paid?

How do you ensure financial security for your family?

As we discuss the increasingly complex, and perhaps confusing, transfer strategies and techniques, it will be helpful for you to set basic goals and to keep them in mind as you proceed through the estate planning process. For example:

- Who do you want to own and manage your farm after you die?
- How will estate settlement costs be paid?
- How do you ensure financial security for your family: parents, children, grandchildren?

As the saying goes, keep your eyes on the prize.

LEARNING THE LINGO

Now it's time to get down to some estate planning basics. In this section we review terminology, talk about how to get started and discuss some basic transfer strategies and techniques. Estate planning language is often unfamiliar and confusing. Even words we think we understand can have unexpected meanings. We explain some essential terms here and have included a glossary at the end of the guide.

Let's start with the most basic. An **estate** is comprised of all the assets you have accumulated over your lifetime and own when you die, including your home, land, buildings and equipment; your financial resources, such as bank accounts, stocks, bonds, retirement accounts and life insurance; and anything else that you possess at the time of your death *(see the worksheet on page 8 to help you inventory your assets.)* The **gross estate** is the net value of your estate before taxes; the **taxable estate** is the gross estate minus all deductions (including administration or attorney's fees), which determines the estate tax. **Estate tax** is the tax imposed on property owned or otherwise subject to tax at death. Some states supplement the federal estate tax by levying state estate taxes, which are sometimes called inheritance or death taxes.

A **will** is a legal document that provides instructions about how your estate will be distributed after you die. In most states it must be written and witnessed by two or three disinterested persons. An **executor** or

How do you ensure financial security for your family?

executrix is the man, woman or institution you name in your will to manage and dispose of your assets according to the instructions you leave in your will. **Probate** is the legal proceeding that validates your will and authorizes the disposition of the assets transferred by the will.

For estate planning purposes, a **gift** is a lifetime transfer of assets for which you receive no payment or a payment for less than market value, also known as a bargain sale. Each year you can make gifts of up to $11,000 to an unlimited number of people without paying gift tax.[1] Gift tax is the transfer tax imposed on property transferred during your lifetime. **Trusts** are legal arrangements under which assets are managed by a trustee for a beneficiary, who is often a third party. Trusts may be created to take effect during one's lifetime *(inter vivos)* or at death *(testamentary)*. *Revocable trusts* may be changed, while *irrevocable trusts* are permanent. **Unified credit** is a federal tax credit used to reduce federal estate and gift tax liability. Also referred to as a "personal exemption," in 2002 the unified credit exemption amount was increased to $1 million for estate and gift taxes. It will increase gradually to $3.5 million in 2009 for estate taxes.[2]

The gift tax exemption will remain at $1 million per person. As a result, through 2009 there no longer will be a "unified" exemption system that applies to both estate and gift taxes. The estate tax is slated for repeal in 2010. However, a sunset provision in the law means that the estate tax is effectively repealed only for 2010. What this means is that for those who die in 2010 there will be no estate tax, however, in 2011 (under the current law) the exemption will revert to $1 million.

GETTING STARTED

Estate planning is one of the most personal things you will ever do. You will need to revisit your plan over time as your goals, financial circumstances and family relationships change. Laws, especially tax laws, also change. So part of getting started with the estate planning process is figuring out what your goals are so you can develop strategies to accomplish them. Another part is realizing that as your goals and circumstances change, you must revisit your plan and adapt it to the constant ebb and flow of your life.

We explain the basic estate planning concepts and techniques to help you create your plan. We can't answer your most intimate family and

[1] The annual gift exclusion is indexed for inflation.
[2] In 2002-2003 it will be $1 million; in 2004-2005 it will be $1.5 million; in 2006-2008 it will be $2 million; and in 2009 it will be $3.5 million.

financial questions for you. There is no menu, blueprint or formula to follow; the answers that are right for someone else may or may not be right for you.

You do have choices, and this guide can help you think through them to help you make decisions that satisfy your goals. But it cannot replace good personal, legal and financial advice. So an essential part of getting started also is choosing the best combination of players to support you on your estate planning team.

Choose the best combination of players to support you on your estate planning team.

SET GOALS

With an estate plan, you decide how you want your property to be distributed at retirement and after you die. An estate plan is also a way to build your estate and protect yourself and your family financially while you're alive. But remember, you need to map out a timeline to keep things on track.

What do you want to accomplish with your plan? The following is a sample of typical questions to ask. The issues they address are very sensitive, and the choices you make will profoundly affect the people you care about. So be frank with yourself, spell out your goals and then find the tools to achieve them.

Do you want to take care of dependent children or elderly parents? How will you support yourself or your spouse in the case of a medical emergency or disability? Do you want to generate income for retirement? Who do you want to make decisions about your property if you are ill or after you die? Do you have grown children who want to farm? Do you have children who do not want to farm? How do you want to divide your assets between them? Who do you want to inherit your farm? If you're married, how do you want to provide for your spouse?

INVENTORY YOUR ASSETS

A good way to start the planning process is with a personal financial inventory. What business and personal assets do you own? What are they worth? What debts do you have? You probably do not need detailed appraisals in the initial stages of the planning process, but accurate estimates of asset values are very important. Many farm owners have gotten themselves and their heirs in estate tax trouble by underestimating the fair market value of their land. To plan properly, you must know your financial worth. You might want to pencil in your assets on the following asset inventory worksheet.

To plan properly, you must know your financial worth.

Net Worth Inventory

ASSET	MARKET VALUE	-	LIABILITIES	=	NET WORTH
Farm					
land					
buildings					
equipment					
livestock					
other					
Personal					
residence					
household property					
motor vehicles					
Investment/Savings					
savings account					
checking account					
stocks/bonds					
pensions/IRAs					
other retirement/savings					
Business Assets					
Miscellaneous Assets					

ASSET	FACE VALUE	CASH VALUE	OWNER	BENEFICIARY
Life Insurance Policies:				
policy #1				
policy #2				

DETERMINE OWNERSHIP AND ASSETS

Next, you must determine who owns what. You probably already think you know, but be sure you understand all the associated business and legal relationships. How property is owned affects what you can do with it. A common example involves property owned as joint tenants, with a right of survivorship. If a husband and wife own a farm as joint tenants, the farm will pass automatically, or "by operation of law," to the survivor. Even if the husband tries to leave his share to his children in his will, because of the way the property is owned, the law would prevent this from happening. Joint ownership with rights of survivorship can be a simple, cost-effective way to transfer property. But it may not be the best strategy to accomplish your goals. Make sure you fully understand how your property is owned so that you can make changes if necessary.

ASSEMBLE YOUR TEAM

Who do you want on your estate planning team? Your parents or children, your attorney or lender, your farm management or tax advisor? Estate planning and farm transfer involve some of the most important family, business, financial, legal and tax decisions you will ever make. You must have confidence in your advisors and be able to work with them on an ongoing basis. This won't happen overnight. A good estate and transfer plan will require considerable time and money, but it is an investment in the future of your business and your land. Neglecting to plan could cost your family a lot more than creating a plan. So sit down with someone you trust to help you get started.

APPLYING BASIC TECHNIQUES

Did the inventory of your assets surprise you? Farmers and ranchers who tend to be short on cash are often surprised by the value of their assets. As well as calculating your net worth and determining how your property is owned, we hope you have begun to assemble advisors to include on your estate planning team. What's next? Before we introduce you to two farm families whose situations are fairly typical, we will outline some basic techniques and issues to consider.

Choose the form of business organization that fits.

Your choice of business organization should complement your estate plan. There may be tradeoffs between retaining control of the business and reducing transfer taxes, between selling assets and giving them as gifts, between treating your children equally or fairly, and between paying capital gain or gift taxes now or estate taxes later. The estate planning and farm transfer process is a good time to evaluate your present business arrangement and decide whether it meets your current needs and helps you achieve your farm transfer and estate planning goals.

The basic forms of business organization include sole proprietorships, partnerships, corporations and limited liability companies. Each has its advantages and disadvantages in terms of organizational complexity and transfer perspective. A sole proprietorship is fairly simple. A corporation requires more time and attention to form and maintain. In between are partnerships and limited liability companies, which combine attributes of individual and corporate ownership. From both a management and asset transfer perspective, each offers advantages, depending on the family and business needs of your situation. There is no right way to organize a business; your choice should fit your needs. For more details, see page 32.

Complete a will and keep it updated.

Review your will if it is more than five years old to make sure it reflects your current situation.

A will is a legal document that provides instructions about how you want your estate to be distributed when you die. Revisit your will periodically, especially when important family or financial circumstances change, such as when a child is born, a person important to the farm business dies or a family member makes it clear that he or she has no interest in working in the farm business. Of course, if your financial or marital circumstances change or there is a change in the estate tax laws, it also is important that you review your estate plan and make appropriate changes.

For example, Mom and Dad had executed their first will when their children were young. Twenty-five years later, they revise it as part of their farm estate and transfer plan. But what if something had happened in year 20? The children were out of school and back on the farm working in the business. Would the 20-year-old will have accomplished their objectives? Unlikely. Review your will if it is more than five years old to make sure it reflects your current situation.

Complete a living will/health care proxy and power of attorney.

As the Boy Scout motto says, "Be prepared." Your family needs to be able to make important decisions if you become unable to make them yourself. A living will is a way to state your wishes regarding treatment should you become terminally injured or ill. A health care proxy allows someone else to make critical medical treatment decisions for you. Where possible, a living will should be used to provide guidance to the designated proxy to help them exercise that judgment. Through power of attorney you can designate the same or another person to act on your behalf regarding financial and legal matters. These documents make it possible for you to choose someone to make difficult medical and financial decisions in the event that at some point you cannot make them for yourself.

Deal with both management and asset transfer issues.

If there are unresolved business operation and management issues, they should be discussed during the process of estate planning, if not before. For example, Mom and Dad want to rewrite their wills to provide for their 38-year-old farming son and their recently divorced daughter who has two children. It turns out that the parents and farming son have no formal operating arrangement and the son feels uncomfortable talking about an estate plan.

Photo by Jeremy Green

Land is usually the most valuable, least liquid and most highly appreciated farm asset.

Transfer operating assets before farmland.

For tax and other reasons, operating assets generally should start being transferred as soon as both generations are comfortable with this commitment. People usually transfer operating assets first because they tend to be more affordable and offer a good first equity-building phase. Besides, operating assets, such as cattle and equipment, typically generate the cash flow needed to purchase the land and buildings. Because land is usually the most valuable, least liquid and most highly appreciated farm asset, it often makes sense to transfer it in a second phase after at least some operating assets have been transferred.

Provide liquid assets to bequeath to non-farming heirs and to pay transfer taxes.

