THE PLANNING FOR THE FUTURE OF YOUR FARM BULLETIN SERIES

Farming takes planning. A lot of planning. Whether it's for next year's crop, expanding a herd, buying land, constructing buildings, starting a new venture, or upgrading equipment, farmers are nearly always engaged in planning to keep the farm on track. But farm transition planning—that is, planning for what happens to a farm business and its family from one generation to the next—is a whole different kind of planning. And it's one type of planning farmers often avoid.

Farm transition planning can be challenging and uncomfortable, perhaps because it involves dealing with death, uncertainty, and difficult family situations. But like planning for the next year of production, farm transition planning is critical to a farm's success. With good planning, a farm family can protect farm assets, implement family and business goals, and ensure a smooth transition of a viable operation to the next generation. It's the kind of planning that can pay off big.

Our **Planning for the Future of Your Farm** law bulletin series can help with this important planning need. In the 13-part series, we explain the legal tools used for planning and present strategies that can address a family's goals and needs. We've aligned the series with topics we cover in our popular Planning for the Future of Your Farm Workshop offered each winter. Check the Farm Office website at farmoffice.osu.edu for in-person and webinar workshop dates You'll also find the entire set of bulletins in this series on the Farm Office website. Reading the series and attending our workshop are two big first steps that can lead to creating a plan for the future of your farm.

THE OHIO STATE UNIVERSITY
COLLEGE OF FOOD, AGRICULTURAL, AND ENVIRONMENTAL SCIENCES

NATIONAL AGRICULTURAL LAW CENTER

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WHAT'S IN THE PLANNING FOR THE FUTURE OF YOUR FARM SERIES?

1. **Farm Transition Planning: What it is and What to Expect**
   The concept of farm transition planning, common terms, what farmers can expect from the transition planning process, and how to prepare for it.

2. **The Financial Power of Attorney**
   A Financial Power of Attorney authorizes someone to make financial decisions for another. We explain the different types and how they can help a farm business.

3. **The Health Care Power of Attorney and Advance Directives**
   Medical and end-of-life plans can ease decision making uncertainties for families. This bulletin explains the Health Care Power of Attorney, Living Wills, Donor Registries, and Funeral Directives.

4. **Wills and Will-based Plans**
   A will is a commonly known tool for distributing property. This bulletin explains different types of wills, how they can be used in a farm transition pln.

5. **Legal Tools for Avoiding Probate**
   We review legal tools that transfer assets upon death and avoid the probate process, including beneficiary designations, payable on death accounts, transfer on death designations, and survivorship deeds.

6. **Gifting Assets Prior to Death**
   Gifting is one way to transfer assets to the next generation. In this bulletin, we discuss how gifting works and when it can be advantageous to incorporate gifting into a transition plan.

7. **Using Trusts in Farm Transition Planning**
   Trusts are popular tools in farm transition planning. In this bulletin, we explain how trusts function and highlight how they can meet family and farm planning needs.

8. **Using Business Entities in Farm Transition Planning**
   Many farms have business entities for liability or tax purposes, but business entities can also enable transition of a business to the next generation. We explain how in this law bulletin.

9. **Strategies for Treating Heirs Equitably**
   Whether heirs should inherit assets equally or equitably is a challenging dilemma for parents. We present strategies for equitable distributions of assets in this bulletin.

10. **Strategies for Transferring Equipment and Livestock**
    Equipment and livestock can be more difficult to transfer than other assets. In this bulletin, we review special considerations and strategies that can help minimize the challenges of these transfers.

11. **Strategies for Addressing Special Family Needs**
    Whether it's a disability, substance abuse, gambling, or second marriage, many have special family needs Strategies that provide solutions to these types of needs are the topic of this law bulletin.

12. **Strategies for Long Term Health Care Needs**
    Farmers today must be aware of the possibility of long-term health care costs. We review considerations and strategies for addressing the need and reducing its impact on the farm and farm assets.

13. **Pulling it all Together and Moving Forward**
    Now that you've learned about legal tools and strategies, what should you do next? We offer a roadmap and checklist for moving forward.

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FARM AND ESTATE TRANSITION PLANNING: WHAT IT IS AND WHAT TO EXPECT

Pick up a farm magazine and it's likely to have an article about estate planning. An internet search will yield hundreds of references to passing on the family farm, protecting a farm's legacy, and bringing the next generation into the operation. We focus a lot of attention today on farm transition and estate planning. That's because good planning carries critical consequences for the future of agriculture.

WHAT IS FARM TRANSITION AND ESTATE PLANNING?

Farming is both a unique way of living and a unique way of making a living. It's common for farmers to hope to pass this uncommon heritage on to future generations. "Farm estate planning" uses legal tools to ensure that the next generations receive farmland and farm assets after farm owners retire and pass on. But farmers often want to bring their heirs into the farming operation and hand it along, too. The term "farm transition planning" refers to using many tools, including estate planning and business planning tools, to prepare for and transfer the farming operation to heirs. Whether your goals are to pass on land and assets, hand the farm business down to future generations, or both, learning about farm transition and estate planning will help you accomplish those goals.

THE FARM TRANSITION AND ESTATE PLANNING PROCESS

The farm transition and estate planning process begins with **identifying goals** for the future of the farm and the farm family. We frequently hear from farmers whose primary goals are to keep farmland in the family and prepare the next generation of managers. Or perhaps a farmer aims to retire, address special issues with children, or plan for long term health care. Whatever the goals may be, healthy **family communication** and **conflict management** are often necessary to accomplish this important first step of identifying goals.

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The next step in the farm transition planning process requires **selecting strategies** to implement established goals. Strategies will likely be necessary in several different areas:

- **Human resource** strategies to identify, prepare and train the next generation of the farm business managers.
- **Financial** tools to aid in funding and implementing goals, such as insurance and retirement plans.
- **Legal** strategies and tools for effective asset protection and transfer, such as estate planning and business planning instruments.

The legal tools and strategies component of farm transition planning is the focus of our Planning for the Future of the Farm bulletin series. Some of the legal tools we explain are traditional instruments often used in estate planning, like wills and trusts. But other legal tools can be useful for a farm transition plan, such as business entities, operating agreements, leases, and gifting strategies. These legal tools work hand-in-hand with human resource strategies and financial tools to implement a farm's goals. Putting the legal plan in place is the final step in the farm transition planning process.

The Farm Transition Planning Process

PUTTING A LEGAL PLAN TOGETHER

1. Choose an attorney. The legal side of farm transition planning starts with getting the right attorney. Word-of-mouth is one way to identify a good agricultural attorney, or check with organizations like Extension, the state or local bar association, or the American Agricultural Law Association. Ask for an initial consultation and meet an attorney before committing to representation. Several factors can aid in selecting the right attorney: competence, personal comfort, and costs.

- Look for an attorney with **competence** in estate and business planning—composed of both legal knowledge and practical experience. But don't stop there-- it's also very important that the attorney is competent with agriculture and experienced in working with farm clients. Farms and farm businesses are different than other types of assets and businesses. An attorney who knows farming will have insight into the laws, tools and strategies that apply to farm situations. Be wary of an attorney who has never worked with farm clients and knows little about agriculture.
- **Personal comfort** with an attorney is essential. It can ensure open communication and make it easier to share necessary information about finances, assets, business plans, and family issues and dynamics. Discomfort can lead to misunderstandings, withholding of critical information, and plans that don't align with a family's goals.
- **Costs** can vary. It's completely acceptable to request an estimate of legal fees. Don't be afraid to ask what the entire plan, from start to finish, could cost.