Liquid assets are cash and cash equivalents. Financial assets, such as bonds, stocks, mortgages and certificates of deposit, are easier to convert into cash than operating assets or farmland. All too often, one of the major problems is the lack of cash to satisfy the obligations of non-farming heirs and to pay estate settlement costs, including state inheritance tax. There is no easy answer to this one. Life insurance is an effective solution but can be very expensive. It also tends to provide a lower rate of return than other investments. Saving can be difficult for farmers. Borrowing for estate settlement costs is problematic. And liquidation of assets, especially land, is what we are trying to avoid in the first place.

The liquidity issue is one of the most pervasive challenges in farm estate planning. It highlights the need for more complete financial and retirement planning, which will result in more available cash, the recognition that "equitable" will not always be "equal" for farm families, and the importance of avoiding unnecessary transfer taxes. For now, recognize the challenges and agree that doing nothing is the only option not to consider.

Farm Transfer and Tax Reduction Case Studies

Now that you have had a chance to digest some of these basics, we invite you to join us in a closer examination of farm transfer and tax reduction strategies. We have chosen two real-life situations to show how specific families have combined options to achieve their goals. (We have changed the names and modified details to protect confidentiality.)

Consider the choices presented in these stories in context with your own circumstances. Refer to the "Follow-up Strategies" section on page 32 for more detail. Remember, there is no right way to plan your estate. The cases and examples we provide are the way specific individuals have dealt with their own particular situations. You can use their ingredients to create your own recipe, but this is not a cookbook. What you decide to do and how you decide to do it is entirely up to you.

The list on the following page outlines the basic strategies used to transfer farms and reduce estate taxes. It is comprehensive but by no means exhaustive. It should provide the basic building blocks to use as you discuss your options with your family advisors.

What are some of the challenges of farm transfer and the estate planning process?

What are your options?

Photo by Jeremy Green

FARM TRANSFER AND TAX REDUCTION STRATEGIES

Transferring management responsibility and asset ownership gradually can provide a smooth transition for the farm business from one generation to the next.

Estate splits between spouses enable both estates to utilize their federal unified credits.

Buy/Sell agreements can ensure orderly transfer of the farm business.

Limited partnerships or corporations can allow separation of management and ownership of the business, if desirable.

Trusts can provide financial security for surviving spouses, children and grandchildren.

Long-term care insurance can protect family assets from paying for nursing home costs.

Annual gifts of assets to children can help transfer the business and reduce estate taxes.

Life insurance can be used to fund buy/sell agreements, establish trusts, provide for nonfarm heirs or pay estate taxes.

"Special use valuation" can reduce estate taxes if the fair market value of the farmland greatly exceeds its agricultural value.

Minority discounts can substantially reduce gift and real estate tax liability when minority interests of a family farm business are transferred.

Agricultural conservation easements can protect land permanently from nonfarm development and significantly reduce transfer taxes in cases where the market value of the farmland is much greater than its restricted value. Selling an easement can protect farmland, reduce taxes and provide cash for retirement and estate planning needs.

Scenic View Farm

Photo by Jeremy Green

Our first case study, Scenic View Farm, is located in New York's Hudson River Valley, about 45 minutes from the nearest urban center. Jim and Frances Smith own the 500-acre farm and milk 300 cows. Their son Jim Jr. is 28 and recently married. Their daughter Sheila is 25 and engaged. Both have worked on the farm since returning home from college. Their other two children, Bill and Mary, live and work off the farm.

Jim and Frances are in their mid-50s and have decided it is time to update their wills and start the farm transfer and estate planning process. What are some of the challenges they face? What are their options? What if Jim and Frances do nothing?

The Smiths own the farm jointly with a right of survivorship and operate as a sole proprietorship. They drafted their wills when the children were young, and the wills contain an "I Love You" provision passing all assets to the surviving spouse. Their main concern at that time was the choice of guardians for their children. However, over the years they have built a successful business.

With their present net worth of $1.3 million and no additional estate planning, what would happen if Jim and Frances were involved in an auto accident and died within several weeks of each other? How would Jim Jr. and Sheila buy the farm from their siblings? Would they be able to pay settlement costs, such as legal, accounting, appraisal and funeral expenses, which are typically as much as 4 to 6 percent of the estate?

One solution would be a properly structured buy/sell agreement. As part of a partnership, corporation or limited liability company farm business arrangement, this could set the framework for an orderly buyout in the event of a death. The buy/sell arrangement could set the price and terms of any buyout and should address possible financing options. The buy/sell agreement would ensure that the next generation could plan for their farm's future as well.

A simple estate split would allow both parents to use their unified credits and pass up to $2 million in 2002 and $7 million in 2009 to their children free of federal estate taxes. However, if all assets go to the surviving spouse, the problem with using the marital deduction is that the unified credit is lost.

To split the estate, Jim and Frances would need to change the ownership of the real estate from joint tenants to tenants in common. This would eliminate the survivorship aspect of joint tenancy. As a result, each parent could leave their half-interest directly to their farming children in their wills. Or, each could leave their half-interest to a trust with instructions to the trustee to allow farming as a priority and that this interest must be sold to the farming children on pre-arranged terms. Such an estate split would enable them to use their unified credits fully, essentially doubling the amount of assets they can transfer free of federal estate tax.

ASSETS		LIABILITIES	
Farmland	$750,000	Mortgage	$250,000
Farm buildings	250,000	Other debt	150,000
Residence	75,000		
Cattle/equipment/inventory	500,000	*Total Debt*	*$400,000*
Life insurance benefit	100,000		
Other assets	25,000		
Total Assets	*$1,700,000*	NET WORTH	*$1,300,000*

Horizon Acres

Photo by Jeremy Green

Our second case study involves Horizon Acres, located about two hours from Chicago. Bill and Roberta Jones own a corn and soybean operation with their son Roy. They farm a total of 2,500 acres in a partnership arrangement. They own 1,500 of these acres and rent the remaining 1,000. Roy has three other siblings, each with children of their own. At 65, Bill and Roberta would like to retire and move to Arizona. But can Bill and Roberta afford to transfer their farm to Roy? With an estimated land value of $1,500/acre, Bill and Roberta's net worth looks like the chart on page 19.

Most of their $3.1 million net worth is tied up in their land, which they bought for $250 per acre in the early 1960s. Their untimely deaths could result in a potentially contentious intra-family showdown over buyout terms for Roy. An immediate sale would trigger more than $370,000 in capital gains tax[3] based on the appreciation in value from $250/acre to $1,500/acre, but of greater concern is how Roy would find the $2.5 million

[3] *The state income tax may increase the tax bite by an additional $40,000.*

The longer you wait, the fewer options you have, and they become more difficult and costly.

Start planning your estate today!

he would need to buy out his siblings at their parents' death—assuming they did what many parents do—divide their assets equally among their children.

What now? Before we discuss that question, it is important to note that Bill and Roberta should have started this process sooner, as much as 10 or 15 years earlier. As the following discussion will illustrate, time is a critical ally. Bill and Roberta need to start to transfer the farmland by sale and gift immediately to Roy. They must also consider how to provide for sufficient liquidity to give Roy the opportunity to buy out his siblings' shares when Bill and Roberta die.

One way to do this is through insurance. Roberta could transfer ownership of their $50,000 life insurance policy to one of their children or to a life insurance trust. But because their policy is modest relative to their $3.1 million estate, Bill and Roberta should explore whether buying additional life insurance would be a cost-effective way to create instant liquidity and address the financial expectations of their nonfarm children without burdening Roy with debt in a family buyout scenario. They could purchase a second-to-die policy. Such a policy would pay death benefits at the death of the surviving spouse, when the fair versus equal dilemma becomes all too real. To avoid inclusion in the estate, someone else must own the policy. It could be one of their farming children or an insurance trust.

Or they could consider forming a family limited partnership as a way to transfer ownership of assets to the next generation. The limited partnership would hold ownership of the land, but the general partner managing interest would be transferred to Roy. The other children would hold limited partnership investment interests.

Besides exploring life insurance options and changing ownership of the farmland, Bill and Roberta should transfer the remaining operating assets to Roy as soon as possible. They could consider an installment sale of the farmland to Roy or a formal lease with an option to purchase. While the sale of a highly appreciated asset creates significant potential for capital gains taxes, a sale arrangement locks in Roy's legal right to buy the farm, or at least to have the first shot at it. Wills can be changed unilaterally, while contracts cannot.

ASSETS		LIABILITIES	
Farmland	$2,225,000	Operating Line of Credit	$250,000
Farm buildings	125,000		
Residence	75,000		
Equipment/inventory	750,000	*Total Liabilities*	*$250,000*
Life insurance benefit	50,000		
Other assets	100,000		
Total Assets	*$3,325,000*	NET WORTH	*$3,075,000*

Sales arrangements offer great potential for creativity and flexibility in estate planning. If Roy feels that the farmstead and surrounding 500 acres are the critical core to his future farming operation, the Joneses may want to sell that portion of the farm to him now. They could transfer the rest by will, future sale or gift of $11,000 per year per person tax free to Roy and his wife and to his siblings.

They could do this—if they have the time. Bill and Roberta's estate plan and farm transfer efforts would work very well if they plan early in life. It takes time to put the pieces into place. The longer you wait, the fewer options you have, and they become more difficult and costly.

Conservation Options

Many farmers and ranchers wonder what will happen to their land when they stop cultivating it. Producers who pass their operations on to their children may take comfort knowing that their land will be productive in the future. But what about those who have no heirs who want to take over?

Often, landowners would like to support conservation efforts with gifts of land, conservation easements or other charitable donations. But farm transfer and land protection can complicate estate planning efforts. So it is important to understand them. We will discuss four topics: conservation easements (both donating and selling them), life estates, charitable remainder trusts and charitable gift annuities. These options can be used separately or in conjunction with each other, so we also will discuss possible interrelationships.

Conservation Easements

A conservation easement is a deed restriction landowners voluntarily place on their property to protect resources such as productive agricultural land, ground and surface water, wildlife habitat, historic sites or scenic views. Conservation easements are flexible documents tailored to each property and the needs of individual landowners, and typically prohibit subdivision and development. They may cover an entire parcel or portions of a property. Agricultural conservation easements are designed to keep land available for farming.

A **wetlands easement** is designed to restore and protect wetlands and their associated upland acreage. Wetland easements are drafted specifically to enhance wildlife habitat and achieve other wetlands functions such as protecting water quality. Like conservation easements generally, they are deed restrictions that are conveyed to, and enforced by, conservation organizations or public entities. They protect land from subdivision and development, but unlike agricultural conservation easements, wetlands easements limit agricultural uses to those that are compatible with protecting and enhancing the wetlands and associated upland habitat. For instance, wetlands easements typically prohibit tillage or cultivation. The federal Wetlands Reserve Program (WRP) offers landowners the option of either 30-year or permanent easements. For permanent easements, the U.S. Department of Agriculture (USDA) compensates participating owners based on the agricultural value of the property. Thirty-year easements are 75 percent of what would be paid for a permanent easement.

A **floodplain easement** may be appropriate for land with a history of flooding. This easement provides the Natural Resources Conservation Service with the full authority to restore and enhance the floodplain's functions and values. A landowner may obtain authorization to engage in other activities. Compatible uses may include managed timber harvest, periodic haying or grazing. In general, the value of the easement is based on the property's agricultural value.

An **agricultural conservation easement** can protect land for future agricultural use and reduce transfer taxes. Used with other estate and financial planning techniques, an agricultural conservation easement can help you transfer your farm or ranch to the next generation.

An agricultural conservation easement is a restriction that runs with the title to the land to limit subdivision, non-farm development and other uses of the land that are inconsistent with farming. It is created by a written agreement between a landowner and a conservation organization or public body. Like all legal agreements affecting the chain of title, an easement must be recorded in the local land records. It is enforced by the organization or public body that holds it.

An agricultural conservation easement protects private property rights and generally allows a variety of farm uses. It can be tailored to fit specific family and farm circumstances. For example, you might want to exclude some land from the easement or to reserve lots for building on less productive land or woods. A few well-sited building lots could provide housing for the next generation or for farm employees, or cash to pay estate taxes and/or distribute to non-farm heirs. However, reserved or excluded lots should be carefully located to minimize any impact on the farming operation and avoid the best agricultural land.

THE BENEFITS OF DONATING AGRICULTURAL CONSERVATION EASEMENTS

Why do farmers or ranchers donate an agricultural conservation easement? One major reason is that they want to protect their land and keep it available for agriculture in the future. Another important reason is that donating an easement can provide tax savings.

Generally, the value of an agricultural conservation easement is the fair market value of the land minus its restricted value. Thus, placing an agricultural conservation easement on your land can significantly reduce the size of your taxable estate. Depending on the value of your estate, donating an easement could reduce your estate taxes, as well. Finally, conservation easements qualify for an income tax deduction (up to 30 percent of adjusted gross income) if donated during your lifetime. This deduction can be carried forward for up to five additional years if you are unable to use it all in one year.

An untested application is to use an agricultural conservation easement to protect your farm if it must be sold to pay nursing home costs. While an easement would not prevent the sale of the farm, it could stop a developer from buying it and carving it up into a subdivision or farmettes. However, it must be clear that the primary reason for the agricultural conservation easement is to protect the farm and not just to avoid paying nursing home costs.

The estate planning benefits are very important. A conservation easement increases the likelihood that your heirs can afford to purchase your land, which may avoid potential family conflicts and provide sufficient direction to your executor(s) and trustee(s) regarding valuation and sale terms of assets.

ADDITIONAL ESTATE TAX EXCLUSION UNDER SECTION 2031(C)

Section 2031(c) of the Internal Revenue Code provides for a limited exclusion of eligible land subject to a qualified conservation easement.

The Taxpayer Relief Act of 1997 enacted a modified version of the American Farm and Ranch Protection Act, and this was expanded in the Economic Growth and Tax Relief Reconciliation Act of 2001. Section 2031(c) of the Internal Revenue Code (IRC) provides for a limited exclusion of eligible land value subject to a qualified conservation easement. The exclusion for eligible land value is limited to $500,000.

Section 2031(c) enables landowners to use the estate tax benefits of conservation easements in two ways. The first is by reducing the size of the gross estate based on the full value of the easement. The second is by excluding 40 percent of the residual value of the protected land from the estate, subject to the scheduled exclusion limitation.

For example, let's say the fair market value of your land is $2 million. If you protect it with a qualified conservation easement, assuming it reduces the land value by 50 percent, you could reduce your taxable estate by $1 million. Plus, another 40 percent of the remaining value of the land could be excluded from the taxable estate, as well, up to a limit of $500,000. In our example, another $400,000 could be excluded from the taxable estate.

To qualify, the land must be subject to a qualified conservation easement as defined in Section 170(h) of the Internal Revenue Code and transferred to a qualified family member.

To receive the 40 percent exclusion, the conservation easement must reduce the value of eligible land by at least 30 percent. Smaller reductions result in a smaller percentage exclusion. Lastly, retained development rights, other than those subordinate and directly supportive of farming, ranching or timbering, are subject to estate tax.

Section 2031(c) provides for a post-mortem election that, depending on state law, may make it possible for the executor to place a conservation easement on a farm or ranch after the owner has died, as long as all beneficiaries consent in writing.

Consider Jack and Molly Thomson's family ranch in one of Colorado's mountain valleys. The Thomsons own a 1,500-acre cattle ranch, which is operated by their son Tim and his wife, Sue. A recent increase in demand for 35-acre ranchettes has raised the value of their land to $3,000 per acre, which is 10 times its restricted value of $300 per acre. When Jack realized that a million dollar estate tax bill on the ranchland alone would force Tim and his siblings to subdivide and sell off the ranch in lots, he decided to take action.

Because of the low cost basis[4] in the property when Jack bought the ranch many years ago (he paid $30 per acre) a lifetime sale or gift would have considerable capital gains or gift tax consequences. These would prevent the Thomsons from achieving their goals to protect the ranch and keep it in the family. So, the Thomsons decided to place a conservation easement on their ranch as part of their wills. When they die, the land will be valued, and therefore taxed for estate purposes, at its restricted value, potentially saving the family more than $1 million in estate taxes.[5] In addition, up to $500,000 of the value of the land subject to the easement could be excluded from the taxable estate entirely.

If Jack and Molly had a higher annual income, they could have donated the conservation easement during their lifetimes and taken an income tax charitable deduction for the difference between the market value and restricted value of the land. The maximum deduction in any one year is limited to 30 percent of their adjusted gross income. Excess deductions can be carried forward for up to five years. For the value of the agricultural conservation easement to be eligible for a tax deduction, it must be permanent, serve a public conservation purpose and yield a significant public benefit. In the Thomsons' case, conservation of the ranch would be consistent with state agricultural protection legislation and would further local planning goals.

[4] *In most cases, the basis includes the cost of the property plus the value of improvements reduced by depreciation.*

[5] *Of course, the actual estate tax due will be calculated as of the date of the owner's death. Our estimate of estate tax savings is based on the assumption that there will be only modest appreciation in the restricted value of the land.*

THE BENEFITS OF SELLING AGRICULTURAL CONSERVATION EASEMENTS

Increasingly, state and local governments are establishing purchase of agricultural conservation easements (PACE) programs. PACE programs go by many names, often purchase of development rights, or PDR. In these programs, states, municipalities and qualified nonprofit organizations buy conservation easements from landowners to restrict non-farm development and protect land for agriculture.

The recent farm bill, known as the Farm Security and Rural Investment Act of 2002, contains significant increases in spending for its conservation titles. Nearly $600 million of federal funds were authorized through the Farmland Protection Program (FPP) to match public and private funding sources to purchase agricultural conservation easements. (At publication time, the proposed rule for FPP calls for a name change to the Farm and Ranch Lands Protection Program.) The program will provide up to 50 percent of the appraised fair market value of the easement as matching funds to other sources, including the landowner. In addition, other federal programs such as the Wetlands Reserve Program (WRP) and the Conservation Reserve Enhancement Program (CREP) have funds available to purchase long-term easements designed to protect other natural resources such as wildlife habitat and wetlands.

If you live in an area that has a PACE program (Appendix C p. 57), selling an agricultural conservation easement can be a valuable estate planning strategy. It would allow you to change some of your real estate value into cash while continuing to own and operate your farm. Although you can use the income however you wish, for estate planning purposes you may want to set it aside for retirement or use it to distribute wealth equally among your children. This way you could leave your farm to your children who would like to farm and leave cash to your non-farm children. Many farm families have used the proceeds from the sale of an easement to reinvest in their farm businesses by purchasing more land, investing in new equipment or livestock, or paying down debt. Two recent studies by AFT have documented the fact that 75 percent of farmers who participate in PACE programs do just that.[6]

Most conservation easements are permanent, and permanent is a very long time. When considering whether a conservation easement is the right option for a farm or ranch, you and your family should carefully consider its impact on your land (are the reserved home sites properly located), your business (will the restrictions still allow you enough flexibility to

[6] *Robin L. Sherman, Suzanne Milshaw, Robert C. Wagner and Julia Freedgood, 1998,* Investing in the Future of Agriculture: The Massachusetts Farmland Protection Program and the Permanence Syndrome *(Northampton, Mass.: American Farmland Trust); Kirsten Ferguson and Jeremiah Cosgrove, 2000,* From the Field: What Farmers Have to Say about Vermont's Farmland Conservation Program *(Northampton, Mass.: American Farmland Trust).*

expand or diversify your farm or ranching business), your finances (have you thought through the tax implications), and your estate planning and transfer plans (have you integrated the conservation component with the rest of your estate planning and transfer efforts).

Many easement programs only offer lump sum payment options. The sale of a conservation easement is considered the sale of a capital asset and is treated as capital gain to the extent that it exceeds the basis in the property. Revenue Ruling 77-414 allows the taxpayer to reduce the basis of the entire property if it is impractical or impossible to allocate the basis between the easement and the remaining restricted property. In addition, it should be noted that payments for easements are not excludable from income under Section 126 of the Internal Revenue Code, which applies only to cost-share payments for depreciable capital improvements.[7] However, creative use of PACE can expand your options and minimize your tax bill.

For example, Joel and Gertrude Schmidt own a 150-acre dairy farm in Lancaster County, Pennsylvania. Mostly retired, Joel was renting the farm to his son, Joe. Joel and Gertrude wanted to sell the farm at its agricultural value to Joe but needed additional funds to secure their retirement.

Selling an agricultural conservation easement would allow you to change some of your real estate value into cash while continuing to own and operate your farm.

The Schmidts decided to sell an easement for $450,000 to the Lancaster County Agricultural Preserve Board as part of their estate plan. Then they entered into an installment purchase contract with Joe for the farm's $300,000 restricted value. This way, they realized the fair market value of their land, and Joe was able to buy the farm at its agricultural value.

To defer capital gains taxes on the proceeds from the sale of the easement, the Schmidts could have used a strategy called "like-kind exchange" under Internal Revenue Code Section 1031 instead. In this case, using a qualified third party, they could have traded the agricultural conservation easement for rental property in town. This could defer the capital gain and provide an income stream for their retirement. Either way, selling an agricultural conservation easement and the land at its restricted value would create a win/win option for the Schmidts.