2. Expect to have two or more meetings with an attorney. The first meeting is typically for reviewing goals and information, but might also involve discussing strategies and options. Additional meetings could involve reviewing the tools and strategies to include in the plan and executing legal documents.

3. Prepare for the first meeting. Advance preparation can help the first meeting move more efficiently and effectively. An attorney might let you know in advance of information to gather before the first meeting. Also consider these tips:

- **Write it down.** Write out your goals for the farm business and farm assets. Also include information about the family, its special needs, and its dynamics. Consider details an attorney may need to know about the farm and the family, like who has "sweat equity" in the business, siblings that don't get along, children with problems managing finances, big purchases coming up, and who wants to be involved in the farm—this and similar information will help with developing a plan that addresses future issues.
- **Compile asset and personal information**. Gather all asset information such as deeds, account numbers and balances, and beneficiary designations, along with personal information on you and your family members. OSU Extension offers a helpful document, *Getting Your Farm and Family Affairs in Order,* that can aid in organizing the information. Doing so before meeting with your attorney can save time and the costs of having your attorney track down the information.
- **Organize financial information**. Use the information gathered in step two to prepare a simple balance sheet showing farm assets, non-farm assets, debts, and net worth. Full disclosure of your financial situation is necessary to developing a plan that addresses financial challenges and opportunities, and is another way to save on the costs of paying your attorney to compile the information.

4. You may need your other advisors, too. Communication among all of your professional advisors may be necessary to ensure that all strategies align with one another. You may need to check in with financial advisors, accountants, insurance agents, and other professionals you rely upon.

SPEAKING THE FARM TRANSITION LANGUAGE

Farm transition planning uses many legal terms, and familiarization with the terms should help you through the process. On the next page, we provide definitions to common terms you may encounter along the way.

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Speaking the farm transition language: common terms to know	
Advance directive. A legal document that gives instruction on a person's health care wishes, such as a living will and health care power of attorney.	***Irrevocable trust.*** A trust that cannot be changed or cancelled by the person who executed the trust.
Basis and step-up in basis. The basis is the value of an inherited asset for tax purposes. A step-up in basis is an adjustment of the basis to the asset's fair market value at the time of the death that triggers the inheritance.	***Joint tenancy.*** Ownership of real property jointly by two or more parties, either as joint tenants with rights of survivorship or as tenants in common.
Beneficiary. A person designated to receive proceeds from an asset such as an account, insurance policy, or trust upon the death of the owner of the asset.	***Living trust.*** A trust created during a person's lifetime to manage assets before and after the person's death. A living trust can be revocable or irrevocable.
Business entity or structure. An organization formed to conduct business, such as sole proprietorships, partnerships, corporations, cooperatives, and limited liability companies.	***Living will.*** A legal document stating a person's wishes for medical treatment and life-sustaining measures if the person is at the end of life and unable to communicate.
Capital gains tax. A tax on the increase in the value of an asset between the time it is bought and the time it is sold.	***LLC, Limited Liability Company.*** A business entity that can protect its owners from personal responsibility for business debts and liabilities with pass-through taxation.
Deed. A written document that transfers title to real property to a new owner.	***Long-term care insurance.*** Insurance coverage for long-term services and support not covered by health insurance, such as nursing home or custodial care.
End-of-life directive. A written legal document with instructions for end-of-life medical decisions if a person is unable to make decisions at that time.	***Operating agreement.*** A document that governs the internal operations of a limited liability company and is binding on all members of the limited liability company.
Estate. All of the real and personal property a person owns at death.	***Payable on death account.*** An account set up to be directly transferred to a beneficiary upon the death of the account holder, without going through probate.
Estate administration. The process of collecting assets, paying debts, and distributing the property of a person after the person's death.	***Probate.*** A legal process overseen by a court to administer a person's estate after death.
Federal estate tax. A tax on the portion of a person's estate that exceeds the federal estate tax exemption amount.	***Revocable trust.*** A trust that can be changed or cancelled by the person who executed it prior to that person's death.
Federal estate tax exemption. An amount of assets in an estate that are exempt from the federal estate tax, as determined by Congress and adjusted annually.	***Survivorship deed.*** A deed that transfers the title to a joint owner's share of jointly owned real property upon death to the surviving joint owners.
Financial power of attorney. A legal document that appoints someone to make financial decisions for a person if the person is unable to manage their finances.	***Tenancy in common.*** A form of joint ownership of real property that allows a joint owner to transfer their share of property to a person other than a joint tenant.
Gifting. Giving cash or assets to a beneficiary during the giver's lifetime rather than after death, which can reduce the value of the giver's estate and the possibility of estate taxes at death.	***Transfer on death affidavit.*** A written instrument that establishes a direct transfer of real property to a designated beneficiary upon the death of the owner without going through probate administration.
Health care power of attorney. A legal document that allows an individual to empower another person to make important medical decisions on their behalf when they cannot do so themselves.	***Trust.*** A legal instrument that holds assets and appoints a trustee to oversee and distribute assets according to the terms of the trust.
Intestacy. Dying without a will, which results in the deceased's assets being subject to probate and distributed according to the state's intestacy law.	***Trust administration.*** The process of managing the assets within a trust according to the terms of the trust.

THE FINANCIAL POWER OF ATTORNEY

We can't always take care of our own financial and personal affairs. Whether due to medical issues, mental incapacity, schedule conflicts, or other unexpected circumstances, we sometimes need someone else to handle those needs. A Financial Power of Attorney (POA) is a legal instrument that can help in those times. It allows you as the "**principal**" to name an "**agent**" to perform duties such as managing your bank accounts, finances, and investments, signing your tax returns, or handling a specific business matter. It's a flexible legal document that you and your attorney can tailor to address different needs at different times. In this bulletin, we explain how financial POAs can be helpful to your situation and how they work.

HOW A FINANCIAL POWER OF ATTORNEY CAN HELP YOU

It gives you control. If you don't have a POA and become incapacitated, a court may have to appoint a legal guardian to act for you. The person the court selects as your guardian may be a person you wouldn't want to be involved in your affairs. With a Financial POA, you have control over who deals with your financial matters, and you can define the scope of that agent's authority.

It creates consistency. Authorizing someone to step in when you cannot avoids disruptions and keeps your finances and affairs running efficiently and smoothly.

It provides certainty. Third parties often want or require proof that someone has the legal authority to handle someone else's finances and dealings so that they don't end up in the middle of a fraud or theft situation. A Financial POA provides that proof to the parties you deal with.

THE UNIFORM POWER OF ATTORNEY ACT AND OHIO'S STATUTORY FORM

Many states, like Ohio, have adopted the **Uniform Power of Attorney Act**, a model law that provides default rules for POAs and standardizes requirements across states that adopt the law.

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Like many states, Ohio's Act provides a statutory POA form that aligns with the state. The law also aims to deter financial abuse, because giving someone financial and asset decision making authority poses risk, especially for elderly and disabled persons. Ohio's version of the Uniform POA Act outlines an agent's powers, states prohibited acts, and provides remedies for principals if an agent violates the POA. The **prohibited powers list** clarifies those powers a POA *does not grant unless* the principal specifically states that the agent has that power, which includes:

- Create a trust for the principal or make changes to an existing trust
- Give away the principal's property
- Create or change rights of survivorship
- Change beneficiary designations
- Let others act in place of the named agent
- Waive the principal's right to be a beneficiary of a joint and survivor annuity, including a survivor benefit under a retirement plan.