If you are considering an agricultural conservation easement as part of your estate plan, think about how it interrelates to your other financial and family objectives. As the owner of your farm, you are in the best position to evaluate the options and determine what will work best for you.

[7] *C. Graves, 88 Tax Court, Decision #43617.*

LIFE ESTATES

A life estate can be combined with an agricultural conservation easement to save estate taxes, support a worthy charity and protect your land.

Usually, if you give away property and retain use of it, the IRS will tax it as part of your estate. However, with a life estate, you may donate your farm or your home to a charity or a nonprofit organization and retain lifetime use of it for yourself and your spouse without having it included in your estate. Thus, a gift with a retained life estate accomplishes several objectives.

- You can support your favorite charity or nonprofit organization;
- You can use an income tax deduction for the present value of your remainder interest in your home or farm;
- Your farm or residence will not be taxed as part of your estate; and
- You and your spouse can enjoy your home or farm for the rest of your lives, knowing that it will support a worthy cause in the future.

Photo by Tim McCabe, USDA NRCS

It is important to consider whether it may be more difficult to operate your farm with a life estate because the future owner may want to have a say in how the property is managed.

A life estate can be combined with an agricultural conservation easement to save estate taxes, support a worthy charity and protect your land. Consider the Morgans.

Bud and Alice Morgan own a 600-acre cash grain operation in the Upper Midwest. They have retired from farming and are renting their land to neighbors. Since Bud and Alice don't have children who want to farm, they want to donate their property to the college they had both attended, retaining the life use of their home and farm. But they were dismayed when they learned that their alma mater would give them no assurance that the farm would stay a farm after they died.

After discussing it with their advisors, the Morgans decide to protect their farm with an agricultural conservation easement before donating it to their alma mater. The easement will ensure that even when the farm is sold, it will not be sold for development but will remain available for agriculture.

By combining a conservation easement with the life estate, they were able to protect their farm, support their alma mater and substantially reduce their estate taxes.

CHARITABLE REMAINDER TRUSTS

A CRT can help you avoid capital gains shrinkage.

When you think about retiring, have you ever thought it would be nice to sell the farm, invest the proceeds and use the income for your retirement? If so, ask yourself how much will be left after paying federal and state capital gains taxes, which often knock off 25 to 30 percent. Let's look at Fred and Mary Bensons case.

The Bensons are ready to retire and their children don't want to farm. They have figured that $30,000 of income per year will supplement their Social Security and IRA income to provide a comfortable retirement. They estimate that their 275-acre farm will sell for about $500,000. The $500,000 invested at 6 percent yields $30,000 per year, right?

It would, if the Bensons netted $500,000 from the sale. However, they are only going to realize about $375,000 after taxes. And that $375,000 only will yield $22,500 a year at 6 percent. Is there a way to avoid this capital gains shrinkage?

Yes: A charitable remainder trust (CRT), which works like this. You create a CRT and then donate appreciated property (like the farm you bought 50 years ago for $150 per acre) to a CRT. The trustee of the CRT


Photo by Jeremy Green

sells the property and invests the proceeds. The CRT pays out an annual return of 5 to 8 percent. You can choose the rate of return. And you get an income tax deduction as well. What's the catch? The assets remaining in the CRT must go to a designated charity or nonprofit when the CRT terminates at your death, or after a term of years you select. However, you could use some of the income from the CRT to purchase life insurance to "replace" the value of the CRT.

The Bensons wanted to create a CRT because they wanted to make a gift to a conservation organization that they supported. Also, they will net more income than they would without a CRT: $7,500 more annually, assuming they select a 6 percent payout. They will totally avoid capital gains tax and be entitled to an income tax deduction for the present value of the gift. Finally, their estate will not have to pay any death taxes on the CRT principal.

Charitable remainder trusts are not for everyone, especially if a family member plans to take over the farm. Funding CRTs with farm real estate is more complicated than other types of appreciated property, as it often takes longer to sell farms. Avoid the temptation to line up a prospective buyer before you donate the property to the CRT because this could disqualify the tax advantages. Make the donation when you are confident of finding a buyer but before a binding agreement is in place.

CRTs can be combined with life insurance and other estate planning strategies to provide a larger income stream for retirement, preserve other assets for heirs and allow you to support your favorite charities and nonprofits.

COMPARISONS OF CRT V. CASH SALE

	CRT	Cash Sale
Sale proceeds	$500,000	$500,000
Capital gains taxes (@ 25 percent)	0	125,000
Net proceeds for investment	500,000	375,000
Income/year (@ 6 percent return)	30,000	22,500
10-year income stream	300,000	225,000
Estate tax (@ 50 percent)	0	187,500
Charitable gift	500,000	0

CHARITABLE GIFT ANNUITY

A charitable gift annuity (CGA) is part charitable gift and part payment on an annuity contract. The donor designates a charity or nonprofit and transfers property directly to the organization in exchange for a fixed annuity for life. Usually the property is a highly appreciated asset, and sometimes the annuity is good for the life of another beneficiary—like a spouse. Because the property is transferred directly to the nonprofit (and not to an intermediary like a trustee), donors must be sure that the organization has sufficient financial resources to ensure payment of the annuity over the full term of the contract.

A CGA is a simple contract between the donor and a charity and relatively easy to establish. It gives a landowner an immediate income tax deduction and regular payments for life, while also providing long-term financial support to a charity or nonprofit. Most are funded with financial assets. Here we discuss how to use a farm or other real estate to fund a CGA.[8]

A CGA gives a landowner an immediate income tax deduction and regular payments for life, while also providing long-term financial support to a charity or nonprofit.

If the property is important agricultural land, or has other meaningful open space values, the nonprofit may protect it with a conservation easement and then sell it. Then it sets aside the proceeds in an account and uses the income to make the payments to the donor. The amount of the annuity payment is determined by several factors, including:

- The age and number of beneficiaries;
- The annuity rate agreed upon by the donor and the nonprofit organization or charity; and
- The value of the donated property.

The Council on Gift Annuities publishes annuity rates for beneficiaries with different ages. The older the beneficiary, the higher the maximum annuity. Usually, it ranges from 6 to 10 percent a year. If the donor gives the charity appreciated property, the income is characterized as part capital gain, part ordinary and part tax-free return of principal.

The donor chooses the schedule of payments: annually, semi-annually or quarterly. Unless the charity and the donor determine otherwise, payments will begin one year from the date of the property transfer to allow sufficient time for marketing and sale of the property.

The donor must obtain a qualified appraisal to determine the value of the property. The tax deduction is based on the value of the property, the age of the beneficiary, the annuity rate selected and the federal discount rate in effect at the time of the gift. As a general rule of thumb, the deduction will be about 40 to 50 percent of the value of the gift.

[8] *State law in New York and New Jersey will not allow use of real estate to fund a CGA.*

Marge Stevenson is a 77-year-old widow who owns 100 acres of farmland in Indiana. When her husband, Roger, died, she inherited the land, which was being rented by a neighboring farmer. Although she knew Roger never wanted it sold for development, Marge could not manage the property alone and wondered what to do. After expenses, rent from the farm was $7,500 per year. Marge wanted to increase, or at least maintain, her income, divest management responsibility, reduce estate taxes and save the farm for agriculture. She also wanted to support Roger's favorite nonprofit conservation organization.

Marge decided to transfer her farm subject to a conservation easement to that nonprofit in exchange for a CGA. The appraised value of the property was $200,000. This was adjusted to reflect the charitable gift and a conservation easement. The adjusted value was $150,000, which will yield $13,200 a year for the rest of her life. The rate was established at 8.8 percent based on her age. Out of the total annuity payment, about $2,600 was tax-free income, $4,300 was capital gain income and the balance was ordinary income.

Because of the CGA, Marge's income increased at least $5,700, and she no longer has management responsibilities for the property. Because her farm is no longer part of her estate, Marge's estate taxes will be lower and she can shield other assets from estate tax liability. Her charitable tax deduction was about $105,000, which will help reduce her income tax liability. Finally, Marge's generosity and foresight helped protect a productive farm and supported the work of a conservation organization.

Photo by Tim McCabe, USDA NRCS

SUMMARY OF CONSERVATION OPTIONS FOR ESTATE PLANNING

Objective	Option
Permanently protect your farm	• Donate agricultural conservation easement • Sell agricultural conservation easement
Reduce estate, gift and income taxes	• Donate agricultural conservation easement • Sell agricultural conservation easement • Create charitable remainder trust • Donate farm and retain life estate • Establish charitable gift annuity
Generate income for retirement	• Create charitable remainder trust • Sell agricultural conservation easement • Establish charitable gift annuity
Generate income for other purposes	• Sell agricultural conservation easement • Sell wetlands easement • Sell floodplain easement
Avoid capital gains taxes	• Create charitable remainder trust • Donate farm and retain life estate
Support conservation organizations	• Create charitable remainder trust • Donate farm and retain life estate • Establish charitable gift annuity • Donate agricultural conservation easement
Protect other natural resources	• Sell or donate conservation easement • Sell or donate wetlands easement • Sell or donate floodplain easement

BUSINESS ORGANIZATION AND FARM TRANSFER STRATEGIES

You can organize your farm business in several different ways, which vary in complexity, formality and expense. The basic forms of business organization include the sole proprietorship, partnerships, corporations and limited liability companies:

Sole proprietorship is the simplest form of business organization and requires no formal written documentation other than basic farm, financial and tax records. Traditionally, it has been the preferred choice for most farms operated by one owner.

Partnership is the simplest form of business organization involving more than one owner. While written partnership agreements are strongly recommended from a business perspective, they are not required by law. All states have some provisions that relate to partnership arrangements. These will apply to partnerships with or without written agreements. As with the sole proprietorship, the partners are each liable for the debts and obligations of the partnership. Partnerships are frequently used to bring family members into the farm business and are an effective way to share ownership of operating assets like cattle and equipment. They also give the younger generation an opportunity to build equity in the business.

Limited partnership is somewhat more complex than the general partnership. Under such an agreement, which must be in writing and in accordance with state legislation, two different classes of partners are created. General or managing partners control the partnership and bear full legal responsibility for the partnership's debts and obligations. In contrast, the limited partners are passive investors who do not actively manage the partnership and whose liability is limited to their investment in the limited partnership. Family limited partnerships are more appropriate when families want to separate management responsibilities from ownership interests, for example, to accommodate on- and off-farm children.