OBTAINING, EXECUTING AND RECORDING A POA

It is possible to prepare your own Financial POA using a state's standard forms on the internet. But you should strongly consider **consulting with an attorney** for your POA. An attorney can help you decide when you need a POA, address issues unique to your situation, help you decide what types of authority to grant an agent, and determine when the authority begin and end. Typically, an attorney can draft a Financial POA quickly with moderate legal fees, making it well worth the investment to have a tailored document that protects you and meets your needs.

Ohio law addresses how a principal must **execute** a POA for it to be effective. The principal must sign the document, or if unable to sign, may direct another individual to sign for the principal while in the principal's presence. Acknowledgement by a notary public or local official legitimizes the POA.

Additionally, a POA granted for the conveyance, mortgage, or lease of an interest in real property must be **recorded** in the county recorder's office where the property is located prior to recording of the deed, mortgage, interest, or lease. A revocation of a recorded POA must also be recorded in the same county recorder's office where the recording occurred.

GENERAL VERSUS LIMITED POAs

The two main types of Financial POAs differ according to the scope of powers granted to the agent. A general POA grants the most authority while a limited POA limits authority to specific actions or assets.

A **general POA** typically gives the agent authority to do all things necessary to manage assets held by the principal. Examples of powers typically given by a general POA include:

- Buy, sell, lease, mortgage, and give away real and personal property
- Contract in any manner with any person on behalf of the principal
- Operate, buy, sell, enlarge, reduce, or terminate an ownership interest in a business
- Open, close, invest in, and withdrawal from an investment or bank account
- Buy, sell, exchange, and exercise voting rights on stocks and bonds
- Buy, sell, exchange, assign, settle, and exercise commodity futures contracts
- Buy, cancel, collect, and change beneficiaries on a life insurance policy
- Litigate for any money or other thing of value owed to the principal
- Sign, acknowledge, seal, deliver, file, or record any instrument on behalf of the principal
- Engage, pay, or discharge an attorney, accountant, investment manager, or other advisor

A **limited POA** grants an agent the authority to act only for a specific purpose, during a certain period of time, or for particular assets. The document will specify the actions the agent may take on behalf of the principal, and the agent has no authority to act beyond that limited scope of authority. For example, a principal selling real estate can execute a limited POA that gives an agent authority to sign the deed on the principal's behalf on the day of the closing. The agent does not have authority to act on any other matter or at any other time for the principal.

THE AGENT'S FIDICUARY DUTIES, PAYMENT, AND LIABILITY

An agent has the legal duties of a "fiduciary" when performing under a Financial POA. Consider closely whether the person you want to appoint as a POA is capable and willing to carry out these legal duties. As laid out in Ohio's law, the agent must act in accordance with the principal's reasonable expectations and best interest, in good faith, and only within the scope of the authority granted by the POA. Ohio law details many specific duties that require competence, care, and diligence by the agent, as well as maintaining records of receipts and disbursements and cooperating with the principal's Health Care POA to carry out health care needs. Unless a POA states otherwise, an agent is entitled to compensation and reimbursement of expenses for performing duties, as long as costs are reasonable.

Ohio law also provides that an agent who violates the agent's duties can be financially liable for value lost as a result of the violations. On the other hand, the law states that an agent who acts in good faith is not liable to the principal's beneficiaries or if the principal's property declines in value.

WHEN POA AUTHORITY BEGINS AND ENDS

There are advantages and disadvantages to different approaches for beginning and ending a Financial POA, and it can be quite beneficial to review the options with your attorney before making decisions.

The beginning. When exactly can an agent begin dealing with matters authorized by the POA? This is a very important provision of the POA to discuss with an attorney because the document will be effective immediately *unless* you state otherwise. It's typical for a principal to sign a Financial POA because the need exists at the current time. For example, if a farm business owner wants to allow another to assist with certain business matters

Another option is for a Financial POA to "spring" into effect only upon a certain event, but it must clearly state the events that trigger the POA authority. This type of POA can be difficult for an agent to use, as third parties might question whether the triggering event has actually occurred. For example, if the Financial POA is only effective in the event of a medical emergency, a bank might require the agent to offer proof of the medical emergency. That is why Ohio law allows a principal to authorize one or two people to determine in writing if the triggering event has occurred, which can provide the proof necessary to confirm that the POA is valid.

Durability. Ohio's Uniform POA Act law states that unless provided otherwise by the principal, a POA is **"durable."** This means that the Financial POA remains in effect if the principal becomes incapacitated. In the above example of a Financial POA triggered by a medical emergency, the Financial POA would remain in effect if the principal then becomes incapacitated.

What is incapacity? How do we know when someone is "incapacitated" for purposes of a determining if a Financial POA is in effect? The law provides a definition of "incapacity," which means the inability of an individual to manage property or business affairs for the following reasons:

- The person is impaired in the ability to receive and evaluate information or make or communicate decisions, even with technological assistance.

- The person is missing, detained, or outside the United States and unable to return.

A principal may authorize someone to determine when the principal is incapacitated. If the principal doesn't do so, the law allows a physician or psychologist to examine a principal to determine impairment or an attorney, judge, or government official to determine that the principal is missing, detained or unable to be in the United States.

The ending. It's also important to clarify when the POA authority ends, or Ohio law will make the termination. Under Ohio law, a POA that is not durable ends upon the principal's incapacity. The law also states that an agent's authority ends if the principal dies or revokes the POA, the termination provisions of the POA are met, the purposes of the POA is accomplished, or the agent dies, resigns, or becomes incapacitated. A principal can change or terminate a POA at any time as long as the principal has mental capacity. Notifying financial institutions of a POA termination can ensure that they know the agent no longer has authority to act for the principal. Note that if the POA grants powers to convey interests in property and has been recorded, the revocation must also be recorded in the same county recorder's office.

SUMMING IT UP

A Financial POA is an important document for everyone to have in their estate planning package. It allows you flexibility for managing financial affairs and the power to choose who will manage those affairs if you are unable to do so. Without a POA, the court must appoint a guardian for you. We advise working with an attorney to establish your Financial POA, ensuring that your document meets your goals and needs and that you understand the terms and conditions of your Financial POA.

RESOURCES AND REFERENCES

Ohio Revised Code Chapter 1337, "Power of Attorney"
Ohio Revised Code Sections 1337.21 to 1337.64, "Uniform Power of Attorney Act"
Ohio State Bar Association, "Law Facts: Financial Powers of Attorney" (May 18, 2019).

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THE HEALTH CARE POWER OF ATTORNEY AND ADVANCE DIRECTIVES

Health care decisions are difficult, and especially so when determining whether to have a risky medical procedure, remain on life support equipment, or donate body organs. What if you're incapacitated and unable to make these decisions for yourself? Similarly, what if you have wishes for your funeral and burial arrangements that you want someone to follow? Several documents can step in to address these needs—the Health Care Power of Attorney, Living Will Declaration, Anatomical Gifts Declaration, Donor Registration, and Funeral Arrangements. These advance directives are important documents that can ease the burdens of health care and end-of-life decision making for both you and your family.

THE HEALTH CARE POWER OF ATTORNEY

A Health Care Power of Attorney is a legal document that gives the person you appoint—your "agent"—the power to determine your health care needs. The agent may set up appointments, choose treatment, communicate with your doctors, determine where to obtain long term care, and more. Like other states, Ohio law states that the agent has the power to receive information about proposed health care, review health care records, and make health care decisions to the same extent that you could if you were able to do so, unless you express otherwise in the document.

Ohio law states that a Health Care Power of Attorney is effective only when your doctor determines that you have lost the capacity to make informed health care decisions. The Health Care Power of Attorney may also include special instructions that authorize the agent to refuse the provision of artificially or technology supplied nutrition or hydration if you are in a permanently unconscious state. Alternatively, you may have a separate Living Will Declaration that further addresses end-of-life care, discussed below. You may revoke and change a Health Care Power of prior to death, and it extinguishes upon death.

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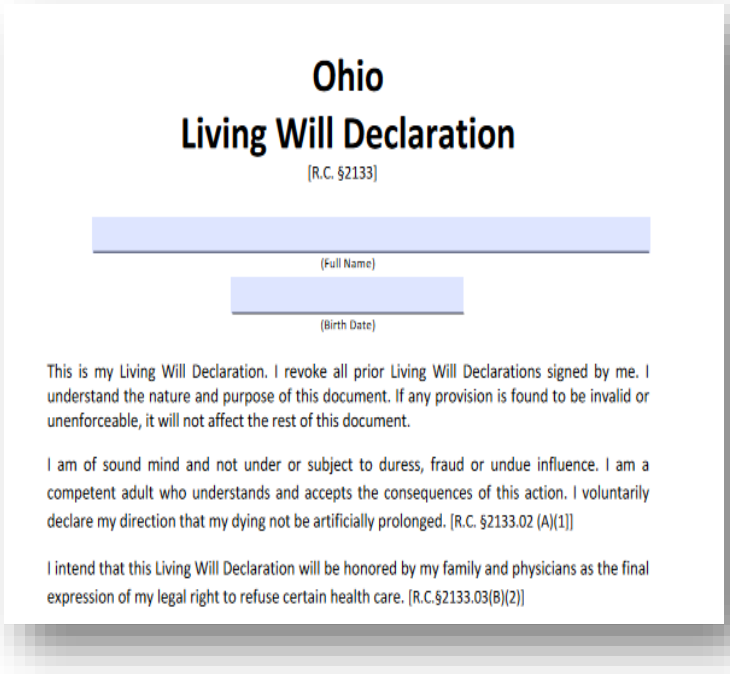
THE LIVING WILL DECLARATION



Ohio

Living Will Declaration

[R.C. §2133]

(Full Name)

(Birth Date)

This is my Living Will Declaration. I revoke all prior Living Will Declarations signed by me. I understand the nature and purpose of this document. If any provision is found to be invalid or unenforceable, it will not affect the rest of this document.

I am of sound mind and not under or subject to duress, fraud or undue influence. I am a competent adult who understands and accepts the consequences of this action. I voluntarily declare my direction that my dying not be artificially prolonged. [R.C. §2133.02 (A)(1)]

I intend that this Living Will Declaration will be honored by my family and physicians as the final expression of my legal right to refuse certain health care. [R.C.§2133.03(B)(2)]

A person may provide instructions on end-of-life care through a Living Will Declaration. If you are in a terminal condition or permanently unconscious state and there is no reasonable possibility that you would regain the capacity to make decisions, a Living Will Declaration directs your doctor to provide only comfort and pain management care and allow you to die naturally. The declaration states that your doctor is not to administer life-sustaining treatment, CPR, artificially or technologically supplied nutrition or hydration, or take any actions that postpone your death. The declaration also authorizes your doctor to issue a "Do Not Resuscitate Order."

According to Ohio's Rights of the Terminally Ill Act, a Living Will Declaration is valid only if you are either in a terminal condition, which means an irreversible, incurable, and untreatable condition from which there is no recovery and death is likely to occur without life-sustaining equipment, or in a permanently unconscious state, which means an irreversible condition in which you are permanently unaware of yourself or your surroundings. Two doctors must examine you and agree that you are in a terminal condition or permanently unconscious. A Living Will Declaration also directs the attending doctor to make reasonable efforts to notify at least one of three contact persons listed in the document.

ANATOMICAL GIFTS DECLARATION AND DONOR REGISTRY

Gifting body organs and tissues and making arrangements for cremation or burial are also difficult end-of-life decisions. A few options are available to address these issues in advance and relieve stress and discord among survivors. If you wish to make gifts of body organs and tissues, it's possible to do so in a Living Will Declaration or Health Care Power of Attorney. However, Ohio and all other states also maintain a donor registry system that can be helpful in a medical emergency. The Ohio Bureau of Motor Vehicles oversees the registration process, allowing for immediate recognition on your driver's license that you authorize donations of body organs or tissues.

DISPOSITION OF REMAINS, FUNERAL ARRANGEMENTS AND BURIAL OR CREMATION

Ohio law allows you to name a person who can determine what happens to your body after your death, referred to as the "right of disposition." The appointment can give the person the right to make arrangements for anatomical gifts, determine the location, manner, and condition of your funeral, and make burial, cremation, and similar decisions. The form may indicate your preferences on such matters and identify the source of funds to be used to pay for arrangements. The law also provides that a person who acts according to the appointment cannot be held liable for following your preferences.

COMMUNICATING YOUR PLANS

Let others know about your Health Care Power of Attorney and advance directives so that the documents are used if a medical or end-of-life situation arises. Give copies to those you've appointed as agents and to your doctors, attorney, and religious advisor, and keep copies with your other important records. Discuss your decisions with family and close friends. Not knowing what you would want can create stress at a very difficult time, and communicating your wishes in advance will likely reduce that stress. Even if others don't agree with your decisions, sharing them beforehand could minimize the potential of conflict, misunderstandings, and even a legal battle among family members.

RESOURCES AND REFERENCES

Ohio Revised Code Chapter 1337, "Power of Attorney."
Ohio Revised Code § 2108.70, "Assignment of rights regarding disposition of remains."
Ohio Revised Code § 2133.02, "Declaration relating to use of life-sustaining treatment."

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WILLS AND WILL-BASED FARM TRANSITION PLANS

Your will, or "last will and testament," allows you to determine what happens to your property after your death. A will is a necessary part of a farm transition or estate plan, but how it is used can vary widely. Some farm transition plans can may need only a will in conjunction with a few simple tools—we refer to these as "will-based plans." Other farm transition plans, however, may be more complex and required additional legal tools. We explain wills and their role in farm transition planning in this bulletin.

WILLS SERVE MANY PURPOSES

The "reading of the will" after someone dies can be a drama-filled event, with family members wondering who gets what and what the will says. The options for what a will might say may be surprising, because a will can serve many purposes in addition to its well-known purpose of giving property to family members. A will can have many functions, such as:

Determining where property goes. A will transfers property after death according to a person's wishes. The terms of a will can be quite specific about how property passes, though. The will can include restrictions and conditions tailored to the deceased person's wishes and can "disinherit" heirs that otherwise would receive property if the person didn't have a will. The will can also include alternative plans for changed conditions and circumstances.

Minimizing the probate process. A will sends clear directions to the probate court. Without a will, the court would otherwise have to determine how the property should pass according to law. And as we explain later, a will can direct property to an existing trust and reduce the need to transfer the property through the probate process. Both actions can reduce the time spent in probate, as well as the costs.

Choosing who administers the estate. A person can appoint an **administrator** who will work with the probate court to settle the person's estate. The administrator, also called an executor or personal representative, will help resolve the deceased person's financial affairs and carry out the directives in the will. It's an important role, so it's important to choose an executor carefully.

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Naming guardians. One critical role a will can play is to address who will care for dependents such as minor children and incompetent adults upon the death of their caretakers. Parents or other persons with dependents may nominate a guardian in the will, and the court will review that nomination when appointing a legal guardian. The will may also specify whether the guardian is to manage the dependent's personal needs, property, or both.

WHAT IF YOU DON'T HAVE A WILL?