Corporations are separate legal entities that provide liability protection to the individual owners or shareholders and continuous existence for the business operation even as individual owners change. "S" corporations pass income through to the shareholders and are taxed the same way as partnerships. "C" corporations are taxed at both the corporate level and at the shareholder level, if there are dividends. There are fewer restrictions on the numbers of shareholders, and different classes of stock are permitted with a "C" corporation. In especially large businesses with many owners, the "C" corporation may be more attractive notwithstanding the double tax at the corporate and shareholder levels.

Limited Liability Companies (LLC) are functional hybrids combining the limited liability of corporations with the flexibility and pass-through tax treatment of partnerships. Most states have enacted laws allowing the formation of limited liability companies. The LLC permits greater flexibility of ownership than "S" corporations and provides limited liability to all its members. In contrast, in a limited partnership at least one general partner must be liable for all debts and obligations of the partnership. However, the LLC can serve as the general partner in a limited partnership and the individual will be protected from liability.

Written Agreements Are Essential

With the exception of the sole proprietorship, business operating agreements should be in writing. For limited partnerships, limited liability corporations and corporations, the law requires written agreements. But even the simplest family partnership should be in writing. Written agreements are not a guarantee that the business will operate smoothly, but will result in more thorough advance discussion of management and dissolution issues, fewer misunderstandings after the agreement is completed and a solid basis for resolving disputes.

Written agreements protect both the older and younger generations.

Written agreements protect both the older and younger generations' interests. Potentially difficult issues like dissolution, divorce, disability and death can be thought through in advance. It may be helpful to engage in the "but what if" exercise as you work with your advisors to put together your operating agreement for your partnership, limited liability company or corporation.

Every operating agreement must spell out what will happen in cases of dissolution, divorce, disability and death.

Buy/Sell Arrangements Are Critical

Every operating agreement must spell out what will happen in cases of dissolution, divorce, disability and death. No one likes to think about these things at the start of a marriage or business relationship, but they must be addressed. The agreement should deal with what happens to the business when its composition changes and address how it will occur. One of the often-overlooked aspects of buy/sell provisions is the funding mechanism. Even if the agreement sets forth valuation procedures and payment terms, answer the critical question: How will the designated or authorized buyer pay for the transfer of the business interest?

There are four basic ways to fund a buy/sell arrangement:

- Savings
- Insurance
- Loans
- Luck (you know, the rich uncle or the lottery)

Once you have figured out how to fairly value the business interest, think about where to raise the funds to complete the buy-out under those terms. While there is no right way to do it, decide in advance how your family will get it done. The bottom line is that your business organization should not determine your estate plan. The estate planning and farm transfer process is a good time to evaluate your present business arrangement and decide whether it may need to be updated or changed.

LIFE INSURANCE AS AN ESTATE PLANNING TOOL

Life insurance should be considered as part of a comprehensive estate plan. Term and whole life are the two basic types of life insurance policies. Term life insurance, commonly referred to as death insurance, is a contract that will pay benefits if the insured dies during the term of the contract. Term life insurance is the least expensive kind of insurance to purchase. The younger the insured, the lower the cost.

Whole life insurance provides death benefits, which are similar to those of term insurance, and gradually builds cash value over time as premiums are paid. For this reason it is much more expensive than term life insurance.

Life insurance might fit into your estate plan in the following ways:

Financial security - Life insurance proceeds are income tax free and can be used by your family to pay off personal debts, car loans, mortgages or for other family living expenses or college tuition.

Generate an inheritance - A life insurance policy can generate wealth at your death as a way to create a modest financial inheritance for your family. Often, your other assets are needed to provide a comfortable standard of living during retirement.

Replace wealth - Life insurance can replace the value of assets that have been transferred or will be transferred to another family member or charitable organization. Farm families could decide to transfer the farm to the farming children and give insurance proceeds to the non-farming children. This would help parents treat all their children fairly. Combined with a charitable contribution, income tax "savings" resulting from such a gift are sometimes used to purchase life insurance to "replace" the value that has been given away. The life insurance proceeds can then be distributed to heirs instead.

Pay estate taxes - Life insurance may be particularly useful for farm businesses, since there may not be sufficient cash or other liquid assets to pay estate taxes on time (within nine months of death for federal estate taxes). In addition, farmland and other farm assets are difficult to sell on short notice. Life insurance can be a cost-effective way to make sure that you have cash on hand to pay the estate taxes when they are due.

Life insurance can be a cost-effective way to make sure that you have cash on hand to pay the estate taxes when they are due.

Fund a buy/sell agreement - Even the best-written buy/sell agreement will not work if buyers cannot come up with the money to exercise their right to buy the farm business. Key person insurance is a way to generate the money to use to fund the buy/sell agreement. The policy is often owned by the business entity (corporation, partnership or limited liability company) and can be used to buy out the key person's share of the business. It can also be used to cushion the financial impact of such a loss to the farm business.

Insurance policies are contracts. Policy owners designate one or more beneficiaries to receive the proceeds when they die. Because the insurance contract designates the beneficiary, you can't change this designation in your will. You must make any changes to your insurance policy by contacting your insurance company directly.

If you own an insurance policy when you die, it will be included in your estate for tax purposes. If your estate is going to trigger some estate tax, you may want to transfer the ownership. You don't need to change the designated beneficiary to another individual or a trust.

Two cautions are in order. Any policy transfer within three years of death will be brought back into the estate for tax purposes. Second, the transfer may trigger gift taxes if the cash value of the policy is over $11,000.

You could also give cash to the person you want to own the policy and have this person buy the policy. This approach works well when you have absolute confidence that the person will carry out your wishes. Of course, the disadvantage is that you have little or no control over whether the premiums are paid, who will receive the proceeds or how the proceeds will be used. Trust and trustworthiness are essential with this option.

You can create a life insurance trust to provide greater guidance and control over the insurance policies. A trustee could be directed to purchase and/or hold insurance policies and then disburse the proceeds according to the trust document.

Here again, the transfer of policies to the trust may trigger gift taxes. In addition, gifts to the trust to purchase insurance may need to be combined with a limited beneficiary's right to withdraw those funds in order to keep the trust's insurance policies out of your estate.[9]

The benefits of life insurance seem compelling in many cases. Premiums must be paid and other details must be followed to get the intended results and avoid unintended results. There is little room for error or omission without serious consequences.

TRUSTS AND ESTATE PLANNING

Trusts are legal arrangements that separate the ownership and benefit of an asset. Typically trusts work like this: You set up a trust by placing assets in the care of a trustee. The trustee is required by law to wisely and prudently manage those assets according to the trust document that you created for the benefit of one or more designated beneficiaries. The trust document also designates who will receive the assets once the trust terminates.

[9] *The* Crummy *power gives a trust beneficiary the right to withdraw property from the trust when it is contributed—often for a period of 30 days.*

In many cases the trustee can only distribute the income from the trust and not the trust assets.

Assets are often placed in trusts to provide for their professional management. Trusts can be used to protect assets from creditors and to save estate taxes if used in conjunction with a comprehensive estate plan.

Trusts are characterized according to when they take effect and whether or not they can be changed. Trusts that take effect during your lifetime are called inter vivos. They are called testamentary when they take effect at death. A revocable trust can be changed while an irrevocable trust cannot.

Credit shelter trusts are specifically created under a will to take advantage of the federal estate tax exemption. In a credit shelter trust, assets equal to the current federal exemption amount are used to fund a trust that typically will pay income to your spouse and distribute the principal to your children at your spouse's death. This trust normally should not qualify for a marital deduction. Because exemption amounts are slated to rise dramatically over the next several years, this type of trust should be considered very carefully and revisited regularly.

Living trusts are created to permit the separation of management and benefits of assets during your lifetime. They are useful in managing your assets or avoiding probate in particularly sensitive or complicated situations. However, in most farm family businesses, living trusts are too cumbersome for transferring farm assets. Living trusts may be one of the most over-utilized estate planning techniques. Often they are promoted as a way to "avoid probate," "protect your assets" and "save estate taxes." By themselves, living trusts may avoid probate, but to achieve the other estate planning objectives, living trusts will not get the job done alone.

Medicaid trusts are created to protect assets from being used to pay for nursing home costs or support. While they can be useful, two important cautions are in order. First, living trust assets are considered "available" and will be used to determine eligibility for Medicaid. Second, transfers of assets to individuals (often children) or irrevocable trusts are subjected to "look-back" periods for Medicaid eligibility determinations. Recently these time periods have been increased to 36 months for outright transfers and, in some states, to 60 months for transfers to and from irrevocable trusts.

Several states, including California, Indiana, Connecticut and New York, have established a public-private venture to provide long-term care insurance.

Trusts are legal arrangements that separate the management and ownership of an asset.

Living trusts may be one of the most over utilized estate planning techniques.

Known as the Robert Wood Johnson "Public-Private Partnership Program," it guarantees Medicaid eligibility regardless of assets or available resources once all the long-term care insurance benefits have been expended.

Other types of specialized trusts achieve a wide variety of objectives. Please refer to the glossary for details.

Who Should Be the Trustee?

Trust administration can be complex and time consuming. Many banks have trust administration departments. Both professional and individual trustee fees are usually set by state law, usually based on a percentage of the value of assets in the trust. This percentage generally decreases as the value of the assets increases.

All trustees are held to a legal standard of accountability as fiduciaries or "financial guardians" of the assets. Trustees must manage assets according to the terms of the trust and consistent with a "reasonably prudent investor" standard.

What Types of Assets Can Be Placed in Trusts?

Almost any type of asset can be owned and managed by a trustee for the benefit of a third person. However, some assets, such as stocks and bonds, are much easier to manage than business property such as farmland and other farm assets.

Exercise great caution when placing farm assets in a trust. It may be difficult for a trustee to reconcile trust obligations with the individual management needs of a farm business. If a farm is retained in a trust, it often is appropriate to specify how the farm will be managed in the trust document.

"SPECIAL USE VALUATION" IRC SECTION 2032A

Section 2032A of the Internal Revenue Code allows an election for special use valuation of farmland and buildings on the federal estate tax return. This election allows real property in qualified estates to be valued at its agricultural use value rather than at its highest and best use. However, with exemption levels scheduled to increase from $1 million in 2002 to $3.5 million in 2009, it may not be necessary to elect special use valuation in the first place.

Special use valuation can reduce the value of the taxable estate by as much as $800,000.[10] If both spouses jointly own the farm and make the election, a reduction of up to $1.6 million is available.

[10] *This provision is now indexed for inflation.*

Several requirements must be met to receive special use valuation:

Before Death

- 25 percent of estate must be farm real estate.
- 50 percent of estate must be farm assets (real estate and other assets).
- Farm must have been family-owned for at least five of eight years prior to death.
- The decedent or a member of the family must have materially participated in the operation of the farm for at least five of eight years prior to retirement, disability or death.

Electing special use allows real property to be valued at its agricultural use and can reduce the value of the taxable estate by as much as $800,000.

After Death

- Election by executor.
- Farm real estate must pass to a qualified heir (usually a family member).
- Farm must remain in farming for 10 years.
- A family member must materially participate in the operation of the farm for at least five of eight years during the 10-year recapture period.
- If the after-death requirements are not met, the tax benefits may be recaptured.

Valuation

Estate taxes are determined by the fair market value of property. With farmland, this value often far exceeds its agricultural use value. Section 2032A requires use of a formula:

$$\frac{\text{cash rent} - \text{property tax}^{11}}{\text{federal land bank loan rates}}$$

If comparable rental land can't be identified, other factors may be used to determine the agricultural value of the land, such as state agricultural assessment values and comparable sales of farmland in areas without development pressure.

Important Considerations about Special Use Valuation

Special use valuation presents an estate planning challenge because of its fairly complex requirements and the fact that your executor may not know whether your estate qualifies until it is too late to make any adjustments. The key here is to regularly revisit your estate plan and re-evaluate whether special use valuation fits your situation.

[11] *Based on average annual computations of the five most recent calendar years before the date of death.*

Revisit your estate plan and re-evaluate whether special use valuation fits your situation.

Depending on the proportion of your assets that are farmland and buildings, you may want to consider electing special use on a partial basis to control valuation of some of your assets—probably real estate with the greatest potential for reduced valuation per acre. In this way your other property would not be subject to the 10-year recapture lien and would be available for transfer or sale outside the family.

Election will affect the basis of the property for which it is used. For example, if special use valuation reduces the value for estate tax purposes from \$1.6 million to \$800,000, the basis of the property will be \$800,000. Usually, the basis would be stepped up to \$1.6 million when transferred at the owner's death.

Lastly, recapture potential exists in several situations you might not expect. The most common is a cash rental. By and large, cash rental does not constitute the required material participation. However, certain cash rents are now treated as a "qualified use" under Section 2032A. Surviving spouses or lineal descendants now can rent property to a family member for farming purposes without jeopardizing its qualified use status.

A second potential recapture trigger trap is the sale of a conservation easement. A 1997 amendment to Section 2032A was intended to clarify whether conveying a conservation easement is a property transfer that triggers recapture. The amended provision states that "A qualified conservation contribution (as defined in Section 170(h)), by gift or otherwise, shall not be deemed a disposition…." A footnote in a recent federal appeals court decision observed that the amendment pertained to a charitable contribution of a conservation easement—but did not apply to a purchased easement. The court's reading essentially ignored the legislative history and the statutory language "or otherwise." Legislative and regulatory clarification may be required to include easement sales as well as donations.

What's the Difference between a Conservation Easement and Special Use Valuation?

Agricultural conservation easements provide greater flexibility in planning and greater potential estate tax savings than Section 2032A special use valuation though the potential estate tax benefits of both special use and conservation easements will diminish significantly over the next several years as exemption levels rise from \$1 million in 2002 to \$3.5 million in 2009. Special use valuation may fit your family's situation if farm assets (including your farmland) make up the majority of your net worth, your estate would be larger than $2.5 million and your family intends to continue to own and operate your farm. Easements may be more useful if (because of development pressure) your land has very high market value and your family is comfortable with the idea of permanent farmland protection.

Special use valuation requires agricultural use for 10 years after death. A conservation easement must be held “in perpetuity” to qualify for a tax deduction. Section 2032A limits the reduction of the taxable estate to $800,000, while there is no limit to the amount of reduction with an easement. With special use, family members must continue to own and operate the farm, and farm assets must comprise 50 percent of the estate. These are not required with a conservation easement.

Both options have merit; so think carefully about how each one interrelates with all your financial and family objectives. Since each will have impacts on your farm business, discuss them with your advisors, including your lender. But remember, you are in the best position to evaluate the options and determine what will work best for you.

Photo by Bob Wagner

OTHER ESTATE TAX REDUCTION TECHNIQUES

Gifting assets makes sense when your estate is large, you are willing to part with the asset, you have adequate resources to maintain your lifestyle and the asset has not greatly appreciated.

Gifts

Farmers, ranchers and other landowners sometimes overlook gifts as an estate planning and tax reduction tool. But well-planned gifts can be an effective way to transfer assets, sometimes even tax free.

Each individual can give $11,000[12] per year to anyone he or she wants—without any gift tax or limits on the number of gifts per year. If a husband and wife make a joint gift, it's $22,000. Several other types of gifts are exempt from gift tax. These include gifts for medical bills or school tuition, gifts to tax exempt charitable organizations and gifts between spouses.

Gifts of more than $11,000 may trigger gift tax or will reduce the unified credit for gift and estate taxes. So you may be making potentially taxable gifts without knowing it. Interest-free loans, creation of irrevocable trusts, assigning life insurance policies, forgiving debt and changing ownership on real estate deeds can all trigger gift taxes for the unwary.

Annual exclusion gifts are particularly effective if you have limited partnership interests or shares of stock in the family business that you can give in relatively small amounts annually. Real estate does not lend itself readily to this technique since it can be unwieldy and perhaps unwise to gift fractional undivided interests or fragmented parcels of land. You can also gift insurance premiums to an individual or to an insurance trust. You must take care, however, to make sure the gift is a complete transfer.

Several caveats are in order. First, when you make a gift you also give up ownership and control of the asset. You cannot take it back if you change your mind or if your circumstances change. Second, gifts of life insurance made within three years of your death will be pulled back into your estate. And third, property that you give away during your lifetime will not receive any step-up in basis. In other words, the recipient of the property will also receive your basis, not the fair market value at the time of the gift.

That said, when should you consider gifts as a way to transfer assets and reduce estate taxes? Generally speaking, gifting assets makes sense when your estate will be larger than the applicable exclusion amount, you are willing to part with the asset, you have adequate resources to maintain your lifestyle and the asset has not greatly appreciated or is likely to appreciate rapidly after you give it away.

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[12] *This annual gift exclusion is indexed for inflation.*

Deferral and Installment Payment of Estate Taxes

Some closely held (family-owned) businesses qualify for deferral and installment payment of estate taxes under IRC Section 6166. The executor of your estate must make this election when the estate tax return is filed.

To qualify for Section 6166, the family business must comprise at least 35 percent of your estate at the time of your death. The value of your estate will include any gifts made within three years of death, even gifts of non-business assets that might have been made in order to qualify for this election. It must be an active trade or business. Passive investments do not count. The business must be closely held; you must own 20 percent of the business (stock or partnership interest) or there must be no more than 15 shareholders or partners. Most family farms, even large farm businesses, will qualify as closely held.

To qualify for Section 6166, the family business must comprise at least 35 percent of your estate at the time of your death.

If your farm qualifies and Section 6166 is elected, your executor can defer payment of the estate taxes attributable to the value of your interest in the closely held business for five years, paying interest only during that time. In addition, your estate can make up to 10 installment payments of the tax owed, plus interest. In this way, estate taxes could be spread over 15 years. The interest rate is 2 percent on the first $1 million of asset value and is based on the federal short-term rate for amounts greater than $1 million.

Some circumstances may trigger acceleration of the unpaid tax. If more than one-half of the qualified business interest is sold or otherwise transferred to a non-family member, any remaining tax will become due. Similarly, if the installment payments are delinquent, the unpaid taxes will be accelerated.

Photo by Bob Wagner

As with special use valuation, executors are personally liable for the deferred taxes unless they file for a "special estate tax lien." However, an "active" trade or business requires a lesser degree of involvement than the material participation required by Section 2032A. In fact, under Section 6166, an unrelated agent or a family member may constitute the necessary degree of involvement to qualify as active.

Some other issues to think about include:

Valuation - closely held businesses present challenging and specialized appraisal issues.

Timing of other transfers - gifts within three years of death are disregarded and will be brought back into your estate to determine eligibility for Section 6166.

Your asset mix - business/personal assets, farm/non-farm, real estate or other business assets. Election of special use valuation or donation of a conservation easement may shift your asset ratio enough to affect eligibility for this election.

Minority discounting is a reliable method of reducing valuation of business assets, including farm assets, for estate, gift and income tax purposes.

Minority Discounts of Closely Held Business Interests

Minority discounting is a reliable method of reducing valuation of business assets, including farm assets, for estate, gift and income tax purposes. Minority discounts are available for an interest that is not actively traded and in situations in which the owner of the interest could not control the enterprise. Formerly, the IRS relied on the "family attribution theory" and valued family stock interests in light of the family's controlling interest. In effect, the IRS ignored minority discounting principles in many family business situations. More recently, however, tax court decisions have acknowledged that minority discounts can and do apply to family businesses. Significantly, the IRS has officially acceded to this position in Revenue Ruling 93-12.

Minority discounts are based on the individual characteristics of each business and its ownership. However, the two primary factors generally recognized as reducing the value of an interest in a business are lack of control and lack of marketability. Both tend to significantly reduce the market value of these interests, which is the ultimate IRS benchmark.

The discounting concept is now being applied to individually owned assets such as real estate. For example, significant minority discounts have been allowed on individual partial interests in farmland and on limited partnership interests in ranchland.

Discounting can also be used in conjunction with special use valuation. A federal appeals court decision[13] sanctioned the application of special use valuation after a minority discount for the limited partnership interest had already significantly reduced its value. Minority discounting is not a slick accounting sleight of hand. It is premised on the rationale that the discounted value of a minority interest in a business or real estate is the accurate fair market value of the asset. If you plan to use minority discounts when transferring farm assets, hire an appraiser experienced with valuing farm business assets and minority interests in those assets. Also make sure you have adequate valuation documentation for gift and estate tax purposes because the IRS will closely scrutinize minority discounting and business appraisals.

These tax reduction techniques are not for the faint of heart. To determine whether any of these techniques will fit your situation, you must thoroughly understand your own business and financial situation. Then, you and your planning team can decide where you want to go and how to get there.

To determine whether any of these techniques will fit your situation, you must thoroughly understand your own business and financial situation.

AFT photo

[13] *Estate of Hoover v. Commissioner, (10th Cir 1995).*

Endnote

Photo by Tim McCabe, USDA NRCS

Estate planning and farm transfer involve some of the most important personal decisions you will ever make. Your choices will affect you, your family and your farm. We hope this guide has helped you think through the issues, stimulated thought and provided a basis for decision-making. Ultimately, we hope it will lead to action.

Keep this guide as a reference and go back to it as needed. But remember, it is not a substitute for professional consultation. Instead, it points to the need for financial and legal assistance as you work on your farm transfer and estate plan. And bear in mind that the tax laws are likely to change again and again. As frustrating as it is for all involved, changing tax laws seem to be a fact of life.