Every state in the U.S. has an "intestacy law" or "statute of descent and distribution" that steps in when a person dies without a will and states how to distribute the person's property. As with other states, Ohio's intestacy law makes assumptions that the deceased would choose to give property to family members. The law establishes an order of preference that gives a surviving spouse first priority, then children of the deceased and their children. If there is no spouse or children, the law looks next to parents, then to other family members. The State of Ohio receives the property if there are no family members. Ohio law also gives the probate court authority to appoint an administrator to assist with settling the estate of a person who dies without a will.

THE FORMALITIES OF MAKING A WILL

Requirements for making a will are straightforward, but failing to meet them can result in a will being declared invalid. Ohio law allows a person 18 years or older to make a will if that person is of "sound mind and memory" and "not under restraint." These terms mean that a person must know what he or she is doing when making a will and that it is a free and voluntary act. A will must be in writing, although it need not be typed, and the person making the will must sign it or if unable to do so, direct someone else to sign it in their presence. Two or more witnesses must also acknowledge that the person made and signed the will and must also sign the will in the presence of the person making the will. but cases questioning the validity of a will often arise.

Many "fill-in-the-blank" wills are freely available, but we advise working with an attorney to develop a will. Doing so will ensure not only that the legal requirements for making the will are satisfied, but more importantly that the will properly fits with the farm transition plan.

DIFFERENT TYPES OF WILLS

How a will distributes property can vary. A will can direct property to an identified party, send property to an established trust, or order that a trust be set up to receive the property. Here's an explanation of these three different types of wills:

A **simple will** directs all property to a surviving spouse or if the spouse is pre-deceased, then to the children. A simple will might also make specific bequests of property, name an executor, and appoint a guardian for minor children. The "simple" name for this type of will means that it does not involve a trust, making it less complex than other will types. Some call this type of will a "sweetheart" will, because the plan is to leave all or most of the property to the deceased's sweetheart. The sweetheart then determines the fate of the property at his or her death.

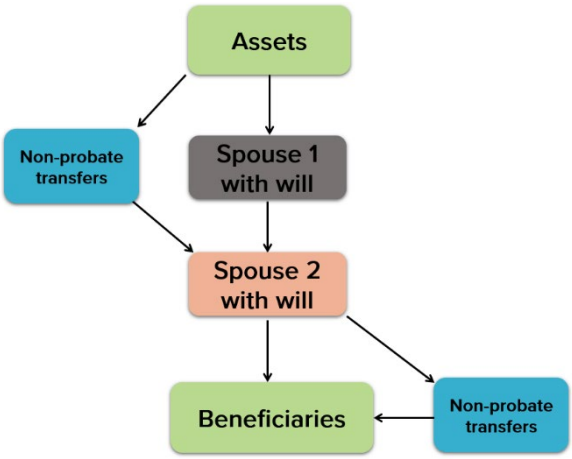
A **pour over will** transfers assets to a "living trust" created prior to death. The assets "pour over" into the trust and the trust provisions then control what happens to the assets. This type of will is an important part of a trust-based plan and ensures that all property goes directly into the pre-existing trust rather than through the probate process.

A **complex will** directs the creation of a trust after death, referred to as a "testamentary trust." A testamentary trust tends to be simpler than a "living trust" and might only arise if certain conditions exist at death. For example, a simple testamentary trust could direct assets into a trust to support minor children if both parents pass. The trust only arises if the children are minors and both parents are deceased. Because a will creates the trust, the probate court would oversee administration of the trust by the trustee named in the will.

A WILL-BASED FARM TRANSITION PLAN

A plan can use a simple will to pass assets from one spouse to the next and then on to heirs. Other tools might be involved in the plan, such as transfer on death accounts, which we explain in other bulletins in this series. But the plan doesn't require the use of a trust. We refer to this approach as a **"will-based plan."** The illustration to the right shows how a will-based plan combined with non-probate tools can transfer farm assets to the intended beneficiaries. This approach can be sufficient for many people, but most often it doesn't work well to address the complexities and assets of farm families and transitioning farm businesses.

A simple will-based plan



DO YOU ALSO NEED A TRUST?

Can you accomplish your plans for the future with a will-based plan? Or do you need a trust-based plan that uses a trust to help carry out the transition of your farm and assets? Those are "it depends" questions, as several factors come into play. The complexity of your situation is probably the critical factor that could lead you to a trust-based plan rather than a will-based plan. For example, if you have heirs with special needs, want to place certain conditions on heirs receiving property, need to address details ensuring transition of the farm to a specific heir, or are worried about federal estate taxes, a will-based plan may not be able to address your needs.

Likewise, you might prefer a trust because you want to avoid probate court involvement and have a trustee in charge of administering your affairs. You may also prefer to place details in a trust because of the privacy it offers in comparison to a will, which becomes an accessible public record when it goes through probate. Finally, legal fees are a factor. While a trust-based plan will likely cost more to create at the outset, it can keep assets out of probate and save on probate fees. A will-based plan is probably less expensive to create, but could result in higher costs if assets must transfer through the probate process.

In the chart below, we outline these issues and illustrate the different outcomes for will-based versus trust-based plans. Discussing the factors with family and an attorney can be helpful, too. To learn more about trusts and using a trust-based plan in farm transition planning, see our other bulletins in this series.

Comparing a will-based plan with a trust-based plan

Factor	Will-based plan	Trust-based Plan
Complexity of situation	Simple	Complex
Concerns about heirs	Little or none	Some or significant
Remarriage concerns	Little or none	Some or significant
Transition of operation	Little or none	Some or significant
Estate taxes	Little or none	Need to maximize savings
Probate	Don't mind; judge is in charge	Want to avoid; trustee is in charge
Privacy	Not important	Important
Cost	Less at outset; maybe more later	More at outset; maybe less later

UPDATING A WILL

How often should you update your will? It's important to be aware of circumstances that can trigger the need to review and possibly change your will. Major life events are the most common reasons for updating a will, including:

- Marriage, remarriage, or divorce in the family
- Birth of a child or grandchild
- Death of a spouse or beneficiary
- Change in health status
- Inheritance or other income that affects the value of your estate
- Moving to a different state
- Estate or tax law changes

WORKING WITH AN ATTORNEY

Many "fill-in-the-blank" wills exist, but be wary of the one-size-fits-all approach they offer. An attorney plays an important role in developing a will that not only expresses your wishes but also addresses contingencies, considers the estate and tax laws that govern your estate, and fits the will into the overall farm transition plan. See our resources on choosing an attorney and talk with friends and family to find an attorney who will help you with the important task of creating a will that can carry out your plans for the future.

REFERENCES AND RESOURCES

Ohio Revised Code section 2105.06," Statute of descent and distribution."
Ohio Revised Code Chapter 2107, "Wills."
Ohio State Bar Association, "Law Facts: Wills" (May, 2015).

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GIFTING ASSETS PRIOR TO DEATH

Gifting assets before your death may seem like an obvious strategy for those who want to transfer assets to their heirs. If you do not need the assets, why not go ahead and transfer the assets now rather than after your death? While gifting can be a good strategy for transferring assets in some circumstances, gifting can help tax implications. Transferring the same assets through an estate plan may be a better strategy. In this bulletin, we discuss how gifting works, gifts and taxes, and when it is advantageous to incorporate gifting into a farm transition plan.

WHAT IS A GIFT?

According to the IRS, a gift is a transfer of property to another without receiving the full value of the gift in return. Just about any asset can be a gift. Cash is the most common gift but many farm families also gift machinery, livestock, grain, and land.