Talk to your family and put together your estate planning team. Pick up the phone and call someone you trust, such as your financial advisor, extension agent, lender, trust officer, tax accountant or attorney. Many people in these professions have a wide range of experience in this area.

Take the next step. The time is now.

American Farmland Trust provides a variety of services to landowners, land trusts, public officials, planners, agricultural agencies and others. Services include workshops on estate planning and farmland protection, Cost of Community Services studies, farmland protection program development and agricultural economic analysis. AFT's *Farmland Information Center* is a clearinghouse for information about farmland protection and stewardship. Visit us on the Web at **www.farmlandinfo.org** for fact sheets on estate planning and other topics or call us at (800) 370-4879 for technical assistance.

Notes

Glossary

Basis: In most cases, the basis of an asset is the asset's cost, minus depreciation, plus the value of improvements to the asset.

Charitable Gift Annuity (CGA): A CGA is part charitable gift and part payment on an annuity contract. The donor transfers property directly to a charity or nonprofit and in return receives a fixed annuity for life.

Codicil: A written change or addition to a will.

Conservation Easement: A deed restriction landowners voluntarily place on their property to protect resources such as productive agricultural land, ground and surface water, wildlife habitat, historic sites or scenic views.

- Agricultural Conservation Easement: A deed restriction that runs with the title to the land to limit subdivision, development and other uses that are inconsistent with its agricultural use.
- Floodplain Easement: A deed restriction that provides the Natural Resources Conservation Service with the full authority to restore and enhance the floodplain's functions and values.
- Wetlands Reserve Program (WRP) Easement: A deed restriction that is intended to restore, enhance and protect wetlands for their water quality and wildlife habitat benefits.

Disclaimer: The irrevocable and unqualified refusal of a beneficiary to accept property during the probate process. Disclaimers are planning tools that are used after death.

Estate: All the assets and liabilities you have accumulated over your lifetime and possess when you die, including your home, farmland, buildings and equipment; your financial resources, such as bank accounts, stocks, bonds, retirement accounts and life insurance; and anything else you owned at your death.

Estate Tax: The transfer tax imposed on property owned or otherwise subject to tax at death. In some states it is called inheritance or death tax.

Executor or Executrix: The personal representative—man, woman or institution—you name in your will to manage and dispose of your assets according to your instructions.

Gift: A lifetime transfer of assets for which you receive no payment. Each year you can make a gift of up to $11,000 to an unlimited number of people without paying gift tax.

Gift Tax: The transfer tax imposed on property transferred during your lifetime.

Gross Estate: The full value of your estate before taxes.

Health Care Proxy: Many states authorize designation of a person to act on another's behalf to make critical medical treatment decisions. Where possible, a living will should be used to provide guidance to the designated proxy to help them exercise that judgment.

Intestacy: State laws that determine how assets are distributed if you die without a will.

Joint Tenancy: Ownership of property that provides for automatic transfer of ownership to surviving joint tenants. Also referred to as "Joint Tenants with Right of Survivorship" or, if husband and wife, "Joint Tenants by the Entirety."

Land Trust: A private, nonprofit organization that protects natural resources such as productive farm and forest land, watersheds, rivers and streams and recreational areas.

Like-Kind Exchange (IRC Section 1031): Allows deferral of capital gain by trading similar property, such as real estate, for other "like-kind" property.

Living Will: A statement of your wishes regarding treatment should you become terminally injured or ill.

Marital Deduction: Estate or gift tax deductions that are allowed for assets transferred to a living spouse.

Medicaid Planning: Estate and financial planning geared toward protecting family assets from being used to pay nursing home costs.

Power of Attorney: A written document authorizing another person to act on your behalf.

Probate: The legal proceeding that validates your will and authorizes the disposition of the assets transferred by the will.

Purchase of Agricultural Conservation Easements (PACE): Public or private programs that buy agricultural conservation easements to protect farmland, also commonly called purchase of development rights or PDR.

Settlement Costs: Costs associated with the probate of a will and distribution of estate assets, including filing fees, fiduciary commissions and legal, accounting, appraisal and funeral expenses.

Special Use Valuation (IRC Section 2032A): Allows real property to be valued at its agricultural use value rather than at its full fair market value for federal estate tax purposes.

Taxable Estate: The gross estate minus all deductions, which determines the estate tax.

Tenancy in Common: Ownership of property that provides for joint ownership of undivided shares. These undivided interests may be transferred to another by sale, gift or will independently of the other owners.

Tenancy by the Entirety: See Joint Tenancy.

Transfer Tax: Taxes imposed on property that is sold (income/capital gain), given away (gift) or inherited (estate, death or inheritance).

Trust: A legal arrangement under which assets are managed by a trustee for one or more beneficiaries, who are often third parties. The following are common types of trusts:

- *Charitable Remainder Trusts* are irrevocable and provide life-long income to the donor, and typically to the donor's spouse. The income is usually generated by investments and managed by a trustee once the property has been sold. When the donor (and/or the donor's spouse) dies, the payments stop and the remaining property is distributed to one or more charitable organizations of the donor's choosing.
- *Credit Shelter Trusts* are specifically created to take advantage of the current federal estate tax exemption. Here, assets equal to the amount of the current exemption are used to fund a trust that typically will pay income to your spouse and distribute the principal to your children at your spouse's death. This trust does not qualify for a marital deduction.

- *Generation Skipping Trusts* provide income for children and grandchildren with distribution of assets to grandchildren or great-grandchildren.
- *Inter Vivos Trusts* are created to take effect during one's lifetime.
- *Irrevocable Trusts* are set up to be permanent.
- *Life Insurance Trusts* are established to hold insurance policies and/or receive proceeds of policies. Trustees can be directed to distribute proceeds to non-farm children or pay estate taxes if desired.
- *Living Trusts* are created to permit the separation of ownership and management of an asset.
- *Medicaid Trusts* are created to protect assets from being used to pay for nursing home costs.
- *Q-Tip Trusts* are created for spouses who qualify for the marital deduction. They provide some limitations on the disposition of the trust assets. Unlike an outright transfer to your spouse, this trust would designate who would receive the trust assets at your spouse's death.
- *Revocable Trusts* can be changed.
- *Spillover Trusts* receive leftover assets from a will or insurance policy after other bequests have been satisfied.
- *Testamentary Trusts* become effective at death, and are created in a will.

Unified Credit Exemption: A federal tax credit used to reduce federal estate and gift tax liability. Also referred to as a "personal exemption." In 2002, the unified credit exemption amount was increased to $1 million for estate and gift taxes. It will gradually increase to $3.5 million in 2009 for estate taxes. The gift tax exclusion will remain at $1 million. As a result, through 2009 there no longer will be a "unified" exemption system that applies to both estate and gift taxes.

Will: A legal document that provides, among other things, instructions about how your estate will be distributed when you die.

Suggested Reading

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Some Organizational Resources

Plenty of good estate planning and farm transfer advice is available, you just need to know where to look. Here are some suggestions.

American Farm Bureau Federation
225 Touhy Avenue, Park Ridge, IL 60068
Telephone: (847) 685-8600
www.fb.org

Cooperative State, Research, Education & Extension Service
1400 Independence Avenue, SW, Room 305 A
Washington, DC 20250
Telephone: (202) 720-4423
www.reeusda.gov

Farm Credit Council (the national trade association of the Farm Credit System)
50 F Street, Suite 900, Washington, DC 20001
Telephone: (202) 626-8710
(800) 525-2345
www.fccouncil.com

Financial Planning Association
5775 Glenridge Drive, NE, Suite B 300
Atlanta, GA 30328
Telephone:(800) 647-6340
www.fpanet.org

Growing New Farmers
c/o New England Small Farm Institute
PO Box 608, Belchertown, MA 01007
Telephone: (413) 323-4531
www.northeastnewfarmer.org

Land Trust Alliance (directory of local land trusts)
1331 H Street, Suite 400, Washington, DC 20005
Telephone: (202) 638-4725
www.lta.org

Leading American Attorneys
2575 University Avenue West, Suite 200
St. Paul, MN 55114
Telephone: (800) 752-4221
www.lawlead.com
www.legalgateway.com

National Association of State Departments of Agriculture
1156 15th Street, NW, Suite 1020
Washington, DC 20005
Telephone: (202) 296-9680
www.nasda.org

National Association of State Universities and Land-Grant Colleges
1307 New York Avenue, NW, Suite 400
Washington, DC 20005-4722
Telephone: (202) 478-6042
www.nasulgc.org

U.S. Department of Agriculture
Washington, DC 20250
Telephone: (202) 720-2791
www.usda.gov

USDA Natural Resources Conservation Service
14th and Independence Avenue, SW
Washington, DC 20250
Telephone: (202) 720-4527
www.nrcs.usda.gov

Appendix A ~ Federal Estate and Gift Tax Rates & Exemption Amounts

Calendar Year	Estate Tax Exemption	Gift Tax Exemption	Highest Estate and Gift Tax Rates
2002	$1,000,000	$1,000,000	50 %
2003	$1,000,000	$1,000,000	49 %
2004	$1,500,000	$1,000,000	48 %
2005	$1,500,000	$1,000,000	47 %
2006	$2,000,000	$1,000,000	46 %
2007	$2,000,000	$1,000,000	45 %
2008	$2,000,000	$1,000,000	45 %
2009	$3,500,000	$1,000,000	45 %
2010	estate and GST taxes repealed	$1,000,000	35 % (gift taxes only)
2011	$1,000,000	$1,000,000	55 %

Appendix B - National Landlink

National Farm Transition Network
10861 Douglas Avenue, Suite B
Urbandale, IA 50322
(800) 447-1985
www.extension.iastate.edu/nftn

Arkansas
FarmLink of Arkansas
Arkansas Development Finance Authority
100 Main Street
Little Rock, AR 72201
(501) 682-5900
Contact name: Ted McNulty
E-mail: tmcnulty@adfa.state.ar.us

California
California FarmLink
P.O. Box 2224
Sebastopol, CA 95473
(707) 829-1691
E-mail: info@californiafarmlink.org
www.californiafarmlink.org

Connecticut
New England Land-Link
P.O. Box 608
Belchertown, MA 01007
(413) 323-4531
E-mail: landlink@smallfarm.org
www.smallfarm.org

Iowa
Ag Connect
124 N. Main Street
Lenox, IA 50851
(614) 333-4656
Contact: Tim Ennis, Executive Director
E-mail: agconnect@ll.net
www.agconnect.org

Farm On
Beginning Farmer Center
ISU Extension Outreach Center
10861 Douglas Avenue, Suite B
Urbandale, IA 50322
(800) 447-1985
Contact: Loren Book
E-mail: lgbook@iastate.edu
www.extension.iastate.edu/bfc