MAKING A GIFT

The process for making a gift depends upon the asset being gifted. Some assets can only be gifted by executing documents while other assets can be gifted by simply handing the asset over to the person receiving the gift. Here is a list of commonly gifted assets and how they are gifted:

- **Real estate.** May only be transferred with properly executed deeds.
- **Financial accounts**. Transfer forms must be completed with the financial institution to transfer ownership.
- **Vehicles and trailers.** Title must be transferred, and a new title issued by the county Clerk of Courts title office. Note that some smaller trailers may not have titles.
- **Machinery, equipment, livestock and grain**. These assets do not have titles, so they are transferred by giving possession of the asset to the giftee.
- **Cash.** Funds are transferred to the giftee.

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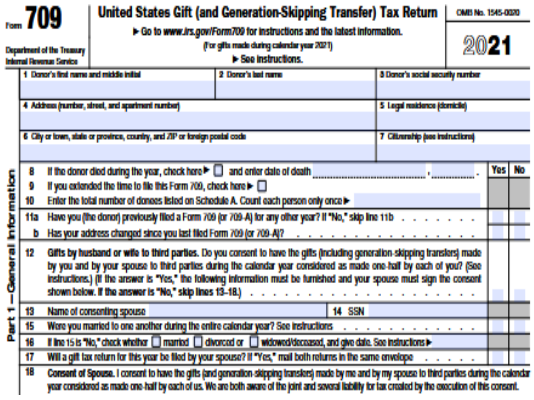
Regardless of what type of asset is gifted and how it transfers, it is good to keep a **written record** of the gift and the value of the gift. Documenting the gift is important in the event of an Internal Revenue Service (IRS) audit and to avoid any misunderstandings about what asset was actually gifted. The written record should include a description of the gifted asset, the value of the gift, who is receiving the gift and the date of the gift. For cash, consider using a check as further record of the gift. The person receiving the gift should also date and sign documentation to confirm that they have accepted the gift.

GIFTS AND TAXES

The gift tax. The federal government and many states assess a tax on gifts, but Ohio does not have a gift tax. The federal gift tax was developed to prevent individuals from avoiding federal estate taxes by gifting away significant assets prior to death. For this reason, it is the giver of a gift who is responsible for paying the gift tax. The gift tax begins at 18% on the first $10,000 and increases by 2% every additional $10,000, to 40% on gifts over $1 million. A giver uses IRS Form 709, pictured here, to document a gift that may be subject to gift tax.



Form 709 (Department of the Treasury, Internal Revenue Service)

United States Gift (and Generation-Skipping Transfer) Tax Return

▶ Go to www.irs.gov/Form709 for instructions and the latest information.

(For gifts made during calendar year 2021)

▶ See instructions.

OMB No. 1545-0020

2021

1 Donor's first name and middle initial | 2 Donor's last name | 3 Donor's social security number

4 Address (number, street, and apartment number) | 5 Legal residence (domicile)

6 City or town, state or province, country, and ZIP or foreign postal code | 7 Citizenship (see instructions)

Part 1—General Information

8 If the donor died during the year, check here ▶ ☐ and enter date of death . . . . . Yes No

9 If you extended the time to file this Form 709, check here ▶ ☐

10 Enter the total number of donees listed on Schedule A. Count each person only once ▶

11a Have you (the donor) previously filed a Form 709 (or 709-A) for any other year? If "No," skip line 11b . . . . . .

b Has your address changed since you last filed Form 709 (or 709-A)? . . . . . .

12 Gifts by husband or wife to third parties. Do you consent to have the gifts (including generation-skipping transfers) made by you and by your spouse to third parties during the calendar year considered as made one-half by each of you? (See instructions.) (If the answer is "Yes," the following information must be furnished and your spouse must sign the consent shown below. If the answer is "No," skip lines 13–18.) . . . . . .

13 Name of consenting spouse | 14 SSN

15 Were you married to one another during the entire calendar year? See instructions . . . . . .

16 If line 15 is "No," check whether ☐ married ☐ divorced or ☐ widowed/deceased, and give date. See instructions ▶

17 Will a gift tax return for this year be filed by your spouse? If "Yes," mail both returns in the same envelope . . . . . .

18 Consent of Spouse. I consent to have the gifts (and generation-skipping transfers) made by me and by my spouse to third parties during the calendar year considered as made one-half by each of us. We are both aware of the joint and several liability for tax created by the execution of this consent.

Exceptions to the gift tax. The good news is that federal law grants many exceptions from the gift tax. A gift to a spouse or a political or charitable organization is not subject to the tax, nor is tuition or medical expenses paid for another. Additionally, federal law allows a certain value of gifted assets to pass free of gift taxes, referred to as the "annual exclusion." Gifts in excess of the annual exclusion may also be given tax free if they count toward the "lifetime exemption" from estate tax. Here's how these two types of gifts work:

1. **Annual exclusion gift.** The annual exclusion gift is truly a "free gift." A person may gift up to $16,000 annually to an unlimited number of people. These annual exclusion gifts have no gift or estate tax implications. Neither the person who gives or the person who receives the gift is subject to a tax. As an example, a person can gift $1 million tax free by giving the annual exclusion gift of $16,000 to 63 different individuals. Note that federal law indexes the annual exclusion gift amount and occasionally increases it by $1,000 as it did in 2022, when it increased from $15,000 to the current $16,000.

2. **Lifetime exemption gift.** Many people are surprised to learn that large gifts can also be free from gift tax by counting toward a person's lifetime exemption from federal estate tax. The lifetime exemption is the amount of wealth a person can have at death that is not subject to federal estate taxes, as determined by Congress and indexed and increased each year. For 2022, the amount is $12.06 million but in 2026, the current federal estate tax law is set to sunset and the exemption will be reduced by one-half.

   Federal law allows the lifetime exemption to be "used up" during a person's lifetime, however. The amount of a gift that exceeds the $16,000 annual exclusion can reduce the giver's lifetime estate tax exemption by that amount when they die. If not, the amount of a gift in excess of $16,000 can be subject to gift tax rates that start at 18% and increase to 40% on gifts over $1 million. People often choose to avoid the gift tax and reduce their lifetime exemption when making gifts over the annual exclusion amount.

The best way to explain these two gift tax exceptions may be by using examples. **Consider the following examples**:

Example 1. John's net worth is $10 million at death and his lifetime exemption is $12.06 million. John's estate owes no estate taxes because his net worth is less than his lifetime exemption.

Example 2. John gives a single gift of $1 million to Daughter while alive and counts it toward his lifetime exemption. John's net worth at death is $10 million. The gift to Daughter was $985,000 over the $15,000 annual exclusion, which reduces his $12.06 million lifetime exemption by that amount to $11.075 million. John's net worth of $10 million at death is still less than his remaining lifetime exemption, so his estate will owe no estate taxes. The $1 million gift to Daughter was essentially a free gift because his net worth remained under the lifetime exemption.

Example 3. Same scenario as Scenario 2, but John dies with a net worth of $12 million. After the gift to Daughter, John's remaining estate tax exemption is $11.075 million. Now his net worth exceeds his remaining lifetime exemption by $925,000, so John's estate will owe federal estate taxes on that amount. John's large gift in this scenario had federal estate tax implications. Had he given Daughter the $1 million in smaller gifts to Daughter and her family over the years, John could have reduced the amount of the gift that would count toward the lifetime exemption.

EFFECT OF GIFTING ON TAX BASIS

An asset's tax basis is generally the purchase price or its value when inherited, less depreciation taken. For example, a tractor purchased for $100,000 with $60,000 depreciation taken has a tax basis of $40,000 remaining.

The tax basis of an asset has significant tax implications. The higher the tax basis, the more depreciation can be taken and the less taxes owed when sold. Using the above example, if the tractor is sold for $70,000, the $40,000 tax basis is not taxed, only the $30,000 gain (sale price – tax basis) is taxed. The higher the tax basis, the less taxes are sold upon sale.

As noted above, the tax basis is usually established at time of purchase or inheritance. This is known as a "step-up" in tax basis because the tax basis is stepped-up to either the purchase price upon purchase or the fair market value upon death of the owner. This step-up in tax basis is particularly important when an asset is inherited because **when an asset is gifted, a step-up in basis does not occur**. For estates with no estate tax liability, an inherited asset with no estate tax also receives a full stepped-up tax basis. The person inheriting can re-depreciate the asset or sell the asset and pay no taxes on the sale, if sold for no more than the stepped-up tax basis.

Consider another example. The tractor above with a tax basis of $40,000 was inherited by Bill from his father's estate. The tractor was appraised for $80,000 at the time of father's death, so Bill receives the tractor with a stepped-up tax basis of $80,000. Bill can either depreciate the tractor and offset $80,000 of income or sell the tractor for $80,000 and pay no tax on the sale. If Bill's father would have gifted the tractor to Bill during life, Bill would have received it with the lower $40,000 basis. From a tax perspective, Bill was better off inheriting the tractor rather than being gifted the tractor.

As these examples show, there can be negatives consequences to gifting assets. Before gifting an asset, be sure to analyze all of the tax implications of the gift. You may find that passing the asset by updating your estate plan is a better strategy for your heirs.

USING GIFTING STRATEGIES IN A FARM TRANSITION AND ESTATE PLAN

While gifting is not always the best tax strategy for farm transition plans, there are times when its advantages outweigh the loss of a step-up in tax basis. Gifting can be, and often is, an important part of a plan. The following scenarios illustrate situations where gifting can be a good option:

Transferring a depreciating asset. Sometimes the older generation owns machinery, equipment, livestock, or other assets that will lose value over time. Owning these types of assets also carries with them some degree of liability exposure. If an owner does not need income from the assets, it can make sense to transfer the assets now rather than upon death. In this situation, transferring the assets during life to remove the challenges of ownership outweighs the lost step-up in tax basis.

Gifting appreciating assets. For people who are close to or over the estate tax exemption, gifting appreciating assets can be a good strategy. If the asset is gifted now, the future appreciation of the asset is transferred out of the giver's estate. For example, a farm that is worth $1 million today but is expected to have a significant increase in value is gifted. When the value of the farm doubles, the additional $1 million in appreciation occurs in the giftee's estate rather than the giver's estate. The gift causes a loss of a stepped-up tax basis, but it is probably well worth it to avoid a 40% estate tax on the $1 million appreciation.

SUMMING IT UP

Gifting is another tool in the farm transition and estate planning toolbox. Sometimes it's a good tool to build a transition plan while other times it should be left in the toolbox. Be sure to have a discussion with your attorney and tax advisor before making any significant gifts. A thorough analysis can ensure an understanding of tax implications for both the person giving and the person receiving the gift.

RESOURCES AND REFERENCES

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USING BUSINESS ENTITIES IN FARM TRANSITION PLANNING

Business entities can be a valuable tool in farm transition planning. Many attorneys advise forming a business entity as a way to limit liability and manage taxes, but an increasing number of agricultural attorneys have found ways to use business entities as a means to transition the farming operation to the next generation. We explain business entities and how they can be used in farm transition and estate planning in this bulletin.

BUSINESS ENTITY BASICS

The farm business can be an informal structure, such as a sole proprietorship or can be formally organized, such as a corporation or limited liability company. Each type of entity has its own set of liability protections, tax issues, ownership transfer processes, and other characteristics to consider.

Sole proprietorships and general partnerships. Sole proprietorships and general partnerships are the simplest business entities, and according to the U.S. Census of Agriculture, the majority of U.S. farms are one of these two. They are business entities that generally require no filing of paperwork with a state. While the details may vary from state-to-state, the characteristics of these types of entities are fairly consistent nationwide. They afford no liability protection to the owners, any liabilities of the business are also the personal liabilities of the owner, and taxes are assessed directly to the sole proprietors or the partners at individual rates.

By default, if there is no business entity, an individual who owns lands, equipment, and other goods to make a profit will own those assets as a **sole proprietor**. The sole proprietor is the business, and the business is the sole proprietor. The business has no existence beyond the sole proprietor, so when the proprietor dies, the business ends and the assets are divided up through the proprietor's estate. A sole proprietorship has limited usefulness in a transition plan because entities that are separate from the owners are best suited for farm transition planning.

By law, the sole proprietor and the business are one and the same, so the sole proprietor is personally liable for the business.

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Liability exposure can be a concern for partnerships, because Ohio law states that each partner is personally and fully responsible for the liabilities of the partnership, including those that arise from an act of another partner.

If two or more people own land, equipment, and other goods to make a profit, then they own the business as general partners in a **partnership**. A partnership may be informal or may use a written partnership agreement. In either event, Ohio's Uniform Partnership Act provides laws that govern partnerships in Ohio. A partnership is a person in the eyes of the law and can own assets and conduct business as a person would, and is typically more flexible and less formal than a corporation. A partnership may and often does continue after the death of a partner. For these reasons, a partnership can be an effective component of a farm transition plan.

The simplicity of sole proprietorships and general partnerships come with the tradeoff of **no liability protection**. The sole proprietor is personally responsible for any liability of the business because there is no separation between the proprietor and the business. In a general partnership, all partners can be personally liable for any losses, debts, or mistakes related to the business and the other general partners. If one partner signs a contract, the other partners are bound to and personally liable for the contract.

Corporations. A corporation is an organized business entity with a separate legal status from its owners. Corporations have the right to buy and sell property, carry debts, enter into contracts, and more. This is why we hear the phrase "corporations are people." Shareholders own the corporation and typically elect a board of directors who in turn select officers to run the day-to-day operations of the corporation. Shareholders have limited liability and are only liable for losses up to their investment in shares.

A corporation has more formal business requirements than sole proprietorships or partnerships, but offers personal liability protection and taxation options for its owners.

State laws governing corporations can be rather complex and burdensome. The shareholders and board of directors must hold annual meetings and keep detailed records of meetings and activities. Corporations are typically governed by majority rule, such that the owners of 51% of voting stock decide how the corporation operates.

There are two primary types of corporations: C-corps and S-corps.

1. **C-corps** are taxed directly, but shareholders are also taxed on any dividend they receive, which results in double taxation. When people think of a corporation, they often think of C-corps.
2. **S-corps** are a sub-set of corporations with special rules. People often refer to these as closely held corporations because they may have no more than 100 shareholders and have pass through taxation. S-corps may not have corporate shareholders and can only issue one class of stock.

Limited liability companies. A limited liability company (LLC) combines features of partnerships and corporations, and many attorneys describe the LLC as the best of both worlds. Like a corporation, an LLC is an organized business entity that has a legal status separate from its owners with personal liability protection for the owners. Like a partnership, owners of an LLC can create flexibility in how the LLC is governed. For taxation, LLCs may choose to be taxed directly like a C-corporation or to pass taxes to the members as in a partnership or S-corporation.