Maine
New England Land-Link
P.O. Box 608
Belchertown, MA 01007
(413) 323-4531
E-mail: landlink@smallfarm.org
www.smallfarm.org

Maryland
Eastern Shore Land Conservancy
P.O. Box 169
Queenstown, MD 21658
(410) 827-9756
E-mail: info@eslc.org
www.eslc.org

Maryland Farm Link
Maryland Department of Agriculture
50 Harry S. Truman Pkwy., Room 208
Annapolis, MD 21401
(410) 841-5770
(800) 492-5590 ext. 5770
Contact name: Valerie Gonlin
www.mda.state.md.us/farmlink/farmlink.htm

Massachusetts
New England Land-Link
P.O. Box 608
Belchertown, MA 01007
(413) 323-4531
E-mail: landlink@smallfarm.org
www.smallfarm.org

Michigan
Michigan Farm Bureau
7373 West Saginaw Highway
P.O. Box 30960
Lansing, MI 48909
(517) 323-7000
www.michiganfarmbureau.com

Minnesota
Minnesota Farm Connection
Passing On the Farm
140 Ninth Avenue
Granite Falls, MN 56241
(320) 564-4808
Contact: Jean R. Knakmuhs, Director
E-mail: pofc@kilowattnet

Montana
Montana Farm Link
Alternative Energy Resources Organization
432 North Last Chance Gulch
Helena, MT 59601
(406) 443-7272
www.aeromt.org

Nebraska
Land Link
Center For Rural Affairs
P.O. Box 406
Walthill, NE 68067
(402) 846-5428
Contact: Joy Johnson
E-mail: joyj@cfra.org
www.cfra.org

New Hampshire
New England Land-Link
P.O. Box 608
Belchertown, MA 01007
(413) 323-4531
E-mail: landlink@smallfarm.org
www.smallfarm.org

New Jersey
State Agricultural Development Committee
State of New Jersey
P.O. Box 330
Trenton, NJ 08625-0330
(609) 984-2504
Contact: Sherry Dudas
E-mail: agsduda@ag.state.nj.us
www.state.nj.us/agriculture

New York
New York Farm Link
Department of Agricultural, Resource & Managerial Economics
Warren Hall, Cornell University
Ithaca, NY 14853-7801
(800) 547-FARM
(607) 255-9854
Contact: Steve Richards
info@nyfarmlink.org
www.nyfarmlink.org

North Dakota
North Dakota Department of Agriculture
600 East Blvd., Dept. 602
State Capitol
Bismarck, ND 58505-0020
(701) 328-2231
E-mail: ndda@state.nd.us
www.agdepartment.com

Ohio
Ohio Farm Link
Ohio Farmers Union
1011 N. Defiance St.
Ottawa, OH 45875
(800) 321-3671
(419) 523-5300
www.ohiofarmers.net

Pennsylvania
Pennsylvania Farm Link
2708 A North Colebrook Road
Manheim, PA 17545
(717) 664-7077
Contact: Marion Bowlan
E-mail: pafarmlink@redrose.net
www.pafarmlink.org

South Dakota
Agriculture Enterprise Program
South Dakota Department of Agriculture
Division of Agricultural Development
523 East Capitol Avenue
Pierre, SD 57501-3182
(605) 773-5436
(800) 228-2554
Contact: Terri LaBrie
E-mail: terri.labrie@state.sd.us
www.state.sd.us\doa

Utah
Utah State University
4800 Old Main Hill
Logan, UT 84322
(435) 797-2208
Contact: Vic Saunders
E-mail: vic.saunders@usu.edu
www.ag.usu.edu
www.usu.edu

Vermont
Land Link Vermont
UVM Center for Sustainable Agriculture
63 Carrigan Drive
Burlington, VT 05405
(802) 656-0233
Contact: Deb Heleba
E-mail: dheleba@zoo.uvm.edu
www.uvm.edu/landlinkvt

New England Land-Link
P.O. Box 608
Belchertown, MA 01007
(413) 323-4531
E-mail: landlink@smallfarm.org
www.smallfarm.org

Virginia
Virginia FarmLink
Virginia Department of Agriculture and Consumer Services
P.O. Box 1163
Richmond, VA 23218
(804) 786-3501
Contact: William P. Dickinson, Jr.
E-mail: wdickinson@vdacs.state.va.us

Washington
Washington FarmLink Program
Cascade Harvest Coalition
300 19th Avenue
Seattle, WA 98122
(877) 728-9453
(206) 205-6372
Contact: Mary Embleton
E-mail: mary@oz.net
www.cascadeharvest.org

Wisconsin
Farm Link Services
Wisconsin Farm Center
Department of Agriculture, Trade and Consumer Protection
P.O. Box 8911
Madison, WI 53708-8911
(800) 942-2474
(608) 224-5049
Contact: Gwen Garvey
E-mail: gwen.garvey@datcp.state.wi.us
www.datcp.state.wi.us

Appendix C - Purchase of Agricultural Conservation Easement Programs

State Programs

California	California Farmland Conservancy Program (916) 324-0862
Colorado	Great Outdoors Colorado (303) 863-7522
Connecticut	Farmland Preservation Program (860) 713-2530
Delaware	Delaware Agricultural Lands Preservation Program (302) 739-4811
Kentucky	Kentucky Purchase of Agricultural Conservation Easements Program (502) 564-4696
Maine	Land for Maine's Future (207) 287-1487
Maryland	Maryland Agricultural Land Preservation Program (410) 841-5860
Massachusetts	Agricultural Preservation Restriction Program (617) 626-1704
Michigan	Purchase of Development Rights Program (517) 335-3468
New Hampshire	Agricultural Lands Protection Program (603) 271-3557
New Jersey	New Jersey State Agricultural Development Committee (609) 984-2504
New York	Agricultural and Farmland Protection Program (518) 457-2713
North Carolina	Conservation Trust for North Carolina (919) 828-4199
Ohio	Ohio Office of Farmland Protection (614) 728-4828
Pennsylvania	Bureau of Farmland Preservation (717) 783-3167
Rhode Island	Farmland Purchase of Development Rights Program (401) 222-2781
Utah	LeRoy McAllister Critical Land Conservation Fund (801) 538-1571
Vermont	Vermont Housing and Conservation Board (802) 828-5066

Local Programs

Marin County, California	Marin Agricultural Land Trust (415) 663-1158
Sonoma County, California	Sonoma Co. Agricultural Preservation & Open Space District (707) 565-7360
Boulder, Colorado	City of Boulder Open Space and Mountain Parks Department (303) 441-3440
Douglas County, Colorado	Douglas Co. Open Space (303) 660-7334
Routt County, Colorado	Routt Co. PDR Program (970) 879-0825
Kane County, Illinois	Kane Co. Development Department (630) 232-3483
Fayette County, Kentucky	Lexington-Fayette Urban Co. Government (859) 425-2227
Anne Arundel County, Maryland	Anne Arundel Co. Agricultural Land Preservation Program (410) 222-7441
Baltimore County, Maryland	Baltimore Co. Agricultural Land Preservation Board (410) 887-4488 ext. 241
Calvert County, Maryland	Calvert Co. Agricultural Land Preservation Program (410) 535-2348

Carroll County, Maryland	Carroll Co. Agricultural Land Preservation Program (410) 386-2131
Frederick County, Maryland	Frederick Co. Agricultural Land Preservation Program (301) 694-1134
Harford County, Maryland	Harford Co. Agricultural Land Preservation Program (410) 638-3103
Howard County, Maryland	Howard Co. Agricultural Land Preservation Program (410) 313-5407
Montgomery County, Maryland	Montgomery Co. Agricultural Land Preservation Program (301) 590-2831
Washington County, Maryland	Washington Co. Agricultural Land Preservation Board (240) 313-2430
Peninsula Township, Michigan	Peninsula Township PDR (231) 223-7322
Gallatin County, Montana	Gallatin Co. Open Lands Board (406) 285-3728
Londonderry, New Hampshire	Londonderry Orchard & Open Space Preservation Program (603) 432-1100 ext. 101
Morris County, New Jersey	Morris Co. Agriculture Development Board (973) 829-8120
East Hampton, New York	Town of East Hampton (631) 324-2178 ext 384
Pittsford, New York	Town of Pittsford (716) 248-6220
Southampton, New York	Southampton Community Preservation Department (631) 287-5720 ext 384
Southold, New York	Town of Southold Development Rights Purchase Program (631) 765-5711
Suffolk County, New York	Suffolk Co. Farmland Preservation Program (631) 853-5111
Warwick, New York	Town of Warwick Agriculture Advisory Board (845) 986-4528
Forsyth County, North Carolina	Forsyth Co. Farmland Preservation Program (336) 767-0720
Wake County, North Carolina	Wake Co. Farmland Preservation Program (919) 250-1056
Buckingham Township, Pa	Buckingham Township (215) 794-8834
Bucks County, Pa.	Bucks Co. Agricultural Land Preservation Board (215) 345-3409
Chester County, Pa.	Chester Co. Agricultural Land Preserve Board (610) 344-6285
Lancaster County, Pa.	Lancaster Co. Agricultural Preserve Board (717) 299-8355
Plumstead Township, Pa.	Plumstead Township (215) 766-8914
Solebury Township, Pa.	Solebury Township Land Preservation Committee (215) 297-0347
Albemarle County, Virginia	Albemarle Co. Department of Planning and Community Development (804) 296-5841
James City County, Virginia	James City Co. PDR Program (757) 259-3161
Loudoun County, Virginia	Loudoun Co. PDR Program (703) 737-8868
Virginia Beach, Virginia	Virginia Beach Agricultural Reserve Program (757) 426-5775
King County, Washington	King Co. Farmland Preservation Program (206) 296-1470
San Juan County, Washington	San Juan Co. Land Bank (360) 378-4402
Skagit County, Washington	Skagit Co. Conservation Futures Program (360) 336-9365
Thurston County, Washington	Thurston Co. Advance Planning (360) 786-5480
Dunn, Wisconsin	Town of Dunn Rural Preservation Program (608) 255-4219

"The family farm is like a baseball team—all its players contribute to its success. In Your Land is Your Legacy, a team of experienced estate planning specialists examines various techniques to help keep the 'farm team' hitting home runs forever."

Wade Martin
National Coordinator, Structured Settlements
PaineWebber, Inc., Princeton, N.J.

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Vice President & Farm Business Consultant
First Pioneer Farm Credit, ACA, Enfield, Conn.

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Lynne Sherrod
Executive Director
Colorado Cattlemen's Agricultural Land Trust
Arvada, Colo.