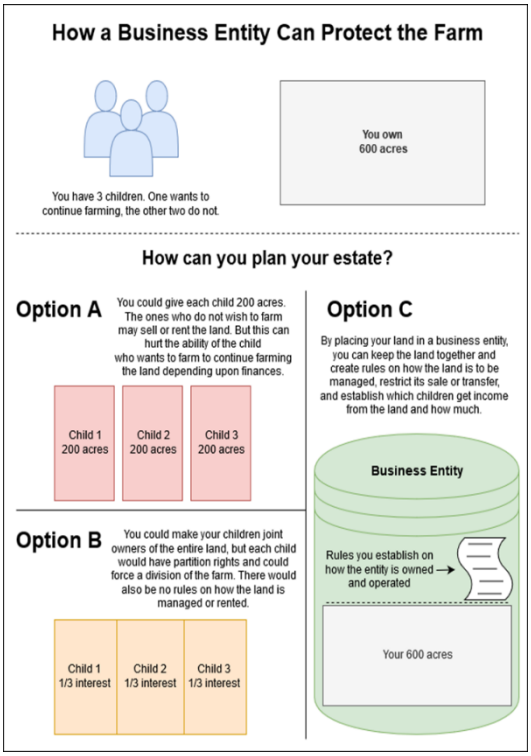
The LLC combines the benefits of a partnership and a corporation by offering personal liability protection, tax options, and flexibility in governance.

LLCs are the entity of choice for most new farm businesses, for many reasons. We discuss the usefulness of LLCs in transition planning in the rest of this bulletin, but be aware that there are times when a partnership or corporation may be a better choice than an LLC. The concepts we discuss below apply similarly to partnerships and corporations.

USING THE LLC FOR FARM TRANSITION PLANNING

LLCs allow for considerable creativity when designing a farm transition plan. Here are several roles an LLC can play in carrying out the goals of a farm transition and estate plan.

1. Protecting farmland. No asset is more important to a farmer than the land. An LLC can protect the land for future generations by preventing any one family member from forcing the sale of the land and making it difficult to transfer land unless the family collectively agrees to do so. But leaving land to family members outright to own jointly exposes family land to risk**.** That's because Ohio's **partition law** allows a co-owner of land to ask the court to sell the land and divide sale proceeds among the owners. A co-owner can seek partition regardless of what share they own, as can successor owners and creditors. With partition rights, the original co-owners and their spouses, heirs, and creditors all have the ability jeopardize the goal of keeping land in the family.



An LLC removes the risk of partition. Ohio law grants partition rights only to co-owners of land, not to co-owners of an LLC. When land is placed in an LLC, partition rights are extinguished because the LLC owns the land rather than the individuals co-owning the land. The owners of the LLC do not have the ability to use the partition law to force the sale of the land. **Consider the following examples.**

Example 1. Mom and Dad want to leave their farmland to their three children. They have a simple will that gives all of the land to the three children as co-owners. Arthur, one of the children, decides that he would rather have money than continue to own the land. The other two children are unable or unwilling to buy Arthur out at his asking price, so Arthur files a partition action. The court orders the land to be sold at a Sheriff's sale and the sale proceeds to be divided among the three children. The family no longer owns the land.

Example 2. As above, Arthur is a co-owner of the land given by Mom and Dad to the three children. Arthur gets into financial difficulties. His creditors file a lien on his ownership of the land and proceed with a partition action seeking payment of the lien. The court orders the sale of the land to pay the lien, the creditor receives Arthur's share of the sale proceeds, and the other two children receive their shares. The family no longer owns the land.

Example 3. Mom and Dad put their land in an LLC. Their three children inherit the LLC. Now, when Arthur wants to sell, he does not have partition rights. Arthur is an owner of the LLC, not a direct owner of the land. The only way Arthur can cash out is if one of the other owners agree to purchase his ownership. If Arthur gets in financial trouble, his creditors do not have partition rights and cannot force the sale of the land. At most, the creditors are only entitled to Arthur's share of the profits from the LLC. The family continues to own the land.

2. Discounting of value. An LLC can be used to decrease the value of assets. This is important when a person's net worth exceeds the federal estate tax exemption. All wealth exceeding the federal estate tax exemption is taxed at 40%, so it is important to make all efforts to minimize the negative effect the estate tax can have on the goal of transitioning the farm to the next generation.

An LLC can decrease net worth with a concept called **discounting**. Essentially, the value of the ownership in a closely held company is discounted to be less than the value of the assets in the company. This is due to minority ownership, shared management, and transfer restrictions on the assets, all factors that reduce asset values. Discounts can be as high as 30-40%, which can minimize the risk of estate taxes being assessed on farm assets. **Consider this example**:

Mom and Dad own a farm and their net worth exceeds the federal estate tax exemption by $1 million, so their heirs will owe $400,000 in estate taxes upon their death.

Mom and Dad own 500 acres of land valued at $5 million. They put the land in an LLC, and each holds 50% ownership in the LLC. They also set up the LLC so that a decision requires a majority vote and ownership interests can only be transferred to direct family members. Neither Mom nor Dad have majority ownership or control, and each is limited as to whom they can transfer their ownership – all important factors to obtaining a discount.

Let's assume a 35% discount applies to Mom and Dad's LLC ownership interest because the discounting factors exist. Now, instead of owning land valued at $5 million, they co-own an LLC worth $3.25 million. Mom and Dad have reduced their net worth by $1.75 million by placing their land in the LLC. They have given up little to receive a significant reduction in their net worth.

3. Designation of management. An LLC can also designate the future managers of assets. Not all beneficiaries of a transition plan may be qualified to manage the farm's assets. Or perhaps some of the beneficiaries are interested in managing assets while others are not. Another possibility is that the beneficiaries might not get along well and be able to make asset management decisions easily. An LLC can address these issues by determining who will have management and decision-making authority. **Consider this example:**

Mom and Dad intend for their three children to jointly inherit their farmland. Two children live out-of-state and have never been involved with the land while the third child lives locally and has been involved with the farm. Mom and Dad's transition plan transfers the land to an LLC, makes the children owners of the LLC, and designates the local child to be the manager of the LLC. The management provisions help ensure that the land will be managed properly and that the out-of-state children's unfamiliarity with the land will not cause disruptions or poor decision making.

4. Negating the need for a trust. Many farm transition plans include a trust as the primary estate planning document, as we explain in other bulletins in this series. Using a trust can avoid probate and include terms and conditions for the distribution of assets at death. But in some cases, an LLC can negate the need for a trust. Like a trust, an LLC can avoid probate and contain ownership restrictions, management responsibilities and other terms and conditions. An LLC may also save time and legal fees. **Consider this example**:

> Mom and Dad want their children land to inherit their farmland. They don't want the land sold outside of the family and want one specific child to manage the land. Instead of a trust, Mom and Dad establish an LLC with their required terms and conditions, and make ownership of the LLC "transfer on death" to their children. The children inherit the LLC without going through probate and are subject to the transfer and management terms of the LLC. Mom and Dad accomplished their transition plan without the use of a trust.

LLCs can replace a trust, or sometimes LLCs and trusts are used in combination in a transition plan. Before assuming that you need a trust, explore the possibility of using business entities instead.

FORMING AN ENTITY: DO YOU NEED AN ATTORNEY?

The internet is full of advice and fill-in-the-blank forms for forming a business entity. It's a decision that requires more than an internet search, however. Your attorney is a necessary resource not just for selecting an entity that carries out your goals, but for designing your entity so that it does what you want it to do. An attorney can tailor the legal documents for your business entity to your goals, ensuring that they contain the appropriate provisions and mechanisms to achieve those goals.

SUMMING IT UP

Choosing the right business entity for you, your family, and your farm is an important step in the farm transition planning process. An LLC is one type of entity that can help protect farmland, minimize estate tax risk, designate management authority, and keep assets out of probate. If any of these goals are in your farm transition plan, be sure to review them with an attorney who can help you design the entity that fits your plan for the future of your farm.

REFERENCES AND RESOURCES

Ohio Revised Code, Chapter 17, "Corporations-Partnerships"

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